KESTREL ENERGY INC
Form 10KSB/A
March 22, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-KSB/A
(Amendment No. 1)

(Mark One)
|X| Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended June 30, 2004

|_| Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File No: 0-9261

KESTREL ENERGY, INC.

(Exact name of registrant as specified in its charter)

State of Incorporation: Colorado I.R.S. Employer Identification No. 84-0772451

1726 Cole Boulevard, Suite 210
Lakewood, Colorado 80401
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (303) 295-0344

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Title of Each Class
Common Stock, No Par Value

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

|X| YES |_| NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-B is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. |_|

The issuer's revenues for its most recent fiscal year were $1,304,581.

At September 30, 2004, 10,133,200 common shares (the registrant's only class of voting stock) were outstanding. The aggregate market value of the 4,925,473 common shares of the registrant held by nonaffiliates on that date (based upon the mean of the closing bid and asked price on the OTC Bulletin Board) was $2,955,284.

Kestrel Energy, Inc. (the "Company") hereby amends the following Items of its Form 10-KSB for the period ended June 30, 2004 by restating each of the enumerated Items as follows:

PART II

Item 7. Financial Statements.

See pages F-1 through F-19 for this information.

Item 8A. Controls and Procedures

Disclosure Controls and Procedures

At the end of the period reported on in this report, the Company carried out an evaluation, under the supervision and participation of the Company's Chief Executive and Principal Financial Officer (the "Officer") of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Securities Exchange Act Rule 13a-14. Based upon that evaluation, the Officer concluded that the Company's disclosure controls and procedures are effective in all material respects, with respect to the recording, processing, summarizing and reporting, within the time periods specified in the SEC's rules and forms, of information required to be disclosed by the Company in the reports the Company files or submits under the Exchange Act.

Internal Controls

There were no significant changes made in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of the evaluation described above.

PART III

Item 13. Exhibits

(a) Exhibits

Exhibit No.	Description
3.1	Amended and Restated Articles of Incorporation, as filed with the Secretary of State of Colorado on March 16, 1995, filed as Exhibit (3)1 to the Annual Report on Form 10-K/A for the fiscal year ended June 30, 1994 and incorporated herein by reference.
3.2	Amended and Restated Bylaws, as adopted by the Board of Directors on January 16, 1995, filed as Exhibit (3)2 to the Annual Report on Form 10-K/A for the fiscal year ended June 30, 1994 and incorporated herein by reference.
4.1	The form of common stock share certificate filed as Exhibits 5.1 to the Registrant's Form S-2 Registration Statement (No. 2-65317) and Article II of the Registrant's Articles of Incorporation filed as Exhibit 4.1 thereto, as amended on March 4, 1994 and filed with the Annual Report on Form 10-K for the fiscal year ended June 30, 1994 are incorporated herein by reference.
4.2	Warrant Agreement dated January 18, 2000 with American Securities Transfer & Trust, Inc. filed as Exhibit 4.1 to the Registrant's Form

8-A Registration Statement filed January 20, 2000 and incorporated herein by reference.

4.3 Form of Warrant Certificate filed as Exhibit 4.2 to the Registrant's Form 8-A Registration Statement filed January 20, 2000 and incorporated herein by reference.

10.1 Amended and Restated Incentive Stock Option Plan as amended March 14, 1995 and filed as Exhibit 10.7 with the Annual Report on Form 10-K for the fiscal year ended June 30, 1995 and incorporated herein by reference.

10.2 Kestrel Energy, Inc. Stock Option Plan effective as of December 5, 2002 filed as Exhibit 10.1 to the Registrant's Form 10-QSB for the quarter ended December 31, 2002, and incorporated herein by reference.

10.3 Line of Credit with Norwest Bank, Colorado National Association dated February 21, 2000 filed as Exhibit 10.1 to the Registrant's Form 10-Q for the period ended March 31, 2000 and incorporated herein by reference.

10.4 Letter Amendment to Wells Fargo Bank West, N.A. Agreement dated September 27, 2000 filed as Exhibit 10 to the Registrant's Form 10-Q for the period ended September 30, 2000 and incorporated herein by reference.

10.5 Wells Fargo Bank, N.A. Term Loan Agreement dated November 29, 2001 filed as Exhibit 10.2 to the Registrant's Form 10-Q for the period ended December 31, 2001 and incorporated herein by reference

10.6 Promissory Note with Samson Exploration N.L. dated August 6, 2002 filed as Exhibit 99 to the Registrant's Form S-3 registration Statement (No. 333-99151) and incorporated herein by reference.

10.7 Loan Agreement with R&M Oil and Gas, Ltd. Dated January 24, 2003 filed as Exhibit 10.2 to the Registrant's Form 10-QSB for the period ended December 31, 2002 and incorporated herein by reference.

10.8 Revolving Credit Loan Agreement dated May 5, 2003 with Barry D. Lasker filed as Exhibit 99.1 to the Registrant's Form 8-K dated May 5, 2003 and incorporated herein by reference.

10.9 Mortgage, Deed of Trust, Security Agreement, Assignment of Production and Financing Statement with Barry D. Lasker dated May 5, 2003 filed as Exhibit 99.2 to the Registrant's Form 8-K dated May 5, 2005 and incorporated herein by reference.

10.10 Mortgage, Security Agreement, Assignment, Financing Statement and Fixture Filing to R&M Oil and Gas, Ltd. dated January 24, 2003 filed as exhibit 10.10 to the registrant's Form 10KSB for the period ended June 30, 2003 and incorporated herein by reference.

10.11 Amendment 2 revolving credit loan agreement with Barry D. Lasker dated February 24, 2004 filed as exhibit 10.1 to the registrant's Form 10QSB for the period ended March 31, 2004 and incorporated herein by reference.

10.12 Assignment of mortgage from Barry D. Lasker to Samson Exploration

N.L. dated Feb 24, 2004 filed as exhibit 10.2 to the registrant's Form 10QSB for the period ended March 31, 2004 and incorporated herein by reference.

23.1 Consent of Wheeler Wasoff, P.C.

23.2 Consent of Sproule Associates Inc.

31 Certificate of Chief Executive and Principal Financial Officer pursuant to Section 302 of The Sarbanes-Oxley Act of 2002.

32 Certification of Chief Executive and Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

KESTREL ENERGY, INC.
(Registrant)

Date: March 22, 2005

By: /s/ Timothy L. Hoops

Timothy L. Hoops, President,
Chief Executive Officer, Principal
Financial Officer and Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Date: March 22, 2005

By: /s/ Timothy L. Hoops

Timothy L. Hoops, President,
Chief Executive Officer, Principal
Financial Officer and Director

Date: March 22, 2005

By: /s/ Robert J. Pett

Robert J. Pett, Chairman of the Board

Date: March 17, 2005

By: /s/ Kenneth W. Nickerson

Kenneth W. Nickerson, Director

Date: March 21, 2005

By: /s/ John T. Kopcheff

John T. Kopcheff, Director

Date: March 22, 2005

By: /s/ Mark A. E. Syropoulo

Mark A. E. Syropoulo, Director

Date: March ____, 2005 By: ----------------------------------

Neil T. MacLachlan, Director

KESTREL ENERGY, INC.

Financial Statements

June 30, 2004 and 2003

(With Report of Independent Registered Public Accounting Firm Report Thereon)

INDEX TO FINANCIAL STATEMENTS

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Kestrel Energy, Inc.

We have audited the accompanying balance sheet of Kestrel Energy, Inc. as of June 30, 2004, and the related statements of operations, stockholders' equity and cash flows for the two years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kestrel Energy, Inc. as of June 30, 2004, and the results of its operations and its cash flows for the two years then ended, in conformity with accounting principles generally accepted in the United States of America.

Wheeler Wasoff, P.C.

Denver, Colorado
September 30, 2004

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KESTREL ENERGY INC.

BALANCE SHEET

June 30, 2004

Assets	
Current assets	
Cash and cash equivalents (note 1)	$ 162,507
Accounts receivable	366,278
Other current assets	12,171
Total current assets	540,956
Property and equipment, at cost	
Oil and gas properties, successful efforts method of accounting (note 7 and 8)	
Unproved	260,355
Proved	11,081,664
Pipeline and facilities	807,851
Furniture and equipment	54,207
	12,204,077
Accumulated depreciation, depletion and amortization	(9,754,427)
Net property and equipment	2,449,650
	$ 2,990,606
Liabilities and Stockholders' Equity	
Current liabilities	
Notes payable-related party (note 3)	$ 650,000
Accounts payable-trade	245,198
Accrued liabilities	85,582

Total current liabilities	980,780
Long-term liabilities	
Asset retirement obligation (note 2)	177,126
Total long-term liabilities	177,126
Total Liabilities	1,157,906
Commitments and contingencies (notes 2 and 6)	
Stockholders' equity (note 4)	
Preferred stock, $1 par value. 1,000,000 shares authorized; none issued	--
Common stock, no par value. 20,000,000 shares authorized; 10,133,200 shares outstanding	20,562,085
Accumulated (deficit)	(18,729,385)
Total stockholders' equity	1,832,700
	$ 2,990,606

The accompanying notes are an integral part of the financial statements.

KESTREL ENERGY INC.

Statements of Operations

Years ended June 30, 2004 and 2003

	2004	2003
Revenue		
Oil and gas sales	$ 1,651,796	$ 1,304,581
Total revenue	1,651,796	1,304,581
Costs and expenses		
Lease operating expenses	733,315	644,751
Dry holes, abandoned and impaired properties	52,438	1,238,214
Exploration expenses	103,642	63,677
Depreciation, depletion and amortization	124,022	339,002
General and administrative	622,645	797,282
Total costs and expenses	1,636,062	3,082,926
Other income (expense)		

Interest expense and financing costs	(73,536)	(115,690
Gain on sale of property and equipment	--	21,538
Loss on sale of available-for-sale securities	--	(575,893
Interest income	891	1,953
Other, net	117,888	99,567
Total other income (expense)	45,243	(568,525
Income (loss) before income taxes and cumulative effect of change in accounting principle	60,977	(2,346,870
Provision for income tax	13,000	--
Tax benefit of net operating loss carryforward	(13,000)	--
Cumulative effect of change in accounting principle	--	10,890
Net income (loss)	$ 60,977	$(2,335,980
Basic earnings per share	$ .01	$ (.25
Diluted earnings per share	$ .01	$ (.25
Basic weighted average number of common shares outstanding	9,802,777	9,288,325
Diluted weighted average number of common shares outstanding	9,809,256	9,288,325

The accompanying notes are an integral part of the financial statements.

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KESTREL ENERGY, INC.

Statements of Stockholders' Equity

Years ended June 30, 2004 and 2003

	Common stock			Accumula
	Shares	Amount	Accumulated (deficit)	Compreh Income
Balance July 1, 2002	9,115,200	$ 20,043,907	$(16,454,382)	$ (52
Common shares issued (note 4)	670,000	335,000	--	
Warrants exercised	13,000	16,250	--	
Less cost of warrant exercise	--	(572)	--	

Realized (loss) on securities classified	--	--	--	52
as available for sale	--	--	--	
Net (loss)	--	--	(2,335,980)	
Balance June 30, 2003	9,798,200	20,394,585	(18,790,362)	
Warrants exercised	335,000	167,500	--	
Net income	--	--	60,977	
Balance June 30, 2004	10,133,200	$ 20,562,085	$(18,729,385)	$

The accompanying notes are an integral part of the financial statements.

KESTREL ENERGY INC.

Statements of Cash Flows

Years ended June 30, 2004 and 2003

	2004	200
Cash flows from operating activities		
Net income (loss)	$ 60,977	$(2,33
Adjustments to reconcile net loss to net cash used in operating activities		
Cumulative effect of change in accounting principle	--	(1
Depreciation and depletion	124,022	33
Dry holes, abandoned and impaired properties	--	1,23
Loss on sale of available-for-sale securities	--	57
Gain on sale of property and equipment	--	(2
Debt for services and costs - related	1,584	14
Other	--	1
Changes in operating assets and liabilities, net of dispositions	--	
(Increase) in accounts receivable	(11,708)	(14
(Increase) decrease in other current assets	6,229	(1
Increase (decrease) in accounts payable - trade	(184,463)	18
Increase (decrease) in accounts payable - related party	--	(5
(Decrease) in accrued liabilities	15,584	(1
Net cash provided (used) in operating activities	12,225	(10
Cash flows from investing activities		
Capital expenditures	(195,822)	(42
Proceeds from sale of securities	--	5
Proceeds from sales of property and equipment	--	2
Net cash (used) provided by investing activities	(195,822)	(34
Cash flows from financing activities		

Loans from related parties	50,000	94
Repayment of notes - related parties	--	(25
Repayments of borrowings	--	(51
Proceeds from issuance of common stock and warrants	--	35
Proceeds from warrant exercise	167,500	
Payment of offering costs	--	
Net cash provided by financing activities	217,500	52
Net (decrease) in cash and cash equivalents	33,903	7
Cash and cash equivalents, beginning of year	128,604	5
Cash and cash equivalents, end of year	$ 162,507	$ 12
Supplemental cash flow information - cash paid for interest	$ 69,883	$ 4
Supplemental disclosure of noncash investing and financing activities		
Repayment of debt through securities	$ --	24
Asset Retirement Obligation	$ 13,791	$ 11

The accompanying notes are an integral part of the financial statements.

KESTREL ENERGY INC

Notes to Financial Statements

June 30, 2004 and 2003

(1) Summary of Significant Accounting Policies

(a) Organization

Kestrel Energy, Inc. (the Company) was incorporated under the laws of the State of Colorado on November 1, 1978. The Company's principal business is the acquisition, either alone or with others, of interests in proved developed producing oil and gas leases, and exploratory and development drilling.

The Company presently owns oil and gas interests in the states of Louisiana, New Mexico, Oklahoma, Texas and Wyoming.

(b) Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(c) Cash Equivalents

Cash equivalents consist of certificates of deposit. At June 30, 2004, $54,163 of the cash equivalent balance is pledged as security in lieu of posting oil and gas performance bonds in the state of Wyoming. The funds are restricted as to their use and cannot be accessed by the Company without the written release by the appropriate jurisdictional authority. For purposes of the statements of cash flows, the Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents.

(d) Property and Equipment

The Company follows the successful efforts method of accounting for its oil and gas activities. Accordingly, costs associated with the acquisition, drilling and equipping of successful exploratory wells are capitalized. Geological and geophysical costs, delay and surface rentals and drilling costs of unsuccessful exploratory wells are charged to expense as incurred. Costs of drilling successful development wells are capitalized. Upon the sale or retirement of oil and gas properties, the cost thereof and the accumulated depreciation or depletion are removed from the accounts and any gain or loss is credited or charged to operations.

Depreciation, depletion and amortization of capitalized costs of proved oil and gas properties is provided on a field by field basis using the units-of-production method based upon proved reserves. Acquisition costs are amortized by using total proved reserves as the denominator. Development costs are amortized using proved developed reserves, rather than total proved reserves, as the denominator.(See also note 2).

Pipeline and facilities are stated at original cost. Depreciation of pipeline and facilities is provided on a straight-line basis over the estimated useful life of the pipeline of twenty years.

Furniture and equipment are depreciated using the straight-line method over estimated lives ranging from three to seven years.

Management periodically evaluates capitalized costs of unproved properties and provides for impairment, if necessary, through a charge to operations.

Proved oil and gas properties are assessed for impairment on a well by well basis or a field-by-field basis where unitized. If the net capitalized costs of proved properties exceeds the estimated undiscounted future net cash flows from the property, a provision for impairment is recorded to reduce the carrying value of the property to its estimated fair value. The Company recorded no impairment for its proved oil and gas properties for the year ended June 30, 2004 and $903,214 for the year ended June 30, 2003.

(e) Gas Balancing

The Company uses the sales method of accounting for gas balancing of gas production, and would recognize a liability if the existing proven reserves were not adequate to cover the current imbalance situation.

As of June 30, 2004, the Company's gas production is in balance.

(f) Income Taxes

The Company accounts for income taxes under the provisions of Statement of Financial Accounting Standards No. 109 (SFAS 109), "Accounting for Income Taxes." Under the asset and liability method of SFAS 109, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry-forwards. Deferred tax assets and liabilities are measured using enacted income tax rates expected to apply to taxable income in the years in which those differences are expected to be recovered or settled. Under SFAS 109, the effect on deferred tax assets and liabilities of a change in income tax rates is recognized in the results of operations in the period that includes the enactment date.

(g) Stock-Based Compensation

In October 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS 123), effective for fiscal years beginning after December 15, 1995. This statement defines a fair value method of accounting for employee stock options and encourages entities to adopt that method of accounting for its stock compensation plans. SFAS 123 allows an entity to continue to measure compensation costs for these plans using the intrinsic value based method of accounting as prescribed in Accounting Pronouncement Bulletin Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25). The Company has elected to continue to account for its employee stock compensation plans as prescribed under APB 25. Had compensation cost for the Company's stock-based compensation plans been determined based on the fair value at the grant dates for awards under those plans consistent with the method prescribed in SFAS 123, the Company's net income (loss) and income (loss) per share would have been increased to the pro forma amounts indicated below:

		Years ended June 30, 2004	2003
Net earnings (loss):			
	As reported	$ 60,977	$ (2,335,980)
	Pro forma	57,778	(2,341,995)
Basic Earnings per share:			
	As reported	.01	(.25)
	Pro forma	.01	(.25)
Diluted Earnings per share:			
	As reported	.01	(.25)

Pro forma	.01	(.25)

(h) Net earnings (loss)per Share

Basic earnings per share are computed by dividing earnings available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect per share amounts that would have resulted if dilutive potential common stock had been converted to common stock. The following reconciles amounts reported in the financial statements.

At June 30, 2003, all outstanding options and warrants were excluded from the computation of diluted loss per share for the years then ended, as the effect of the assumed exercises of these options was antidilutive.

The following is a reconciliation of the numerators and denominators used in the calculations of basic and diluted earnings per share for 2004:

	2004		
	Net Income	Shares	Per A
Basic earnings per share:			
Net income and share amounts	$ 60,977	9,802,777	$
Dilutive securities Stock options		6,479	
Diluted earnings per share			
Net income and assumed share conversion	$ 60,977	9,809,256	$

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(i) Revenue Recognition

Sales of oil and gas production are recognized at the time of delivery of the product to the purchaser.

(j) Translation of Foreign Currencies

Monetary items are translated at the rate of exchange in effect at the balance sheet date. Non-monetary items are translated at average rates in effect during the period in which they were earned or incurred. Gains and losses resulting from the fluctuation of foreign exchange rates have been included in the determination of income.

(k) Fair Value

The carrying amount reported in the balance sheet for cash, accounts receivable, accounts payable and accrued liabilities approximates fair value because of the immediate or short-term maturity of these financial instruments.

(l) Concentration of Credit Risk

Financial instruments which potentially subject the Company to concentrations of credit risk consist of cash and accounts receivable. The Company maintains cash accounts at three financial institutions. The Company periodically evaluates the credit worthiness of financial institutions, and maintains cash accounts only in large high quality financial institutions, thereby minimizing exposure for deposits in excess of federally insured amounts. The Company believes that credit risk associated with cash is remote. The Company is exposed to credit risk in the event of nonpayment by counter parties, a significant portion of which are concentrated in energy related industries. The creditworthiness of customers and other counter parties is subject to continuing review.

(m) Recent Accounting Pronouncements

In June 2003, the FASB approved SFAS. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity". SFAS. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. This Statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. SFAS. 150 is not expected to have an effect on the Company's financial position.

In December 2003, the FASB issued a revised Interpretation No 46, "Consolidation of Variable Interest Entities." The interpretation clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to certain types of entities. The Company does not expect the adoption of this interpretation to have any impact on its financial statements.

(o) Reclassification

Certain amounts in the 2003 financial statements have been reclassified to conform to the 2004 financial statement presentation.

(p) Segment Reporting

The Company follows SFAS 131, "Disclosure about Segments of an Enterprise and Related Information", which amended the requirements for a public enterprise to report financial and descriptive information about its reportable operating segments. Operating segments, as defined in the pronouncement, are components of an enterprise about which separate financial information is available that is evaluated regularly by the Company in deciding how to allocate resources and in assessing performance. The financial information is required to be reported on the basis that is used internally for evaluating segment performance and deciding how to allocate resources to segments. The Company operates in one segment, oil and gas producing activities.

(q) Comprehensive Income

The Company adopted SFAS 130, "Reporting Comprehensive Income". SFAS 130 requires the reporting of comprehensive income in addition to net income from operations. Comprehensive income is a more inclusive financial reporting methodology that includes disclosures of certain financial information that historically has not been recognized in the calculation of net income. There is no component of comprehensive income reported for years ended June 30, 2003 or June 30, 2004.

(r) Allowance for Bad Debts

The Company considers accounts receivable to be fully collectible as recorded as of June 30, 2004, therefore, no allowance for doubtful accounts is required. The Company reviews the credit worthiness and historical collection of accounts receivable in assessing whether an allowance for doubtful accounts is required.

(2) Asset Retirement Obligations

In 2001, the Financial Accounting Standards Board (FASB) issued SFAS 143, "Accounting for Asset Retirement Obligations." SFAS. 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. This statement requires companies to record the present value of obligations associated with the retirement of tangible long-lived assets in the period in which it is incurred. The liability is capitalized as part of the related long-lived asset's carrying amount. Over time, accretion of the liability is recognized as an operating expense and the capitalized cost is depreciated over the expected useful life of the related asset. The Company's asset retirement obligations relate primarily to the plugging, dismantlement, removal, site reclamation and similar activities of its oil and gas properties. Prior to adoption of this statement, such obligations were accrued ratably over the productive lives of the assets through its depreciation, depletion and amortization for oil and gas properties without recording a separate liability for such amounts.

The transition adjustment related to adopting SFAS 143 on July 1, 2002, was recognized as a cumulative effect of a change in accounting principle. The cumulative effect on net income of adopting SFAS No. 143 was a net favorable effect of $10,890. At the time of adoption, total assets increased $117,147, and total liabilities increased $205,842. The amounts recognized upon adoption are based upon numerous estimates and assumptions, including future retirement costs, future recoverable quantities of oil and gas, future inflation rates and the credit-adjusted risk-free interest rate. Changes in asset retirement obligations during the year were:

Asset retirement obligations as of July 1, 2003	$ 216,009
Liabilities incurred	13,791
Liabilities settled	--
Revision to estimate (included in depreciation, depletion and amortization)	(52,674)
Asset retirement obligations as of June 30, 2004	$ 177,126

(3) Notes Payable

On February 14, 2002, the Company borrowed $97,940 from Victoria Petroleum N.L. ("VP") and $255,382 from Lakes Oil N.L. ("Lakes") due May 15, 2002 with interest at 8%. The loans were secured by shares of VP and seismic data owned by the Company. As of June 30, 2002, an aggregate $294,953 had been repaid and VP assumed the balance due to Lakes of $58,369. On May 13, 2002, VP advanced an additional $350,000 to the Company with interest at 7.5%. The loan of $350,000 was assigned to an unrelated company and subsequently converted, including interest of $10,500, to 515,000 shares of the Company's common stock (See Note 6b).

On August 6, 2002, the Company borrowed $500,000 from Samson Exploration N.L. ("Samson"), due December 4, 2002,or at any other date agreed to by the parties, with interest at 10%. The Company agreed to pay $50,000 as a financing fee to Samson. Proceeds from the loan were used to repay the Company's outstanding balance on its line of credit to Wells Fargo. On February 4, 2003, the Company repaid Samson in full, including all accrued interest and fees, with $327,143.15 in cash and the transfer of the Company's remaining 25,000,000 shares of Victoria Petroleum N.L. common stock, valued at $247,349.

On January 24, 2003, the Company borrowed $400,000 from R&M Oil and Gas, Ltd., ("R&M") of which Timothy L. Hoops, one of the Company's directors and its President and CEO, is a partner. That loan is due on January 31, 2005, bears interest at 12.5% per annum and is secured by the Company's oil and gas interests in Grady County, Oklahoma. In the event of a default under the terms of the R&M loan, and the sale of the collateral securing the loan, the Company would receive any remaining proceeds after payment to R&M of its expenses in connection with such sale(s) and any indebtedness due and payable to R&M under the loan. The proceeds from the R&M loan were used to retire the outstanding debt to Samson Exploration N.L. at that time and reduce the Company's accounts payable position. The R&M loan was approved unanimously by the Board of Directors with Mr. Hoops abstaining.

On May 5, 2003, the Company entered into a Line of Credit Agreement with Barry D. Lasker, the Company's former President and CEO, for a maximum loan to the Company of $200,000. Under the terms of the agreement all outstanding amounts were due on May 4, 2005 and bore interest at 10% per annum. The initial proceeds of the loan consisted of $40,000 cash and the conversion to debt of approximately $152,000 of unpaid wages and unreimbursed business expenses owed to Mr. Lasker by the Company. The Lasker loan was secured by the Company's oil and gas interests in Campbell County, Wyoming. In the event of a default under the terms of the Lasker loan, and the sale of the collateral securing the loan, the Company would receive any remaining proceeds after payment to Mr. Lasker of his expenses in connection with such sale(s) and the indebtedness due and payable to him under the loan. On February 5, 2004, Mr. Lasker assigned the $200,000 Lasker Loan to Samson Exploration N.L. (a related party) and Mr. Lasker was paid off in full. The terms and conditions of the Samson loan are a continuance of the terms and conditions of the Lasker loan, except for the deletion of a provision providing for acceleration upon termination of Mr. Lasker's employment by the Company.

On June 8, 2004, the Company borrowed $50,000 from VP with an 8% interest rate which is to be paid on repayment of the loan. This is an unsecured loan due on demand.

(4) Stockholders' Equity

(a) Preferred Stock

The Company is authorized to issue up to 1 million shares of $1 par value preferred stock, the rights and preferences of which are to be determined by the Board of Directors at or prior to the time of issuance.

(b) Common Stock

In June 2003, the Company completed a private placement of 335,000 units at a price of $1.00 per unit. Each unit consisted of two common shares and one common share purchase warrant. Each of the common share purchase warrants sold in that offering entitled the holder to acquire an additional common share of the Company at a price of $0.50 on or before June 18, 2004. The net proceeds of approximately $335,000 were used for payment of the Chadron prospect fee and for 50% of the costs to drill the Sellman-1X exploration well, located in Dawes County, Nebraska. In June 2004, the warrants associated with this placement were exercised and the Company received proceeds of $167,500.

(c) Stock Option Plans

The Company has reserved 36,000 shares of its no par common stock for key employees of the Company under its 1993 Amended Restated Stock Incentive Plan (the Incentive Plan). Under the terms of the Incentive Plan, no stock options are exercisable more than ten years after the date of grant (five years after date of grant for 10% shareholders). All 36,000 options had been granted under the Incentive Plan.

The Company has reserved 75,000 shares of its no par common stock for employees, officers, directors, consultants and advisors of the Company under its 1993 Nonqualified Stock Option Plan (the Nonqualified Plan). Under the terms of the Nonqualified Plan, no stock options are exercisable more than ten years after the date of grant (five years after date of grant for 10% shareholders).

During fiscal 1998, the Company merged the Incentive Plan and the Nonqualified Plan into the Stock Option Plan (the Plan). The Company has reserved 1,200,000 shares of its no par common stock for employees, officers, directors, consultants and advisors of the Company under the Plan. Under the terms of the Plan, no stock options are exercisable more than ten years after the date of grant (five years after date of grant for 10% shareholders).

During fiscal 2004 and 2003, the Board of Directors granted options to purchase shares of common stock to the Company's Compensation Committee pursuant to the Plan. The exercise prices of the options are $.32 to $.33 per share for 2004 and 2003, respectively. The options granted are exercisable upon issuance.

On December 1, 1998, the Board of Directors reduced the number of options outstanding and repriced certain options. The exercise prices of the repriced options range from $1.875 to $2.00 per share. The options are immediately exercisable.

On December 6, 2001, the Plan was amended to increase the number of shares reserved under the Plan to 2,233,000.

On December 5, 2002, the Plan was amended to extend the term of the Plan for an additional ten years to December 16, 2012.

The Company applies APB Opinion 25 and related interpretations in accounting for its plan. Accordingly, no compensation cost has been recognized for stock options granted at or above market value at the date of the grant to key employees and directors.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions used for grants in fiscal 2004 and 2003 respectively: no dividend yield for all years; expected volatility of 232% and 97%; weighted average risk-free interest rates of 4.25% and 4.375%; and expected lives of ten years.

A summary of the status of the Company's fixed stock options plan as of June 30, 2004 and 2003, and changes during the years then ended is presented below:

	2004		
Fixed options	Shares	Weighted average exercise price	Shares
Outstanding at beginning of year	1,607,984	1.40	1,693,964
Granted	10,000	.32	10,000
Exercised	--		--
Cancelled	--		--
Expired	105,133	2.19	95,980
Outstanding at end of year	1,512,851	1.34	1,607,984
Options exercisable at year end	1,512,851		1,607,984
Weighted average fair value of options granted during the year	$ .32		$ .30
Weighted average remaining contractual life	5.03		5.6

(5) Income Taxes

At June 30, 2004 and 2003, the Company's significant deferred tax assets and liabilities are as follows:

	2004	2
Deferred tax assets:		
Net operating loss carry-forwards	$ 5,094,000	4
Depletion carry forwards	273,000	
Oil and gas properties, principally due to differences in depreciation, depletion and impairment	--	
	5,367,000	4
Deferred liabilities:		
Oil and gas properties, principally due to differences in depreciation, depletion and impairment	(537,000)	
	(537,000)	
Valuation allowance	(4,830,000)	(4
Net deferred tax assets	$ --	$

The valuation allowance for deferred tax assets as of June 30, 2004 was $4,830,000. The net change in the valuation allowance for the year ended June 30, 2004 was an increase of $454,000.

At June 30, 2004, the Company had net operating loss carry-forwards of approximately $13,240,000. The utilization of approximately $178,000 of these carryforwards are limited to an estimated $80,000 annually. Of the balance of the loss carryforwards, $13,062,000 is available to offset future taxable income of the Company. If not utilized, the tax net operating losses will expire during the period from 2004 through 2024.

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The following reconciles income taxes reported in the financial statements to taxes that would be obtained by applying regular tax rates to income before taxes:

	2004	2003
Book income	$ 60,977	$(2,346,870)
Income tax expense at statutory rates	23,781	(915,279
Nondeductible expenses	2,585	1,712
Graduated rates	(13,366)	0
Valuation allowance	0	913,568
Income tax provision	$ 13,000	$ 0

(6) Lease Commitments

The Company has non-cancelable operating leases, primarily for rent of office facilities that expire over the next five years. Rental expense for operating leases was $45,181 and $72,980 for the years ended June 30, 2004 and 2003, respectively. The Company's executive offices are located at 1726 Cole Blvd., Suite 210, Lakewood, Colorado 80401, which is comprised of approximately 2,358 square feet, at an initial annual rate of $16.50 per square foot escalating to $17.50 per square foot over the life of the lease.

Future minimum rental commitments under non-cancelable operating leases as of June 30, 2004 are as follows:

Fiscal year:	
2005	$ 39,988
2006	41,167
2007	3,439
	$ 84,594

The Company has a commitment to pay delay rentals for June 30, 2005 of approximately $75,000 for the right to explore those properties.

(7) Disclosures About Capitalized Costs, Costs Incurred and Major Customers

Capitalized costs related to oil and gas producing activities at June 30, 2004 and 2003, are as follows:

	June 30, 2004	June 30, 2003
Unproved - Domestic	$ 260,355	$ 215,892
Proved	11,081,664	10,918,017
	11,342,019	11,133,909
Accumulated depletion and impairment	(9,549,716)	(9,420,570)
	$ 1,792,303	$ 1,713,339

Costs incurred in oil and gas producing activities for the years ended June 30, 2004 and 2003 were approximately as follows:

	2004	2003
Unproved property acquisition costs	$ 44,463	335,000
Proved property acquisition costs	--	--
Development costs	149,855	83,162
Exploration costs	103,642	63,677

During fiscal 2004, the Company had three major customers. Sales to those customers accounted for approximately 33%, 19% and 18% of fiscal 2004 oil and gas sales. The Company does not believe that it is dependent on a single customer. The Company has the option at most properties to change purchasers if conditions so warrant. During fiscal 2003, the Company had three major customers. Sales to these customers accounted for approximately 27%, 11% and 11% of fiscal 2003 oil and gas sales.

During fiscal 2004, the Company spent approximately $58,000 converting proved undeveloped reserves at Hilight field (8 wells) into proved producing reserves. During fiscal 2003, the Company spent approximately $41,500 converting proved undeveloped reserves at Hilight field into proved producing reserves.

(8) Information Regarding Proved Oil and Gas Reserves (Unaudited)

The information presented below regarding the Company's oil and gas reserves were prepared by the Company's independent petroleum engineering consultants, Sproule & Associates, Inc. All reserves are located within the continental United States.

Proved oil and gas reserves are the estimated quantities of crude oil, natural gas and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions.

Proved developed oil and gas reserves are those expected to be recovered through existing wells with existing equipment and operating methods. The determination of oil and gas reserves is highly complex and interpretive. The estimates are subject to continuing changes as additional information becomes available.

Estimated net quantities of proved developed and undeveloped reserves of oil and gas for the years ended June 30, 2004 and 2003, are as follows:

	2004		2003	
	Oil (BBLS)	Gas (MCF)	Oil (BBLS)	Gas (MCF)
Beginning of year	310,700	4,758,700	273,000	12,069,000
Revisions of previous quantity estimates	76,300	77,600	43,000	(7,274,300)
Extensions, discoveries and improved recovery	--	161,000	11,800	231,100
Sales of reserves in place	--	--	--	--
Production	(19,300)	(255,400)	(17,100)	(267,100)
End of year	367,700	4,741,900	310,700	4,758,700
Proved developed reserves - end of year	289,000	2,264,600	232,100	2,351,200

Standardized Measure of Discounted Future
Net Cash Flows Relating to Proved Oil and Gas Reserves

Future net cash flows presented below are computed using year-end prices and costs. Future corporate overhead expenses and interest expense have not been included.

	2004	2003
Future cash inflows	$ 41,365,000	$ 33,352,000
Future costs:		
Production	(8,796,000)	(10,295,000)
Development	(1,509,000)	(1,390,000)
Future net cash flows	31,060,000	21,667,000
10% discount factor	(17,001,000)	(11,070,000)
Standardized measure of discounted future net cash flows	$ 14,059,000	$ 10,597,000

To achieve the 2005 future cash inflows reported, the capital expenditure of approximately $0.67 mm in fiscal 2005, $0.73 mm in fiscal 2006 and $0.11 mm in fiscal 2007 will be required to develop existing proved undeveloped reserves. The capital expenditure of approximately $0.67mm in fiscal 2005 will be required to develop existing proved developed non-producing reserves.

The principal sources of changes in the standardized measure of discounted future net cash flows during the years ended June 30, 2004 and 2003, are as follows:

	2004	2003
Beginning of year	$ 10,597,000	$ 8,898,000
Sales of oil and gas produced during the period, net of production costs	(913,000)	(629,000)
Net change in prices and production costs	--	12,766,000
Changes in estimated future development costs	(119,000)	2,910,000
Extensions, discoveries and improved recovery	498,000	628,000
Revisions of previous quantity estimates and other	3,032,700	(14,866,000)
Sales of reserves in place	--	--
Purchase of reserves in place	--	--
Accretion of discount	963,400	890,000
End of year	$ 14,059,000	$ 10,597,000

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The standardized measure of discounted future net cash flows relating to proved oil and gas reserves and the changes in standardized measure of discounted future net cash flows relating to proved oil and gas reserves were prepared in accordance with the provisions of SFAS 69. Future cash inflows were computed by applying current prices at year-end to estimated future production. Future production and development costs are computed by estimating the expenditures to be incurred in developing and producing the proved oil and gas reserves at year-end, based on year-end costs and assuming continuation of existing economic conditions. Future income tax expenses are calculated by applying appropriate year-end tax rates to future pretax net cash flows relating to proved oil and gas reserves, less the tax basis of properties involved and tax credits and loss carry-forwards relating to oil and gas producing activities. Future net cash flows are discounted at a rate of 10% annually to derive the standardized measure of discounted future net cash flows. This calculation procedure does not necessarily result in an estimate of the fair market value or the present value of the Company's oil and gas properties.

The complete definition of proved oil and gas reserves appears at Regulation S-X 4-10(a)(2), 17 CFR 210.4-10(a)(2). The complete definition of proved developed oil and gas reserves appears at Regulation S-X 4-10(a)(3), 17 CFR 210.4-10(a)(3). The complete definition of proved undeveloped reserves appears at Regulation S-X 4-10(a)(4), 17 CFR 210.4-10(a)(4).