

PIONEER OIL AND GAS
FINANCIAL STATEMENTS
September 31, 2006 and 2005

JONES SIMKINS P.C.



CERTIFIED PUBLIC ACCOUNTANTS

PIONEER OIL AND GAS
FINANCIAL STATEMENTS
September 30, 2006 and 2005

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1011 West 400 North, Suite 100
P.O. Box 747
Logan, UT 84323-0747
Phone: (435) 752-1510 • (877) 752-1510
Fax: (435) 752-4878

OFFICERS:

Paul D. Simkins, CPA
Michael C. Kidman, CPA, MBA
Brent S. Sandberg, CPA
Brett C. Hugie, CPA
Mark E. Low, CPA
H. Paul Gibbons, CPA

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and
Stockholders of Pioneer Oil and Gas

We have audited the accompanying balance sheets of Pioneer Oil and Gas as of September 30, 2006 and 2005, and the related statements of income, stockholders' equity, and cash flows for the 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 audited standards generally accepted in the United States of America. Those standards require that we plan and perform the audit 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 Pioneer Oil and Gas as of September 30, 2006 and 2005, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

JONES SIMKINS, P.C.
Logan, Utah
December 6, 2006

PIONEER OIL AND GAS
BALANCE SHEETS
September 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
<u>Assets</u>		
Current assets:		
Cash	\$ 294,754	758,183
Investments, available for sale	8,000	122,533
Accounts receivable	219,793	353,902
Prepaid income taxes	-	39,000
Resale leases, at lower of cost or market	<u>5,880,385</u>	<u>4,280,444</u>
Total current assets	6,402,932	5,554,062
Property and equipment, net	433,542	501,870
Other assets	<u>2,230</u>	<u>2,230</u>
	<u>\$ 6,838,704</u>	<u>6,058,162</u>
<u>Liabilities and Stockholders' Equity</u>		
Current liabilities:		
Accounts payable	\$ 130,369	329,597
Payable - common stock repurchases	341,334	1,138,599
Accrued expenses	26,488	33,047
Income taxes payable	347,000	-
Note payable	<u>200,000</u>	<u>-</u>
Total current liabilities	1,045,191	1,501,243
Deferred income taxes	69,000	96,000
Asset retirement obligation	<u>70,493</u>	<u>112,852</u>
Total liabilities	1,184,684	1,710,095
Commitments and contingencies		
Stockholders' equity:		
Common stock, par value \$.001 per share, 50,000,000 shares authorized; 7,260,676 and 7,280,556 shares issued and outstanding, respectively	7,261	7,281
Additional paid-in capital	1,054,565	1,058,107
Stock subscription receivable	(99,927)	(164,909)
Accumulated other comprehensive income	5,000	80,533
Retained earnings	<u>4,837,121</u>	<u>3,367,055</u>
	5,804,020	4,348,067
Less treasury stock, 100,000 shares at cost	<u>(150,000)</u>	<u>-</u>
Total stockholders' equity	<u>5,654,020</u>	<u>4,348,067</u>
	<u>\$ 6,838,704</u>	<u>6,058,162</u>

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

PIONEER OIL AND GAS
STATEMENTS OF INCOME
Years Ended September 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Revenue:		
Oil and gas sales	\$ 884,268	1,294,348
Royalty revenue	1,047,639	856,735
Project and lease sales income	<u>1,276,524</u>	<u>4,748,903</u>
	<u>3,208,431</u>	<u>6,899,986</u>
Costs and expenses:		
Cost of operations	464,288	777,762
General and administrative expenses	470,588	420,879
Exploration costs	239,724	351,222
Lease rentals	203,922	23,466
Depreciation, depletion and amortization	<u>73,050</u>	<u>134,713</u>
	<u>1,451,572</u>	<u>1,708,042</u>
Income from operations	<u>1,756,859</u>	<u>5,191,944</u>
Other income (expense):		
Gain on sale of investments	130,079	77,845
Gain (loss) on assets sold or abandoned	309,821	(27,012)
Interest income	14,894	34,410
Interest expense	(54,730)	(1,458)
Other	<u>9,143</u>	<u>5,500</u>
	<u>409,207</u>	<u>89,285</u>
Income before provision for income taxes	2,166,066	5,281,229
Provision for income taxes	<u>(696,000)</u>	<u>(1,170,000)</u>
Net income	<u>\$ 1,470,066</u>	<u>4,111,229</u>
Net income per common share:		
Basic	<u>\$ 0.20</u>	<u>0.52</u>
Diluted	<u>\$ 0.20</u>	<u>0.50</u>
Weighted average common shares:		
Basic	<u>7,269,000</u>	<u>7,905,000</u>
Diluted	<u>7,350,000</u>	<u>8,182,227</u>

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

PIONEER OIL AND GAS
STATEMENTS OF STOCKHOLDERS' EQUITY
Years Ended September 30, 2006 and 2005

	<u>Common Stock</u>		<u>Additional Paid-in Capital</u>	<u>Stock Subscription Receivable</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Retained Earnings (Deficit)</u>	<u>Treasury Stock</u>		<u>Total</u>
	<u>Shares</u>	<u>Amount</u>					<u>Shares</u>	<u>Amount</u>	
Balance at October 1, 2004	7,912,819	\$ 7,912	\$ 2,473,256	\$ (203,659)	\$ -	\$ (744,174)	-	\$ -	\$ 1,533,335
Payments on stock subscription receivable	-	-	-	38,750	-	-	-	-	38,750
Purchase and retirement of common stock	(215,805)	(216)	(322,878)	-	-	-	-	-	(323,094)
Common stock retired through stock split	(776,458)	(775)	(1,163,911)	-	-	-	-	-	(1,164,686)
Stock options exercised	360,000	360	71,640	-	-	-	-	-	72,000
Unrealized holding gain	-	-	-	-	80,533	-	-	-	80,533
Net income	-	-	-	-	-	4,111,229	-	-	4,111,229
Balance at September 30, 2005	7,280,556	7,281	1,058,107	(164,909)	80,533	3,367,055	-	-	4,348,067
Payments on stock subscription receivable	-	-	-	64,982	-	-	-	-	64,982
Purchase and retirement of common stock	(19,880)	(20)	(3,542)	-	-	-	-	-	(3,562)
Purchase of treasury stock	-	-	-	-	-	-	(100,000)	(150,000)	(150,000)
Unrealized holding loss	-	-	-	-	(75,533)	-	-	-	(75,533)
Net income	-	-	-	-	-	1,470,066	-	-	1,470,066
Balance at September 30, 2006	<u>7,260,676</u>	<u>\$ 7,261</u>	<u>\$ 1,054,565</u>	<u>\$ (99,927)</u>	<u>5,000</u>	<u>\$ 4,837,121</u>	<u>(100,000)</u>	<u>\$ (150,000)</u>	<u>\$ 5,654,020</u>

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

PIONEER OIL AND GAS
STATEMENTS OF CASH FLOWS
Years Ended September 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Net income	\$ 1,470,066	4,111,229
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Gain on sale of investments	(130,079)	-
Gain on sale of producing properties	(309,821)	-
Gain on assets sold, abandoned, and dry hole costs	(31,729)	(148,037)
Depreciation, depletion and amortization	73,050	134,713
Accretion expense	3,383	4,748
Employee benefit plan expense	74,227	50,397
Deferred income taxes	12,000	54,000
Interest income	(9,245)	(11,647)
(Increase) decrease in:		
Accounts receivable	134,109	87,548
Prepaid income taxes	39,000	(39,000)
Resale leases	(1,599,941)	(3,228,152)
Increase (decrease) in:		
Accounts payable	(199,228)	221,389
Accrued expenses	(6,559)	4,482
Income taxes payable	347,000	-
Advances on drilling costs	-	(556,573)
Net cash provided by (used in) operating activities	<u>(133,767)</u>	<u>685,097</u>
Cash flows from investing activities:		
Acquisition of property and equipment	(18,735)	(150,823)
Proceeds from sale of investments	130,079	-
Proceeds from sale of producing properties	309,821	10,000
Net cash provided by (used in) investing activities	<u>421,165</u>	<u>(140,823)</u>
Cash flows from financing activities:		
Payable - common stock repurchases	(797,265)	-
Proceeds from note payable	1,000,000	-
Payments on note payable	(800,000)	-
Proceeds from sale of common stock	-	72,000
Purchase of treasury stock	(150,000)	-
Purchase and retirement of common stock	(3,562)	(349,181)
Net cash used in financing activities	<u>(750,827)</u>	<u>(277,181)</u>
Net increase (decrease) in cash	(463,429)	267,093
Cash, beginning of year	<u>758,183</u>	<u>491,090</u>
Cash, end of year	<u>\$ 294,754</u>	<u>758,183</u>

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

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
September 30, 2006 and 2005

Note 1 – Organization and Summary of Significant Accounting Policies

Organization

The Company is incorporated under the laws of the state of Utah and is primarily engaged in the business of acquiring, developing, producing and selling oil and gas properties to companies located in the continental United States.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Company considers all highly liquid investments with a maturity of three months or less to be cash equivalents.

Investments

The Company classifies its investments as “available for sale.” Securities classified as “available for sale” are carried in the financial statements at fair value. Realized gains and losses, determined using the specific identification method, are included in operations; unrealized holding gains and losses are reported as a separate component of accumulated other comprehensive income. Declines in fair value below cost that are other than temporary are included in operations.

Concentration of Credit Risk

The Company maintains its cash in bank deposit accounts, which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant credit risk on cash and cash equivalents.

Resale Leases

The Company capitalizes the costs of acquiring oil and gas leaseholds held for resale, including lease bonuses and any advance rentals required at the time of assignment of the lease to the Company. Advance rentals paid after assignment are charged to expense as carrying costs in the period incurred. Costs of oil and gas leases held for resale are valued at lower of cost or net realizable value and included in current assets since they could be sold within one year, although the holding period of individual leases may be in excess of one year. The cost of oil and gas leases sold is determined on a specific identification basis.

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
September 30, 2006 and 2005

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Accounts Receivable

Accounts receivable are recorded when oil and gas is delivered and are presented net of the allowance for doubtful accounts and are generally unsecured. Accounts receivable are carried at their estimated collectible amounts. Credit is generally extended on a short-term basis; thus accounts receivable do not bear interest although a finance charge may be applied to such receivables that are more than thirty days past due. Accounts receivable are periodically evaluated for collectibility based on past credit history with customers. Provisions for losses on accounts receivable are determined based on loss experience, known and inherent risk in the account balance, current economic conditions, and the financial stability of customers.

Oil and Gas Producing Activities

The Company utilizes the successful efforts method of accounting for its oil and gas producing activities. Under this method, all costs associated with productive exploratory wells and productive or nonproductive development wells are capitalized while the costs of nonproductive exploratory wells are expensed.

If an exploratory well finds oil and gas reserves, but a determination that such reserves can be classified as proved is not made after one year following completion of drilling, the costs of drilling are charged to operations. Indirect exploratory expenditures, including geophysical costs and annual lease rentals are expensed as incurred. Unproved oil and gas properties that are individually significant are periodically assessed for impairment of value and a loss is recognized at the time of impairment by providing an impairment allowance. Other unproved properties are amortized based on the Company's experience of successful drillings and average holding period. Capitalized costs of producing oil and gas properties after considering estimated dismantlement and abandonment costs and estimated salvage values, are depreciated and depleted by the units-of-production method. Support equipment and other property and equipment are depreciated over their estimated useful lives.

On the sale or retirement of a complete unit of a proved property, the cost and related accumulated depreciation, depletion and amortization are eliminated from the property accounts, and the resultant gain or loss is recognized. On the retirement or sale of a partial unit of proved property, the cost is charged to accumulated depreciation, depletion and amortization with a resulting gain or loss recognized in income.

On the sale of an entire interest in an unproved property for cash or cash equivalent, gain or loss on the sale is recognized, taking into consideration the amount of any recorded impairment if the property has been assessed individually. If a partial interest in an unproved property is sold, the amount received is treated as a reduction of the cost of the interest retained.

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
September 30, 2006 and 2005

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Depreciation is provided using the straight-line method over the estimated useful lives of the assets. Expenditures for maintenance and repairs are expensed when incurred and betterments are capitalized. When assets are sold, retired or otherwise disposed of the applicable costs and accumulated depreciation, depletion and amortization are removed from the accounts, and the resulting gain or loss is reflected in operations.

Long-Lived Assets

The Company evaluates its long-lived assets in accordance with SFAS No. 144, “Accounting for the Impairment of Long-Lived Assets”. Long-lived assets held and used by the Company are reviewed for impairment whenever events or changes in circumstances indicate that their net book value may not be recoverable. When such factors and circumstances exist, the Company compares the projected undiscounted future cash flows associated with the related asset or group of assets over their estimated useful lives against their respective carrying amounts. Impairment, if any, is based on the excess of the carrying amount over the fair value of those assets and is recorded in the period in which the determination was made.

Revenue Recognition

Revenue is recognized from oil sales at such time as the oil is delivered to the buyer. Revenue is recognized from gas sales when the gas passes through the pipeline at the well head. Revenue from overriding royalty interests is recognized when earned.

The Company does not have any gas balancing arrangements.

Use 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 primarily related to oil and gas property reserves and prices, 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.

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
September 30, 2006 and 2005

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Income Taxes

Deferred income taxes arise from temporary differences resulting from income and expense items reported for financial accounting and tax purposes in different periods. Deferred taxes are classified as current or non-current, depending on the classification of the assets and liabilities to which they relate. Deferred taxes arising from temporary differences that are not related to an asset or liability are classified as current or non-current depending on the periods in which the temporary differences are expected to reverse. Temporary differences result primarily from intangible drilling costs and depletion.

Earnings Per Share

The computation of basic earnings per common share is based on the weighted average number of shares outstanding during each year.

The computation of diluted earnings per common share is based on the weighted average number of shares outstanding during the year plus the common stock equivalents which would arise from the exercise of stock options and warrants outstanding using the treasury stock method and the average market price per share during the year. Common stock equivalents are not included in the diluted earnings per share calculation when their effect is antidilutive. Common stock equivalents that could potentially dilute earnings per share are common stock options.

Stock-Based Compensation

The Company has stock-based compensation, which is described more fully in Note 12. The Company accounts for stock options granted to employees under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations, and has adopted the disclosure-only provisions of Statement of Financial Accounting Standards (SFAS) No. 123, “Accounting for Stock-Based Compensation” (see Note 18). Accordingly, no compensation cost has been recognized in the financial statements, as all options granted under those plans had an exercise price equal to or greater than the market value of the underlying common stock on the date of grant.

Had compensation cost for the Company’s stock options been determined based on the fair value method at the grant date consistent with the provisions of SFAS 123, the Company’s net income would have been reduced to the pro forma amounts shown below:

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
September 30, 2006 and 2005

Note 1 – Organization and Summary of Significant Accounting Policies (continued)

Stock-Based Compensation (continued)

	<u>2006</u>	<u>2005</u>
Net income as reported	\$ 1,470,066	4,111,229
Deduct:		
Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	<u>(175,000)</u>	<u>-</u>
Net loss pro forma	\$ <u>1,295,066</u>	<u>4,111,229</u>
Loss per share:		
As reported:		
Basic	\$ <u>0.20</u>	<u>0.52</u>
Diluted	\$ <u>0.20</u>	<u>0.50</u>
Pro forma:		
Basic	\$ <u>0.18</u>	<u>0.52</u>
Diluted	\$ <u>0.18</u>	<u>0.50</u>

Note 2 – Investments

Investments are recorded at fair value and consist of the following:

	<u>2006</u>	<u>2005</u>
Investments, at cost	\$ -	-
Unrealized holding gain	<u>8,000</u>	<u>122,533</u>
Investments, at fair value	\$ <u>8,000</u>	<u>122,533</u>

Changes in the unrealized holding gain on investments are as follows:

	<u>2006</u>	<u>2005</u>
Balance, beginning of year	\$ 80,533	-
Unrealized holding gain (loss)	(114,533)	122,533
Decrease (increase) in deferred income taxes on unrealized holding gain (loss)	<u>39,000</u>	<u>(42,000)</u>
Balance, end of year	\$ <u>5,000</u>	<u>80,533</u>

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
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Note 3 – Property and Equipment

Property and equipment consists of the following:

	<u>2006</u>	<u>2005</u>
Oil and gas properties (successful efforts method)	\$ 1,298,658	1,810,050
Capitalized asset retirement cost	45,359	74,293
Office furniture and equipment	<u>136,950</u>	<u>139,360</u>
	1,480,967	2,023,703
Less accumulated depreciation, depletion and amortization	(1,047,425)	(1,521,833)
	\$ <u>433,542</u>	<u>501,870</u>

Note 4 – Asset Retirement Obligation

The Company has an obligation to plug and abandon certain oil and gas wells it owns. Accordingly, a liability has been established equal to the obligation.

Following is a reconciliation of the aggregate retirement liability associated with the Company's obligation to plug and abandon its oil and gas properties:

	<u>2006</u>	<u>2005</u>
Balance at beginning of year	\$ 112,852	158,350
Reduction of obligation due to sale	(45,742)	(50,246)
Accretion expense	<u>3,383</u>	<u>4,748</u>
Balance at end of year	\$ <u>70,493</u>	<u>112,852</u>

Note 5 – Notes Payable

The Company has a bank revolving line-of-credit agreement, which allows the Company to borrow a maximum amount of \$750,000. This agreement bears interest at the bank's prime rate plus 1 percent and is secured by accounts receivable and producing properties. The line-of-credit matures on December 31, 2007 and had no outstanding balance at September 30, 2006 and 2005.

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
September 30, 2006 and 2005

Note 5 – Notes Payable (continued)

The Company has a promissory note to a bank with an outstanding balance at September 30, 2006 of \$200,000. The note bears interest at the bank's prime rate plus 1 percent and is unsecured with no guarantees. The promissory note matures on May 26, 2007.

Note 6 – Stock Subscription Receivable

The stock subscription receivable consists of a six percent receivable due from the Company's ESOP. The receivable is reduced every six months by the amount of the obligation owed by the Company to the ESOP, less interest (see Note 13). During the years ended September 30, 2006 and 2005, the Company recognized \$9,245 and \$11,647 of interest income related to this note.

Note 7 – Income Taxes

The provision for income taxes differs from the amount computed at federal statutory rates for the years ended as follows:

	<u>2006</u>	<u>2005</u>
Income tax provision at statutory rate	\$ 700,000	1,726,000
State tax, net of federal benefit	70,000	-
Reduction of ARO due to sales	(20,000)	-
Change in valuation allowance	-	(556,000)
Other	<u>(54,000)</u>	<u>-</u>
	\$ <u>696,000</u>	<u>1,170,000</u>

Deferred tax assets (liabilities) are comprised of the following:

	<u>2006</u>	<u>2005</u>
Intangible drilling costs and depletion	\$ (83,000)	(89,000)
Asset Retirement Obligation	17,000	35,000
Unrealized holding gain on investments	<u>(3,000)</u>	<u>(42,000)</u>
	(69,000)	(96,000)
Valuation allowance	<u>-</u>	<u>-</u>
	\$ <u>(69,000)</u>	<u>96,000</u>

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
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Note 8 – Sales to Major Customers

The Company had sales to major customers during the years ended September 30, 2006 and 2005, which exceeded ten percent of total sales as follows:

	<u>2006</u>	<u>2005</u>
Company A	\$ 1,268,000	1,072,000
Company B	195,000	-
Company C	194,000	475,000

Note 9 – Related Party Transactions

The Company acts as the operator for several oil and gas properties in which employees, officers and other related and unrelated parties have a working or royalty interest. At September 30, 2006 and 2005 there was \$25,278 and \$16,879, respectively, included in accounts payable due to officers as a result of these activities. The Company also is a member in certain limited partnerships and the operator for certain joint ventures formed for the purpose of oil and gas exploration and development.

The Company leases its office space from certain officers of the Company on a month-to-month basis. The lease requires monthly rental payments of \$2,500 plus all expenses pertaining to the office space. Rent expense for the years ended September 30, 2006 and 2005 was approximately \$30,000 each year.

Company has a stock subscription receivable from the ESOP (see Note 6).

Note 10 – Supplemental Disclosures of Cash Flow Information

During the year ended September 30, 2006:

- Realized a gain of \$31,729 when properties with an asset retirement obligation of \$45,742 and net capitalized asset retirement costs of \$14,013 were sold.
- Recorded an unrealized holding loss of \$114,533 and a decrease in deferred income taxes of \$39,000 on investments, available-for-sale.

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
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Note 10 – Supplemental Disclosures of Cash Flow Information (continued)

During the year ended September 30, 2005, the Company:

- Sold producing properties with a net book value of \$4,156 for \$150,000, of which \$140,000 is included in accounts receivable at September 30, 2005.
- Canceled 776,458 shares of common stock as a result of stock splits (see Note 14). The shares were canceled in exchange for a payable of \$1,164,687, of which \$1,138,599 remains payable at September 30, 2005.
- Recorded an unrealized holding gain of \$80,533 and deferred income taxes of \$42,000 on investments, available-for-sale.
- Realized a gain of \$29,205 when a property with an asset retirement obligation of \$50,246 and net capitalized asset retirement costs of \$21,041 were sold.

Operations reflect actual amounts paid for interest and income taxes approximately as follows:

	<u>2006</u>	<u>2005</u>
Interest	\$ 55,000	1,500
Income taxes	\$ 298,000	1,155,000

Note 11 – Fair Value of Financial Instruments

The Company's financial instruments consist of cash, receivables, payables and notes payable. The carrying amount of cash, receivables and payables approximates fair value because of the short-term nature of these items. The carrying amount of the notes payable approximate fair value as the notes bear interest at floating market interest rates.

Note 12 - Stock Options

The Company has adopted a stock option plan (the Plan). Under the Plan, the Company may issue shares of the Company's common stock or grant options to acquire the Company's common stock from time to time to employees, directors, officers, consultants or advisors of the Company on the terms and conditions set forth in the Plan.

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
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Note 12 - Stock Options (continued)

A schedule of the options and warrants outstanding is as follows:

	<u>Number of Options</u>	<u>Exercise Price Per Share</u>
Outstanding at October 1, 2004	<u>60,000</u>	\$ 0.20
Outstanding at September 30, 2005	60,000	0.20
Granted	<u>360,000</u>	1.20
Outstanding at September 30, 2006	<u>420,000</u>	\$ 0.20–1.20

Note 13 – Stock Based Compensation

The fair value of each option granted during 2006 was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

Expected dividend yield	-
Expected stock price volatility	65%
Risk-free interest rate	5%
Expected life of options or warrants	5.5 years

The weighted average fair value of each option granted during 2006 was approximately \$0.74.

Information related to these options at September 30, 2006 is as follows:

<u>Outstanding</u>			<u>Exercisable</u>		
<u>Exercise Price</u>	<u>Number Outstanding</u>	<u>Weighted Average Remaining Contractual Life (Years)</u>	<u>Weighted Average Exercise Price</u>	<u>Number Exercisable</u>	<u>Weighted Average Exercise Price</u>
\$.20	60,000	4.9	\$.20	60,000	\$.20
1.20	360,000	4.9	1.20	360,000	1.20
<u>\$.20 – 1.20</u>	<u>420,000</u>	<u>4.9</u>	<u>\$ 1.06</u>	<u>420,000</u>	<u>\$ 1.06</u>

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
September 30, 2006 and 2005

Note 13 – Stock Based Compensation (continued)

Employee Stock Ownership Plan

The Company has adopted a noncontributory employee stock ownership plan (ESOP) covering all full-time employees who have met certain service requirements. It provides for discretionary contributions by the Company as determined annually by the Board of Directors, up to the maximum amount permitted under the Internal Revenue Code. The plan has received IRS approval under Section 401(A) and 501(A) of the Internal Revenue Code. Pension expense charged to operations for the years ended September 30, 2006 and 2005 was \$74,227 and \$50,397 respectively. All outstanding shares held by the ESOP are included in the calculation of earnings per share.

Note 14 – Stock Splits

On September 26, 2005, the Board of Directors authorized a 1-for-2,000 reverse stock split and the repurchase of all resulting fractional shares, followed immediately by a 2,000-for-1 forward stock split of the Company's common shares (collectively, the "Stock Splits"). As a result of the Stock Splits, (a) each shareholder owning fewer than 2,000 common shares of the Company immediately before the Stock Splits received \$1.50 in cash, without interest, for each of the Company's common shares owned by such shareholder immediately prior to the Stock Splits and was no longer a shareholder of the Company; and (b) each shareholder owning 2,000 or more common shares immediately before the Stock Splits (i) received 2,000 Common Shares after the Stock Splits in exchange for each lot of 2,000 Common Shares held before the Stock Splits and (ii) any additional Common Shares held other than in a 2,000 share lot were cancelled and exchanged for \$1.50 in cash per share.

Note 15 – Payable - Common Stock Repurchases

As of September 30, 2006 and 2005, the Company had a payable of \$341,334 and \$1,138,599, resulting from the purchase of shares by the Company through the Stock Splits (see Note 14). The payable is non-interest bearing and may be required to be paid within the current period.

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
September 30, 2006 and 2005

Note 16 – Commitments and Contingencies

Limited Partnerships

The Company has an immaterial interest in a limited partnership drilling program and acts as the general partner. As the general partner, the Company is contingently liable for any obligations of the partnership and may be contingently liable for claims generally incidental to the conduct of its business as general partner. As of September 30, 2006, the Company was unaware of any such obligations or claims arising from this partnership.

Employment Agreements

The Company has entered into severance pay agreements with employees and officers of the Company who also serve as board members. Under the terms of the agreements, a board member who is terminated shall receive severance pay equal to the amount such board member received in salary and bonus for the two years prior to termination.

Litigation

The Company may become or is subject to investigations, claims or lawsuits ensuing out of the conduct of its business, including those related to environmental safety and health, commercial transactions, etc. The Company is currently not aware of any such item, which it believes could have a material adverse affect on its financial position.

Note 17– Subsequent Events

On October 1, 2006 the Company sold 100,000 shares of treasury stock for \$1.50 per share to the Company's ESOP in exchange for a six percent receivable due from the ESOP.

PIONEER OIL AND GAS
NOTES TO FINANCIAL STATEMENTS
September 30, 2006 and 2005

Note 18– Recent Accounting Pronouncements

In December 2004, the FASB issued SFAS 123 (R), “Accounting for Stock Based Compensation.” This statement supersedes APB Opinion No. 25, “Accounting for Stock Issued to Employees.” This revised statement establishes standards for the accounting of transactions in which an entity exchanges its equity instruments for goods and services, including the grant of stock options to employees and directors. The Statement is effective for the Company beginning October 1, 2006, and will require the Company to recognize compensation cost based on the grant date fair value of the equity instruments its awards. The Company currently accounts for those instruments under the recognition and measurement principles of APB Opinion 25, including the disclosure-only provisions of the original SFAS 123. Accordingly, no compensation cost from issuing equity instruments to employees has been recognized in the Company’s financial statements. The Company estimates that the required adoption of SFAS 123 (R) will not have a negative impact on its consolidated financial statements.



1011 West 400 North, Suite 100
P.O. Box 747
Logan, UT 84323-0747
Phone: (435) 752-1510 • (877) 752-1510
Fax: (435) 752-4878

OFFICERS:

Paul D. Simkins, CPA
Michael C. Kidman, CPA, MBA
Brent S. Sandberg, CPA
Brett C. Hugie, CPA
Mark E. Low, CPA
H. Paul Gibbons, CPA

INDEPENDENT AUDITORS' REPORT
ON ADDITIONAL INFORMATION

To the Board of Directors and
Stockholders of Pioneer Oil and Gas

Our report on our audit of the basic financial statements of Pioneer Oil and Gas for September 30, 2006 and 2005 appears on page 1. That audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The Schedule of Supplementary Information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information, except for that portion marked "unaudited," on which we express no opinion, has been subjected to the auditing procedures applied in the audit of the basic financial statements, and, in our opinion, the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

JONES SIMKINS, P.C.
Logan, Utah
December 6, 2006

PIONEER OIL AND GAS
SCHEDULE OF SUPPLEMENTARY INFORMATION
ON OIL AND GAS OPERATIONS
September 30, 2006 and 2005

Results of Operations for Producing Activities

	<u>2006</u>	<u>2005</u>
Oil and gas – sales	\$ 1,931,907	2,151,083
Production costs net of reimbursements	(668,210)	(801,228)
Exploration costs	(239,724)	(351,222)
Depreciation, depletion and amortization and valuation provisions	<u>(61,350)</u>	<u>(112,339)</u>
Net income before income taxes	962,623	886,294
Income tax provision	<u>(327,000)</u>	<u>(301,000)</u>
Results of operations from producing activities (excluding corporate overhead and interest costs)	\$ <u>635,623</u>	<u>585,294</u>

PIONEER OIL AND GAS
SCHEDULE OF SUPPLEMENTARY INFORMATION
ON OIL AND GAS OPERATIONS
September 30, 2006 and 2005

Reserve Quantity Information (Unaudited)

The estimated quantities of proved oil and gas reserves disclosed in the table below are based upon an appraisal of the proved developed properties by Fall Line Energy, Inc. Such estimates are inherently imprecise and may be subject to substantial revisions.

All quantities shown in the table are proved developed reserves and are located within the United States.

	<u>2006</u>		<u>2005</u>	
	<u>Oil</u> <u>(bbls)</u>	<u>Gas</u> <u>(mcf)</u>	<u>Oil</u> <u>(bbls)</u>	<u>Gas</u> <u>(mcf)</u>
Proved developed and undeveloped reserves:				
Beginning of year	67,729	1,274,127	93,656	1,381,211
Revision in previous estimates	(7,213)	25,573	(11,908)	149,214
Discoveries and extensions	-	-	-	-
Purchase in place	-	-	-	-
Production	(7,341)	(133,141)	(13,659)	(174,797)
Sales in place	(13,864)	(19,423)	(360)	(81,501)
End of year	<u>39,311</u>	<u>1,147,136</u>	<u>67,729</u>	<u>1,274,127</u>
Proved developed reserves:				
Beginning of year	67,729	1,274,127	93,656	1,381,211
End of year	39,311	1,147,136	67,729	1,274,127

PIONEER OIL AND GAS
SCHEDULE OF SUPPLEMENTARY INFORMATION
ON OIL AND GAS OPERATIONS
September 30, 2006 and 2005

Standardized Measure of Discounted Future Net Cash Flows and Changes Therein Relating to
Proved Oil and Gas Reserves (Unaudited)

	<u>2006</u>	<u>2005</u>
Future cash inflows	\$ 8,350,000	17,163,000
Future production and development costs	(1,627,000)	(2,799,000)
Future income tax expenses	(2,286,000)	(4,884,000)
	4,437,000	9,480,000
10% annual discount for estimated timing of cash flows	(2,131,000)	(4,170,000)
Standardized measure of discounted future net cash flows	\$ <u>2,306,000</u>	<u>5,310,000</u>

The preceding table sets forth the estimated future net cash flows and related present value, discounted at a 10% annual rate, from the Company's proved reserves of oil, condensate and gas. The estimated future net revenue is computed by applying the year end prices of oil and gas (including price changes that are fixed and determinable) and current costs of development production to estimated future production assuming continuation of existing economic conditions. The values expressed are estimates only, without actual long-term production to base the production flows, and may not reflect realizable values or fair market values of the oil and gas ultimately extracted and recovered. The ultimate year of realization is also subject to accessibility of petroleum reserves and the ability of the Company to market the products.

PIONEER OIL AND GAS
SCHEDULE OF SUPPLEMENTARY INFORMATION
ON OIL AND GAS OPERATIONS
September 30, 2006 and 2005

Changes in the Standardized Measure of
Discounted Future Cash Flows (Unaudited)

	<u>2006</u>	<u>2005</u>
Balance, beginning of year	\$ 5,310,000	3,210,000
Sales of oil and gas produced net of production costs	(730,000)	(1,627,000)
Net changes in prices and production costs	(2,991,000)	6,067,000
Extensions and discoveries, less related costs	-	-
Purchase and sales of minerals in place	(842,000)	(862,000)
Revisions of estimated development costs	-	-
Revisions of previous quantity estimate	2,575,000	(718,000)
Accretion of discount	531,000	321,000
Net changes in income taxes	(1,547,000)	(1,081,000)
Balance, end of year	\$ <u>2,306,000</u>	<u>5,310,000</u>

PIONEER OIL AND GAS
SCHEDULE OF SUPPLEMENTARY INFORMATION
ON OIL AND GAS OPERATIONS
September 30, 2006 and 2005

The information on the Company's oil and gas operations as shown in this schedule is based on the successful efforts method of accounting and is presented in conformity with the disclosure requirements of the Statement of Financial Accounting Standards No. 69 "Disclosures about Oil and Gas Producing Activities."

Capitalized Costs Relating to Oil and Gas Producing Activities

	<u>2006</u>	<u>2005</u>
Proved oil and gas properties and related equipment	\$ 1,033,041	1,462,941
Unproved oil and gas properties	<u>265,617</u>	<u>347,109</u>
Subtotal	1,298,658	1,810,050
Accumulated depreciation, depletion and amortization and valuation allowances	<u>(900,246)</u>	<u>(1,369,023)</u>
	\$ <u>398,412</u>	<u>441,027</u>

Costs Incurred in Oil and Gas Acquisition, Exploration and Development Activities

	<u>2006</u>	<u>2005</u>
Acquisition of properties:		
Proved	\$ -	-
Unproved	\$ -	-
Exploration costs	\$ -	-
Development costs	\$ 18,735	150,823