CHINA YILI PETROLEUM CO
Form 10-Q
May 24, 2010

U. S. Securities and Exchange Commission
Washington, D. C. 20549

FORM 10-Q

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2010

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File No. 1-51554

China Yili Petroleum Company
(Name of Registrant in its Charter)

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

c/o 100 Wall Street, 15th Floor, New York, NY 10005
(Address of Principal Executive Offices)

Issuer's Telephone Number: (212) 232-0120

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 __

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 No_

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 ___ Accelerated filer ____ Non-accelerated filer ___ 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 __ No X

As of May 24, 2010, 29,748,348 shares of common stock, par value $.001 per share, were outstanding.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

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

	March 31, 2010 (Unaudited)	December 31, 2009
ASSETS		
CURRENT ASSETS:		
Cash	1,971	$3,161
Other sundry current assets	528	528
TOTAL CURRENT ASSETS	2,499	3,689
Property and equipment, net of accumulated depreciation	8,892,085	8,904,343
TOTAL ASSETS	8,894,584	8,908,032
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	2,070,470	2,070,124
Due to stockholder	304,045	285,870
Accrued expenses	512,141	474,499
TOTAL CURRENT LIABILITIES	2,886,656	2,830,493
STOCKHOLDERS' EQUITY:		
Common stock, $0.001 par value, 100,000,000 shares authorized, 29,290,428 and 29,748,348 shares issued and outstanding at March 31, 2010 and December 31, 2009, respectively	29,748	29,748
Preferred stock, $0.001 par value, 4,700,000 shares authorized, 0 shares issued and outstanding at March 31, 20101 and December 31, 2009		
Preferred stock, Series A, $0.001 par value, 300,000 shares authorized, 0 shares issued and outstanding at March 31, 20101 and December 31, 2009	-	-
Additional paid-in capital	6,784,519	6,780,719
Deficit accumulated during development stage	(1,703,322)	(1,628,917)

Accumulated other comprehensive income	896,983	895,989
TOTAL STOCKHOLDERS' EQUITY	6,007,928	6,077,539
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	8,894,584	8,908,032

The accompanying notes are integral part of the financial statements

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

	For the three months ended March 31, 2010	For the three months ended March 31, 2009	From Inception May 27, 2005 To March 31, 2010
SALES	$ -	$ -	$ -
COSTS AND EXPENSES			
Cost of sales	-		
General and administrative expenses	70,625	57,987	1,668,715
Interest expense	3,800	4,905	34,607
TOTAL COSTS AND EXPENSES	74,425	62,892	1,703,322
NET (LOSS) FROM CONTINUING OPERATIONS	(74,425)	(62,892)	(1,703,322)
INCOME (LOSS) FROM DISCONTINUED OPERATIONS	-	-	57,430
NET LOSS	$ (74,425)	$ (62,892)	$ (1,645,892)
OTHER COMPREHENSIVE INCOME (LOSS) :			
Foreign currency translation adjustments	1,014	(20,023)	896,983
TOTAL COMPREHENSIVE (LOSS)	$ (73,411)	$ (82,915)	$ (748,909)
Basic and diluted loss per common share:			
Continuing operations	$ (0.00)	$ (0.00)	
Weighted average number of shares outstanding	29,290,428	29,748,348	

The accompanying notes are integral part of the financial statements

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

	For the three months ended March 31, 2010	For the three months ended March 31, 2009	From Inception May 27, 2005 To March 31, 2010
OPERATING ACTIVITIES:			
Net loss from continued operations	$(74,425)	$(62,892)	(1,645,892)
Loss from discontinued operations	-	-	(57,430)
Net (loss)	(74,425)	(62,892)	(1,703,322)
Adjustments to reconcile net loss to net cash			
provided by (used in) operating activities:			
Depreciation	13,741	10,396	160,130
Imputed interest	3,800	4,905	34,606
Changes in operating assets and liabilities:			
Other sundry current assets	-	(90)	(528)
Accounts payable	-	-	2,070,470
Accrued expenses	37,562	(2,811)	512,141
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	(19,322)	(50,492)	1,073,497
INVESTING ACTIVITIES:			
Acquisition of property and equipment	-	-	(9,052,215)
NET CASH USED IN INVESTING ACTIVITIES	-	-	(9,052,215)
FINANCING ACTIVITIES:			
Loan received from stockholder	18,129	47,702	304,045
Capital contributions	-	-	6,779,661
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	18,129	47,702	7,083,706
EFFECT OF EXCHANGE RATE ON CASH	3	(2)	896,983
INCREASE (DECREASE) IN CASH	(1,190)	(2,792)	1,971
CASH - BEGINNING OF PERIOD	$3,161	6,057	-
CASH - END OF PERIOD	$1,971	$3,265	$1,971

The accompanying notes are integral part of the financial statements

4

CHINA YILI PETROLEUM COMPANY AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1 BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and pursuant to the requirements for reporting on Form 10-Q. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for annual financial statements. However, the information included in these interim financial statements reflects all adjustments (consisting solely of normal recurring adjustments) which are, in the opinion of management, necessary for the fair presentation of the consolidated financial position and the consolidated results of operations. Results shown for interim periods are not necessarily indicative of the results to be obtained for a full year. The consolidated balance sheet as of December 31, 2009 was derived from the audited consolidated financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2009. These interim financial statements should be read in conjunction with that report.

For further information, refer to the consolidated financial statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2009 filed on April 15, 2010.

The Company’s functional currency is the Chinese Renminbi (“RMB”); however, the accompanying financial statements have been translated and presented in United States Dollars (“USD”).

2 BUSINESS DESCRIPTION

China Yili Petroleum Company and subsidiaries (“the Company”), a development stage company, intend to refine heavy oil into asphalt, fuel oil and lubricants through its wholly-owned subsidiary.

Since inception, the Company has been developing its facilities and obtaining the requisite approvals from the Chinese government and has not earned any revenue from operations. Accordingly, the Company’s activities have been accounted for as those of a Development Stage Enterprise The Company’s financial statements be identified as those of a development stage company, and that the statements of operations, stockholders’ equity and cash flows disclose activity since the date of the Company’s inception.

3 GOING CONCERN

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As shown on the accompanying financial statements, the Company‘s current liabilities exceeded its current assets by $2,884,157 on March 31, 2010. The Company sustained an accumulative loss of $ 1,703,322 from its inception to date. The Company has not earned any revenues from continuing operations since inception. 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.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation

The accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant inter-company balances and transactions have been eliminated in consolidation.

Uses of estimates in the preparation of financial statements

The preparation of financial statements in conformity with generally accepted accounting principles 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 net revenue and expenses during each reporting period. Actual results could differ from those estimates.

Impairment of long-lived assets

Long-lived assets are reviewed for impairment when circumstances indicate the carrying value of an asset may not be recoverable. For assets that are to be held and used, an impairment is recognized when the estimated undiscounted cash flows associated with the asset or group of assets is less than their carrying value. If impairment exists, an adjustment is made to write the asset down to its fair value, and a loss is recorded as the difference between the carrying value and fair value. Fair values are determined based on quoted market values, discounted cash flows or internal and external appraisals, as applicable. Assets to be disposed of are carried at the lower of carrying value or estimated net realizable value.

Deferred income taxes

Deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their respective tax bases. In addition, recognition of future tax benefits, such as carryforwards, to the extent that realization of such benefits is more likely than not and that a valuation allowance be provided when it is more likely than not that some portion of the deferred tax assets will not be realized.

Foreign currency translation

The assets and liabilities of the Company’s subsidiary, using the local currency as its functional currency, are translated to U.S. Dollars based on the current exchange rate prevailing at each balance sheet date and any resulting translation adjustments are included in Accumulated Other Comprehensive Income (Loss). The Company’s revenues and expenses are translated into U.S. Dollars using the average exchange rates prevailing for each period presented.

Income (loss) per common share

Basic income (loss) per common share amounts are computed by dividing net income by weighted-average common stock outstanding during the period. Diluted income (loss) per common share are calculated using weighted-average shares outstanding, adjusted for the dilutive effect of shares issuable upon the assumed exercise of common stock equivalents. As of December 31, 2009 and 2008, there were no common stock equivalents outstanding.

Comprehensive income

Comprehensive income is defined to include all changes in equity except those resulting from investments by shareholders and distributions to shareholders. Among other disclosures, all items that are required to be recognized under current accounting standards as components of comprehensive income are required to be reported in a financial statement that is presented with the same prominence as other financial statements. Comprehensive income includes net income and the foreign currency translation gain, net of tax.

Fair value of financial instruments

Statement of Financial Accounting Standards No. 107, "Disclosures about Fair Value of Financial Instruments", requires that the Company disclose estimated fair values of financial instruments.

The Company's financial instruments primarily consist of cash and cash equivalents, accounts receivable, other receivables, advances to suppliers, accounts payable, accrued expenses and other sundry current liabilities and related party advances and borrowings.

As of the balance sheet dates, the estimated fair values of financial instruments were not materially different from their carrying values as presented on the balance sheet. This is attributed to the short maturities of the instruments and that interest rates on the borrowings approximate those that would have been available for loans of similar remaining maturity and risk profile at the respective balance sheet dates.

New Accounting Pronouncements

In October 2009, the FASB issued a new accounting standard which provides guidance for arrangements with multiple deliverables. Specifically, the new standard requires an entity to allocate consideration at the inception of an arrangement to all of its deliverables based on their relative selling prices. In the absence of the vendor-specific objective evidence or third-party evidence of the selling prices, consideration must be allocated to the deliverables based on management's best estimate of the selling prices. In addition, the new standard eliminates the use of the residual method of allocation. In October 2009, the FASB also issued a new accounting standard which changes revenue recognition for tangible products containing software and hardware elements. Specifically, tangible products containing software and hardware that function together to deliver the tangible products' essential functionality are scoped out of the existing software revenue recognition guidance and will be accounted for under the multiple-element arrangements revenue recognition guidance discussed above. The Company does not anticipate that the adoption of this statement will have a material effect on the Company's financial condition and results of operations because the Company doesn't have any multiple deliverable revenue arrangements.

In December, 2009, FASB issued ASU No. 2009-17, Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities. This Accounting Standards Update amends the FASB Accounting Standards Codification for the issuance of FASB Statement No. 167, Amendments to FASB Interpretation No. 46(R). The amendments in this Accounting Standards Update replace the quantitative-based risks and rewards calculation for determining which reporting entity, if any, has a controlling financial interest in a variable interest entity with an approach focused on identifying which reporting entity has the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and (1) the obligation to absorb losses of the entity or (2) the right to receive benefits from the entity. An approach that is expected to be primarily qualitative will be more effective for identifying which reporting entity has a controlling financial interest in a variable interest entity. The amendments in this Update also require additional disclosures about a reporting entity's involvement in variable interest entities, which will enhance the information provided to users of financial statements. The Company has determined the adoption of this ASU does not have a material impact on its financial statements.

In January 2010, FASB issued ASU No. 2010-06 – Improving Disclosures about Fair Value Measurements. This update provides amendments to Subtopic 820-10 that requires new disclosure as follows: 1) Transfers in and out of Levels 1 and 2. A reporting entity should disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. 2) Activity in Level 3 fair value measurements. In the reconciliation for fair value measurements using significant unobservable inputs (Level 3), a reporting entity should present separately information about purchases, sales, issuances, and settlements (that is, on a gross basis rather than as one net number). This update provides amendments to Subtopic 820-10 that clarifies existing disclosures as follows: 1) Level of disaggregation. A reporting entity should provide fair value measurement disclosures for each class of assets and liabilities. A class is often a subset of assets or liabilities within a line item in the statement of financial position. A reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities. 2) Disclosures about inputs and valuation techniques. A reporting entity should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. Those disclosures are required for fair value measurements that fall in either Level 2 or Level 3. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The Company has determined the adoption of this ASU does not have a material impact on its financial statements.

5 DUE TO STOCKHOLDER

Amounts due certain stockholder of China Yili Petroleum Company, are non-interest bearing and are due on demand. Interest was imputed at 5% per annum for the years ended March 31, 2010 and December 31, 2009..

6 INCOME TAXES

The Company has net operating loss carry-forwards in China of approximately $900,000 which expire between 2012 and 2014.

The Company has a deferred tax asset resulting from the tax loss carry-forwards of approximately $200,000 for which the Company has provided a 100% valuation allowance.

7 RISK FACTORS

Vulnerability due to Operations in PRC

The Company's operations may be adversely affected by significant political, economic and social uncertainties in the PRC. Although the PRC government has been pursuing economic reform policies for more than 20 years, no assurance can be given that the PRC government will continue to pursue such policies or that such policies may not be significantly altered, especially in the event of a change in leadership, social or political disruption or unforeseen circumstances affecting the PRC's political, economic and social conditions. There is also no guarantee that the PRC government's pursuit of economic reforms will be consistent or effective.

Risks of Losses

The Company is potentially exposed to risks of losses that may result from business interruptions, injury to others (including employees) and damage to property. These losses may be uninsured, especially due to the fact that the Company's operations are in China, where business insurance is not readily available. If: (i) information is available before the Company's financial statements are issued or are available to be issued indicates that such loss is probable and (ii) the amount of the loss can be reasonably estimated, an estimated loss will be accrued by a charge to income. If such loss is probable but the amount of loss cannot be reasonably estimated, the loss shall be charged to the income of the period in which the loss can be reasonably estimated and shall not be charged retroactively to an earlier period. As of March 31, 2010, the Company has not experienced any uninsured losses from injury to others or other losses.

Potential Limitations on the Payment of Dividends

The PRC government imposes control over the conversion of Renminbi, or RMB, into foreign currencies. Pursuant to the Foreign Exchange Control Regulations of the PRC issued by the State Council which came into effect on April 1, 1996, and the Regulations on the Administration of Foreign Exchange Settlement, Sale and Payment of the PRC which came into effect on July 1, 1996, regarding foreign exchange control, conversion of RMB into foreign exchange by Foreign Investment Enterprises, or FIEs, for use on current account items, including the distribution of dividends and profits to foreign investors, is permissible. FIEs are permitted to convert their after-tax dividends and profits to foreign exchange and remit such foreign exchange to their foreign exchange bank accounts in China. On January 14, 1997, the State Council amended the Foreign Exchange Control Regulations and added, among other things, an important provision, which provides that the PRC government shall not impose restrictions on recurring international payments and transfers under current account items. Enterprises in China, including FIEs, which require foreign exchange for transactions relating to current account items, if within a certain limited amount may, without approval of the State Administration of Foreign Exchange, or SAFE, effect payment from their foreign exchange account or convert and pay at the designated foreign exchange banks by providing valid receipts and proofs. Conversions in excess of prescribed limits, however, require the prior approval of SAFE.

Obtaining approval from SAFE for foreign currency conversions can be a time-consuming process. Moreover, the PRC government from time to time modifies its regulations regarding conversion of RMB into foreign currencies, and may in the future impose further restrictions on transactions relating to current accounts. For all these reasons, our ability to pay dividends in the future may be limited by our inability to readily transfer funds from our PRC subsidiary to our U.S. parent corporation.

Environmental concerns

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. 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 substantial additional costs to the Company.

8 SUBSEQUENT EVENT

We have evaluated events after the date of these financial statements through the date that these financial statements were issued. There were no material subsequent events as of that date

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Economic and Industry Trend

In past years, China has experienced a real estate boom, which also triggered the rapid development of the construction industry, which uses asphalt as a major material. However, in 2007, the Chinese government implemented a series of policies and regulations to curb inflation and the property market. These policies, together with the worldwide financial crisis in late 2008, have resulted in a slowdown of the real estate market in China and our business, in turn, has been affected. Recently, the Chinese government has changed its policy and prioritized boosting of the economy. The Chinese government has adopted new policies to address the slowdown of the real estate market, such as reducing stamp duties and transactions fees, lowering interest rates. The Chinese government has also decided to inject a stimulus package to boost the overall economy. From all of these, we have seen signs of recovery of the market in China.

Results of Operations

During the quarter ended March 31, 2010, the Company did not generate any revenue or start profitable operation. As a result, there is no cost of goods sold incurred during the three-month period ended March 31, 2010. Likewise we generated no revenue during the three months ended March 31, 2009 or any prior period.

Total operating expenses reported by the Company for the quarter ended March 31, 2010 were mainly attributable to the general and administrative expenses which generally consisted of the facilities maintenance and depreciation cost. Compared to the operating expenses of $57,987 incurred during the quarter ended March 31, 2009, our total operating expenses have increased to $70,625 for the quarter ended March 31, 2010. The Company's operating expenses primarily involved expenses related to its activities in completing its factory, finalizing the development of its products, and securing the government licenses necessary for it to carry out its business plan. In addition, the Company also incured expenses resulting from its status as a U.S. public company and its efforts to enter into the U.S. capital market.

Net loss was $74,425 for the quarter ended March 31, 2010.

Liquidity and Capital Resources

Management anticipates that Yili Asphalt will commence revenue-producing operations in the near 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 plans to approach a Chinese bank in order to borrow those funds on a secured basis, since Yili Asphalt has $8.8 million in capital assets on its books that are currently free of liens. To date, however, it has not obtained a commitment for the funds. If there is a delay in securing the necessary funds, 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 $2.7 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 3. Quantitative and Qualitative Disclosures about Market Risk

Not applicable.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures.

The Company's management under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, performed an evaluation of the effectiveness of the design, maintenance and operation of the Company's disclosure controls and procedures as of March 31, 2010. Pursuant to Rule13a-15(e) promulgated by the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934, “disclosure controls and procedures” means controls and other procedures that are designed to insure that information required to be disclosed by China Yili in the reports that it files with the Securities and Exchange Commission is recorded, processed, summarized and reported within the time limits specified in the Commission’s rules. “Disclosure controls and procedures” include, without limitation, controls and procedures designed to insure that information China Yili is required to disclose in the reports it files with the Commission is accumulated and communicated to our Chief Executive Officer and Chief Financial Officer as appropriate to allow timely decisions regarding required disclosure. In carrying out the evaluation, our Chief Executive and Chief Financial Officer observed the three material weaknesses:

- Inadequate staffing and supervision within the accounting operations of our company. The relatively small number of employees who are responsible for accounting functions prevents us from segregating duties within our internal control system. The inadequate segregation of duties is a weakness because it could lead to the untimely identification and resolution of accounting and disclosure matters or could lead to a failure to perform timely and effective reviews.

    - Lack of expertise in U.S accounting principles among the personnel in our Chinese headquarters. Our books are maintained and our financial statements are prepared by the personnel employed at our executive offices in the City of Tongliao. None of our employees has substantial experience or familiarity with U.S accounting principles. The lack of personnel in our Tongliao office who are trained in U.S. accounting principles is a weakness because it could lead to improper classification of items and other failures to make the entries and adjustments necessary to comply with U.S. GAAP.

- Lack of independent control over related party transactions. Chunshi Li is the sole director and sole officer of China Yili Petroleum Company. From time to time Mr. Li has made loans to finance the operations of Yili Asphalt, has contributed assets to Yili Asphalt, and has arranged transactions between Yili Asphalt and other entities under his control. The absence of other directors or officers to review these transactions is a weakness because it could lead to improper classification of such related party transactions.

Based on his evaluation, our Chief Executive Officer and Chief Financial Officer concluded that China Yili's system of disclosure controls and procedures was not effective as of March 31, 2010 for the purposes described in this paragraph.

Changes in Internal Controlover Financial Reporting

During the three months ended March 31, 2010, there has been no change in our internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) under the Exchange Act)) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The company is not party to any material legal proceeding.

ITEM 1A. RISK FACTORS

There has been no material change to the risk factors set forth in Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(c) Unregistered sales of equity securities

None.

(e) Purchases of equity securities

The Company did not repurchase any of its equity securities that were registered under Section 12 of the Securities Exchange Act during the 1st quarter of fiscal 2010.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. RESERVED

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

31 Rule 13a-14(a) Certification

32 Rule 13a-14(b) Certification

SIGNATURES

Pursuant to the requirements 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.

China Yili Petroleum Company

Date : May 24, 2010

/s/Chunshi Li
Chunshi Li, Chief Executive Officer
and Chief Financial Officer