CHINA YILI PETROLEUM CO
Form 10-K
May 16, 2012

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

FORM 10-K

|X| ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended: December 31, 2011

or

| | TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ______________ to _____________

Commission File No. 0-51554

CHINA YILI PETROLEUM COMPANY
(Exact name of registrant as specified in its charter)

Nevada	20-2934409
(State or other Jurisdiction of incorporation or organization)	(I.R.S. Employer I.D. No.)

TONGLIAO ECONOMIC DEVELOPMENT DISTRICT TONGLIAO F4,
P.R.China 638229
(Address of Principal Executive Offices) (Zip Code)

Issuer's Telephone Number, including Area Code: 973-506-9295

Securities Registered Pursuant to Section 12(b) of the Act: None

Securities Registered Pursuant to Section 12(g) of the Act:
Common Stock, $.001 par value per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 406 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o Nox

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 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. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T §232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.) Yes x No o

Indicate by check mark disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check One)

Large accelerated filer o Accelerated filer o Non-accelerated filer o Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

As of June 30, 2011 (the last business day of the most recently completed second fiscal quarter) the aggregate market value of the common stock held by non-affiliates was approximately $1,422,346

As of May 15, 2012, the number of shares outstanding of the Registrant’s common stock was 29,748,348 shares, $.001 par value.

FORWARD-LOOKING STATEMENTS: NO ASSURANCES INTENDED

This Report contains certain forward-looking statements regarding China Yili Petroleum Company, its business and financial prospects. These statements represent Management's best estimate of what will happen. Nevertheless, there are numerous risks and uncertainties that could cause our actual results to differ dramatically from the results suggested in this Report. Among the more significant risks are:

- We have not yet commenced our petroleum production operations. So problems may occur with production or marketing that we have not anticipated.

- We will not be able to fully implement our business plan unless we obtain several million dollars in additional capital.

- Our business will not be profitable unless we are able to obtain a sufficient supply of heavy oil at prices low enough to permit us to sell our petroleum products at competitive prices.

- Changes in Chinese government regulation, particularly regulation aimed at reducing the environmental hazards attendant to the petroleum refining industry, could significantly increase our operating costs.

Because these and other risks may cause the Company's actual results to differ from those anticipated by Management, the reader should not place undue reliance on any forward-looking statements that appear in this Report.

PART 1

Item 1. Business

China Yili Petroleum Company (the "Company") was incorporated in December 2004 under the laws of the State of Nevada. On August 13, 2007 the Company acquired all of the registered capital of Tongliao Yili Asphalt Co. ("Yili Asphalt"), a corporation organized under the laws of People's Republic of China. Yili Asphalt is engaged in the business of refining heavy oil into asphalt, fuel oil and lubricants.

Tongliao Yili Asphalt Co.

Yili Asphalt was organized in 2005 as a limited company under the laws of People's Republic of China. Its offices and manufacturing facilities which are located 10km away from the City of Tongliao, which is a prefecture level city in the Inner Mongolia Autonomous Region in northern China. This location provides the company with ready access to customers in the industrial sector of northeast China.

Since 2005 we have been engaged in developing a state-of-the-art facility for refining petroleum to produce three categories of end products: asphalt, diesel fuel and lubricants. The facility that we have developed has the capacity to produce, each day, 1300 tons of diesel fuel, 780 tons of asphalt, and 520 tons of lubricants. When we launch our operations, we will immediately be the largest asphalt producer in Inner Mongolia.

Our facility is now completed. And we have finally secured all of the government licenses that we require in order to operate a refinery. Our plan is to initiate production as soon as we are successful in securing working capital.

Suppliers

The success of our operations will depend in large part on our success in obtaining a steady flow of raw petroleum at favorable price. At the present time, we anticipate sourcing petroleum from several channels:

- Liaohe Oil Field. Our facility is located near the Liaohe Oil Field, the third largest oil field in China. Government seismic studies have indicated that the Liaohe Oil Field has reserves of ultra heavy oil in excess of 100 million tons. Because of the close relationship with the government of our management, in particular our Chairman, who served in the government of Jilin Province for ten years, we expect to obtain a high degree of cooperation from the producers in the Liaohe Oil Field.

- China National Offshore Oil Corporation. We have a written commitment from CNOOC to supply us with 200,000 tons of petroleum at market price.

- Ministry of Transportation. China is experiencing a shortage of asphalt, which is severely hampering its efforts to develop its roadway system. For this reason, the Ministry of Transportation has indicated a willingness to assist us in obtaining petroleum supplies as needed. This relationship may prove particularly useful to us, if demand for oil in China continues to push local prices upwards. The Ministry of Transportation is capable of sourcing mineral waste oil from Russia, which tends to be priced substantially below the Chinese market price for heavy petroleum.

Facilities

Our offices and refinery are located on a parcel of industrial land measuring 126,540 m2, which was leased from the local government for fifty years. The central portion of our refinery is a 300,000 ton atmospheric and vacuum distillation unit that was designed for us by China Petroleum Engineering Design Co., Ltd. Our storage facilities consist of:

- Six tanks for storage of raw petroleum. These tanks have a capacity of 30,000 m3, which is sufficient petroleum to assure full capacity operations for 30 days.

- Six asphalt storage tanks. These tanks have a capacity of 12,000 m3, which is adequate to permit us to store twenty days worth of production at 600 tons per day, with the asphalt segregated into four grades.

- Ten tanks for storage of petroleum distillate. These tanks have an aggregate capacity of 14,000 m3, which is adequate to permit us to store 35 days of production.

At present we receive our raw materials by truck, from which it is piped into our storage tanks to be dehydrated. After refining, the end products are removed from our facilities by truck. In the future, however, we expect a rail line to be constructed directly to our plant, funded primarily by the Autonomous Region. The construction has been delayed, in part by our lack of progress in initiating business operations. When completed, however, that improvement should substantially reduce our transportation costs and reduce delays in both inbound and outbound shipments.

Products

The refining of petroleum to produce asphalt produces two other categories of products as residue: diesel fuel and lubricating oil. So our business plan contemplates that we will launch in all three markets at once. Within those markets, the varieties of end user are numerous.

Asphalt. Petroleum asphalt is, in the first instance, moved in one of three directions. It can be burnt to produce coke, which is the main fuel source for steelmaking. In the alternative, it can be blended with anthracite and liquid asphalt, then used as blast furnace refractory material or as the primary component of electrolyte aluminum anodes, electric steelmaking electrodes, heat exchangers, and for other high temperature resistant uses. Finally, asphalt can be used undiluted for paving roads and roofs.

In China, the recent rapid industrial expansion has produced an urgent need for improved roadways, which in turn has driven the demand for asphalt beyond the nation’s production capacity. China now imports a substantial portion of its asphalt requirements, which significantly increases the cost of construction.

Diesel Fuel. Diesel fuel, generally, falls into two categories: light diesel fuel and heavy diesel fuel. Light diesel fuel is the diesel oil used by trucks, tractors and diesel automobiles. Heavy diesel fuel is used in low speed (up to 1,000 RPM) engines.

The growth in demand for diesel fuel in China has been a function of increased industrial production, with concomitant transportation activity. Our management believes that demand will continue to grow, fuelled by China's growing interest in reducing petroleum dependence. We anticipate a growing trend toward more fuel efficient diesel automobiles, which can help the nation to reach its goals of energy independence and an improved environmental.

Lubricating Oil. Although a can of common lubricating oil is present in every home where there is a motor, the lubricating oil that Yili Asphalt will produce will be specially refined to meet specific machine requirements. For example, the bearing case in a grinding machine requires a lubricant of a specific viscosity. Similarly, metal cutting machinery and the hydraulic systems in industrial equipment each require a lubricant with specific characteristics. Our plan is to produce the base material for sale to other refiners, who will then perform the finishing processes to produce lubricants to suit those specific industrial needs.

Employees

We have 10 full-time staff and employees.

Item 1A. Risk Factors

You should carefully consider the risks described below before buying our common stock. If any of the risks described below actually occurs, that event could cause the trading price of our common stock to decline, and you could lose all or part of your investment.

Because we have not yet commenced our production operations, unexpected factors may hamper our efforts to implement our business plan.

We will not record our first sale until we secure working capital. Our business plan contemplates that we will engage in a three-pronged marketing operation, involving production and sales of diesel fuel, asphalt as well as lubricants. Implementation of that business plan will also entail complex production operations and an active sales force. Because these are areas in which we have limited experience, problems may occur with production or marketing that we have not anticipated, which would interfere with our business, and prevent us from achieving profitability.

Our profits will be limited unless we are able to secure a sufficient supply of heavy oil.

We manufacture our products by refining petroleum. The price of petroleum on both the Chinese market and the international market is much higher today than it was five years ago, and our expectation is that the price will remain high for the foreseeable future. Particularly in China, which has experienced unprecedented industrial growth in the past twenty years, the demand for petroleum exceeds the supply. Therefore, in order to achieve efficient operations, it will be necessary for us to develop redundant sources of heavy oil, as we cannot rely on one or two relationships to provide the steady flow of oil that we will need. If we are unable to achieve that redundancy and have interruptions in our petroleum supplies, our profitability will be limited.

Fluctuations in oil prices could impede our efforts to achieve profitability.

The market price of crude oil fluctuates dramatically, driven by economic, political and geological factors that are completely outside our control. We do not intend to engage in hedging against changes in crude oil prices. As a result, a sudden increase in the cost of our raw material – i.e. oil – could reduce or eliminate our profit margin. Although we could respond to the increase by a proportionate increase in our price list, competitive forces might prevent us from doing so – in particular competition from asphalt and diesel fuel producers that are themselves oil producers and are thus shielded from the full effect of increased oil prices.

The capital investments that we plan for the next two years may result in dilution of the equity of our present shareholders.

Our business plan contemplates that we will invest at least 30 million RMB ($4.7 million) in working capital and acquisitions during the next twelve months, and an undetermined amount in the development of a rail line to our refinery. We intend to raise a portion of the necessary funds by selling equity in our company. At present we have no commitment from any source for those funds. We cannot determine, therefore, the terms on which we will be able to raise the necessary funds. It is possible that we will be required to dilute the value of our current shareholders' equity in order to obtain the funds. If, however, we are unable to raise the necessary funds, our growth will be limited, as will our ability to compete effectively.

A recession in China could significantly hinder our growth.

The growing demand for petroleum products in China has been swelled, in large part, by the recent dramatic increases in industrial production in China. The continued growth of our market will depend on continuation of recent improvements in the Chinese economy. If the Chinese economy were to contract and investment capital became limited, construction projects would be delayed or abandoned, and the demand for our asphalt would be reduced. Many financial commentators expect a recession to occur in China in the near future. The occurrence of a recession could significantly hinder our efforts to implement our business plan.

Increased environmental regulation could diminish our profits.

The refining of petroleum involves the production of pollutants. In addition, the transportation of petroleum products entails a risk of spills that may result in long-term damage to the environment. At the present time we estimate that our compliance with applicable government regulations designed to protect the environment will cost us 1 million RMB (approximately $155,000) per year. There is increasing concern in China, however, over the degradation of the environment that has accompanied its recent industrial growth. It is likely that additional government regulation will be introduced in order to protect the environment. Compliance with such new regulations could impose on us substantial costs, which would reduce our profits.

Our business and growth will suffer if we are unable to hire and retain key personnel that are in high demand.

Our future success depends on our ability to attract and retain highly skilled petroleum engineers, production supervisors, transportation specialists and marketing personnel. In general, qualified individuals are in high demand in China, and there are insufficient experienced personnel to fill the demand. In a specialized scientific field, such as ours, the demand for qualified individuals is even greater. If we are unable to successfully attract or retain the personnel we need to succeed, we will be unable to implement our business plan.

We may have difficulty establishing adequate management and financial controls in China.

The People's Republic of China has only recently begun to adopt the management and financial reporting concepts and practices that investors in the United States are familiar with. We may have difficulty in hiring and retaining employees in China who have the experience necessary to implement the kind of management and financial controls that are expected of a United States public company. If we cannot establish such controls, we may experience difficulty in collecting financial data and preparing financial statements, books of account and corporate records and instituting business practices that meet U.S. standards.

Government regulation may hinder our ability to function efficiently.

The national, provincial and local governments in the People's Republic of China are highly bureaucratized. The day-to-day operations of our business require frequent interaction with representatives of the Chinese government institutions. The effort to obtain the registrations, licenses and permits necessary to carry out our business activities can be daunting. Significant delays can result from the need to obtain governmental approval of our activities. These delays can have an adverse effect on the profitability of our operations. In addition, compliance with regulatory requirements applicable to petroleum refining may increase the cost of our operations, which would adversely affect our profitability.

Capital outflow policies in China may hamper our ability to pay dividends to shareholders in the United States.

The People's Republic of China has adopted currency and capital transfer regulations. These regulations require that we comply with complex regulations for the movement of capital. Although Chinese governmental policies were introduced in 1996 to allow the convertibility of RMB into foreign currency for current account items, conversion of RMB into foreign exchange for capital items, such as foreign direct investment, loans or securities, requires the approval of the State Administration of Foreign Exchange. We may be unable to obtain all of the required conversion approvals for our operations, and Chinese regulatory authorities may impose greater restrictions on the convertibility of the RMB in the future. Because most of our future revenues will be in RMB, any inability to obtain the requisite approvals or any future restrictions on currency exchanges will limit our ability to pay dividends to our shareholders.

Currency fluctuations may adversely affect our operating results.

Yili Asphalt generates revenues and incurs expenses and liabilities in Renminbi, the currency of the People's Republic of China. However, as a subsidiary of the Company, it will report its financial results in the United States in U.S. Dollars. As a result, our financial results will be subject to the effects of exchange rate fluctuations between these currencies. From time to time, the government of China may take action to stimulate the Chinese economy that will have the effect of reducing the value of Renminbi. In addition, international currency markets may cause significant adjustments to occur in the value of the Renminbi. Any such events that result in a devaluation of the Renminbi versus the U.S. Dollar will have an adverse effect on our reported results. We have not entered into agreements or purchased instruments to hedge our exchange rate risks.

We have limited business insurance coverage.

The insurance industry in China is still at an early stage of development. Insurance companies in China offer limited business insurance products, and do not, to our knowledge, offer business liability insurance. As a result, we do not have any business liability insurance coverage for our operations. Moreover, while business disruption insurance is available, we have determined that the risks of disruption and cost of the insurance are such that we do not require it at this time. Any business disruption, litigation or natural disaster might result in substantial costs and diversion of resources.

The Company is not likely to hold annual shareholder meetings in the next few years.

Management does not expect to hold annual meetings of shareholders in the next few years, due to the expense involved. The current members of the Board of Directors were appointed to that position by the previous directors. If other directors are added to the Board in the future, it is likely that the current directors will appoint them. As a result, the Company's shareholders will have no effective means of exercising control over the Company's operations.

Item 1B Unresolved Staff Comments

Not Applicable.

Item 2. Properties

The executive offices and refinery used by Yili Asphalt are located on a parcel of industrial land measuring 126,540 m2, which was leased from the local government for fifty years.

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Item 3. Legal Proceedings

None.

Item 4. Mine Safety Disclosures

Not Applicable.

Item 5. Market for Registrant's Common Equity, Related Stockholder Matter and Issuer Purchases of Equity Securities

(a) Market Information

The Company's common stock has been quoted on the OTC Bulletin Board since November 7, 2006. It is currently listed there under the symbol "CYIP." The following table sets forth the range of high and low bid quotations for each quarter within the last two fiscal years, and the subsequent interim period. The reported bid quotations reflect inter-dealer prices without retail markup, markdown or commissions, and may not necessarily represent actual transactions.

	Bid	
Quarter ending	High	Low
March 31, 2010	$ 0.15	$ 0.15
June 30, 2010	$ 2.99	$ 0.15
September 30, 2010	$ 1.08	$ 0.15
December 31, 2010	$ 1.07	$ 0.15
March 31, 2011	$ 0.06	$ 0.06
June 30, 2011	$ 0.06	$ 0.06
September 30, 2011	$ 0.06	$ 0.06
December 31, 2011	$ 0.06	$ 0.06

(b) Shareholders

Our shareholders list contains the names of 190 registered stockholders of record of the Company's Common Stock.

(d) Securities Authorized for Issuance under Equity Compensation Plans

The information set forth in the table below regarding equity compensation plans (which include individual compensation arrangements) was determined as of December 31, 2011

	Number of secu–rities to be issued upon exercise of outstanding op–tions,	Weighted aver–age exercise price of outstanding options,	Number of secu–rities remaining available for fu–ture issuance un–der equity com–pensation plans

	warrants and rights	warrants and rights	
Equity compensation plans ap– proved by security holders	0	--	0
Equity compensation plans not approved by security holders	0	--	0
Total.	0	--	0

(e) Sale of Unregistered Securities

The Company did not issue any unregistered equity securities during the quarter ended December 31, 2011.

(f) Repurchase of Equity Securities

The Company did not repurchase any of its equity securities that were registered under Section 12 of the Securities Act during the quarter ended December 31, 2011.

Item 6 Selected Financial Data

Not Applicable.

Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

During the years ended December 31, 2011, and 2010 the Company did not generate any revenue. As a result, there is also no cost of goods sold incurred during the past years.

The Company incurred $7,067,774 in operating expenses during the year ended December 31, 2011. The Company's ongoing operating expenses totaled $266,325, a modest reduction from the $303,396 in operating expenses incurred in the year ended December 31, 2010. Since we were not engaged in production at any time during the year, the Company's operating expenses primarily involved:

- expenses related to the maintenance and security of its factory; and
- expenses resulting from its status as a U.S. public company and its efforts to enter into the U.S. capital market.

At the end of 2011, we determined that we could no longer justify recording the book value of our factory at its construction cost, since the prolonged delay in initiating operations put in question our prior estimation of the anticipated cash flows from the factory. As a result, we recorded an impairment charge of $6,801,449 on the book value of the factory. This added that amount to our operating expenses for the year.

Net loss was $7,067,774 for the year ended December 31, 2011, a significant increase from the $303,396 net loss in 2010 resulting from the write-down of the factory value.

Liquidity and Capital Resources

Management anticipates that Yili Asphalt will commence revenue-producing operations at some time in the future. In order to do so, however, Yili Asphalt will have to obtain approximately $500,000 in working capital to fund the initiation of operations. Management is uncertain as to how to obtain these funds, as its efforts to approach a Chinese bank in order to borrow those funds on a secured basis have proven unavailing. If the delay in securing the necessary funds continues for a significant time, the date for initiation of revenue-producing operations will be likewise delayed.

Because the Company's refining process yields three different end products (asphalt, diesel fuel, lubricants), the Company's initial operations will entail a sudden increase in working capital demands. Among the more significant funding demands will be:

Marketing. Yili Asphalt intends to engage in direct marketing of all products lines. Management expects that its direct marketing program will prove to be more efficient over the long term than a distribution network. However, the initial burden on its working capital will be considerable, as Yili Asphalt will have to carry the full cost of a sales staff, the expenses of their marketing activities, such as travel, entertainment, and promotion, and the expenses attendant to sales accounting.

Potentially Inefficient Use of Facilities. To optimize the utilization of our refinery, we will have to generate sales of our products in the proportions in which the refinery is designed to produce them: roughly 6:3:2 for fuel, asphalt and lubricants respectively. It is unlikely that sales will occur naturally in those proportions. If sales in one or two of the categories lag the other(s), management will face the Hobson's choice of delaying production in the faster selling category, thus losing the benefit of the demand for that category, or tolerating excess inventories of the slower selling categories. This situation would result in additional demands on our working capital.

In addition to our need for working capital to initiate production, our business plan calls for substantial capital investment over the next twelve months. The primary purposes for which we anticipate a need for capital are:

Additional Working Capital for Growth. We believe there is a high demand for our products in Inner Mongolia and the neighboring provinces. If we are correct, then demand could enable us to quickly expand our operations to full capacity. Growth at that rapid rate would require a commitment of many millions of Dollars for working capital. Our management will have to assess the value of the market opportunities that present themselves, and weight them against the cost of such capital as may be made available to us.

Construction of Dedicated Rail Line. The government of Inner Mongolia has committed to construct a rail line that will have a siding at our refinery. The benefit to us in terms of reduced transportation costs would be substantial. The government's proposal, however, contemplates that Yili Asphalt will make a substantial capital contribution toward the construction project. The amount of the contribution has not been determined.

Acquisition of Refinery. Chunshi Li, our Chairman, has committed to purchase Mongolia Kailu Yili Asphalt Co., Ltd., an asphalt company with a production capacity of 100,000 tons. He intends to assign his rights in Mongolia Kailu to Yili Asphalt if we are able to fund the cost. The purchase price will be 20 million RMB (approximately $3.1 million). In addition, Mongolia Kailu is currently unproductive due to deterioration of its facilities. In order to bring it back online, we will have to fund the construction of a waterproof coiled material production line at its plant, which will entail an investment of several million more Renminbi.

At the present time, we have received no commitments for the funds required for our planned capital investments. Obtaining those funds, if we can do so, will require that we issue substantial amounts of equity securities or incur significant debts. We believe that the expected return on those investments will justify the cost. Without additional funding, the Company will not be able to pursue its business model. If adequate funds are not available or are not available on acceptable terms when required, we would be required to significantly curtail our operations and would not be able to fund the development of the business envisioned by our business model. These circumstances could have a material adverse effect on our business and result in our inability to continue to operate as a going concern.

Off-Balance Sheet Arrangements

The Company does not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition or results of operations.

ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not Applicable.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

INDEX TO FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and stockholders of
China Yili Petroleum Company and Subsidiaries,

We have audited the accompanying consolidated balance sheets of China Yili Petroleum Company and Subsidiaries (A Development Stage Company) as of December 31, 2011 and 2010 and the related consolidated statements of operations and comprehensive losses, changes in stockholders' equity and cash flows for the years ended December 31, 2011 and 2010 and for the period from inception (May 27, 2005) to December 31, 2011. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of China Yili Petroleum Company and Subsidiaries (A Development Stage Company) as of December 31, 2011 and 2010, and the results of its operations and its cash flows for the years ended December 31, 2011 and 2010 and for the period from inception (May 27, 2005) to December 31, 2011 in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As shown in the accompanying financial statements, the Company has sustained losses totaling $8,942,637 since inception. At December 31, 2011 the Company's current liabilities exceeded its current assets by $3,509,203 and its cash aggregated $386. These factors, among others, raise substantial doubt about the Company's ability to continue as a going concern. The accompanying financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Paritz & Company, P.A.

Hackensack, New Jersey
May 16, 2012

CHINA YILI PETROLEUM COMPANY AND SUBSIDIARIES
(A DEVELOPMENT STAGE COMPANY)
CONSOLIDATED BALANCE SHEETS

	December 31, 2011	December 31, 2010
ASSETS		
CURRENT ASSETS:		
Cash	$386	$692
Other sundry current assets	572	547
TOTAL CURRENT ASSETS	958	1,239
Property and equipment, net of accumulated depreciation	2,576,221	9,176,508
TOTAL ASSETS	$2,577,179	$9,177,747
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$2,241,307	$2,143,942
Due to shareholder	457,918	378,700
Accrued expenses	810,936	648,365
TOTAL CURRENT LIABILITIES	3,510,161	3,171,007
STOCKHOLDERS' EQUITY		
Common stock, $0.001 par value, 100,000,000 shares authorized, 29,748,348 shares issued and outstanding at December 31, 2011 and 2010 respectively	29,748	29,748
Preferred stock, $0.001 par value, 4,700,000 shares authorized 0 shares issued and outstanding at December 31, 2011 and 2010		
Preferred stock, Series A, $0.001 par value, 300.000 shares authorized 0 shares issued and outstanding at December 31, 2011 and 2010		
Additional paid-in capital	6,764,373	6,741,902
Deficit accumulated during development stage	(8,942,637)	(1,874,863)
Accumulated other comprehensive income	1,215,534	1,109,953
TOTAL STOCKHOLDERS' EQUITY	(932,982)	6,006,740

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$2,577,179	$9,177,747

The accompanying notes are an integral part of these financial statements

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CHINA YILI PETROLEUM COMPANY AND SUBSIDIARIES
(A DEVELOPMENT STAGE COMPANY)
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSSES

	For the years ended December 31, 2011	For the years ended December 31, 2010	From Inception May 27, 2005 to December 31, 2011
Sales	$ -	$ -	$ -
COSTS AND EXPENSES:			
General and administrative expenses	7,045,303	284,783	8,928,176
Interest expense	22,471	18,613	71,891
Total Cost and expenses	7,067,774	303,396	9,000,067
NET LOSS FROM CONTINUING OPERATIONS	(7,067,774)	(303,396)	(9,000,067)
INCOME FROM DISCONTINUED OPERATIONS	-	-	57,430
NET LOSS	(7,067,774)	(303,396)	(8,942,637)
OTHER COMPREHENSIVE INCOME (LOSS):			
Foreign currency translation adjustments	105,581	213,984	1,215,534
TOTAL COMPREHENSIVE (LOSS)	(6,962,193)	(89,412)	(7,727,103)
Basic and diluted loss per common share:			
Continuing operations	$ (0.24)	$ (0.01)	
Discontinued operations	$ -	$ -	
Weighted average number of shares outstanding:	29,748,348	29,748,348	

The accompanying notes are an integral part of these financial statements

CHINA YILI PETROLEUM COMPANY AND SUBSIDIARIES
(A DEVELOPMENT STAGE COMPANY)
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the years ended December 31 2011	2010	From Inception May 27, 2005 to December 31, 2011
OPERATING ACTIVITIES:			
Net loss from continuing operations	$(7,067,774)	$(303,396)	$ (9,000,067)
Income from discontinued operations	-	-	57,430
Net loss	$(7,067,774)	$(303,396)	$ (8,942,637)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Impairment of long-term assets	6,801,449	-	6,801,449
Depreciation	46,270	45,354	253,292
Imputed interest	22,471	18,613	71,891
Changes in operating assets and liabilities:			
Other sundry current assets	308	2,470	(572)
Accounts payable	-	-	2,241,306
Accrued expenses	132,639	159,109	810,936
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	(64,637)	(77,850)	1,235,665
INVESTING ACTIVITIES:			
Acquisition of property and equipment	-	-	(9,630,962)
NET CASH USED IN INVESTING ACTIVITIES	-	-	(9,630,962)
FINANCING ACTIVITIES:			
Loan received from a stockholder	64,513	84,138	457,918
Capital contribution	-	-	6,722,231
NET CASH PROVIDED BY FINANCING ACTIVITIES	64,513	84,138	7,180,149
EFFECT OF EXCHANGE RATE ON CASH	(182)	(8,757)	1,215,534
INCREASE/ DECREASE IN CASH	(306)	(2,469)	386
CASH - BEGINNING OF YEAR	692	3,161	-
CASH - END OF YEAR	$386	$692	$ 386

The accompanying notes are an integral part of these financial statements

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CHINA YILI PETROLEUM COMPANY
AND SUBSIDIARIES
(A DEVELOPMENT STAGE
COMPANY)

STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

	PREFERRED STOCK SERIES A SHARES	AMOUT	COMMON STOCK SHARES	AMOUNT	ADDITIONAL PAID-IN CAPITAL	DEFICIT ACCUM. DURING DEVELOPMENT STAGE	OTHER COMPREH INCOME
BALANCE - May 27, 2005	-	-		-	-	-	-
Capital Contributions	300,000	300		-	185,795		
Net loss							
BALANCE - DECEMBER 31, 2005	300,000	300		-	185,795	-	-
Additional capital contribution					6,593,866		
Foreign currency translation adjustments							(2,438)
Net loss						(115,937)	
BALANCE - DECEMBER 31, 2006	300,000	300		-	6,779,661	(115,937)	(2,438)
Effect of merger and reverse split			300,051	300	(1,196,392)		
Foreign currency translation adjustments							458,996
Net loss						(464,552)	
BALANCE - DECEMBER 31, 2007	300,000	300	300,051	300	5,583,269	(580,489)	456,558
Foreign currency translation adjustments							464,180
Preferred stock converted to common stock	(300,000)	(300)	29,448,297	29,448	(29,148)		