MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of FX Energy, Inc., together with its consolidated subsidiaries (the Company), is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is a process designed by the Company's principal executive and principal financial officers to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles.

As of the end of the Company's 2009 fiscal year, management conducted an assessment of the effectiveness of the Company's internal control over financial reporting based on the framework established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management has determined that the Company's internal control over financial reporting as of December 31, 2009, was effective.

The Company's internal control over financial reporting includes policies and procedures that: (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of management and the directors of the Company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the Company's consolidated financial statements.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2009, has been audited by PricewaterhouseCoopers LLP, independent registered public accounting firm, as stated in its report appearing on pages F-2 and F-3.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors
of FX Energy, Inc. and its subsidiaries

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of comprehensive loss, of cash flows and of stockholders' equity (deficit) present fairly, in all material respects, the financial position of FX Energy, Inc. and its subsidiaries at December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included 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, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

Salt Lake City, Utah
March 16, 2010

FX ENERGY, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
As of December 31, 2009 and 2008
(in thousands)

	2009	2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 4,225	$ 16,588
Marketable securities	--	4,105
Receivables:		
Accrued oil and gas sales	2,875	1,093
Other receivables	918	1,720
VAT receivable	--	2,514
Inventory	232	211
Other current assets	394	450
Total current assets	8,644	26,681
Property and equipment, at cost:		
Oil and gas properties (successful efforts method):		
Proved	32,700	28,600
Unproved	3,403	2,770
Other property and equipment	7,654	6,667
Gross property and equipment	43,757	38,037
Less accumulated depreciation, depletion and amortization	(11,466)	(11,164)
Net property and equipment	32,291	26,873
Other assets:		
Certificates of deposit	406	406
Loan fees	729	842
Total other assets	1,135	1,248
Total assets	$ 42,070	$ 54,802

-Continued-

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

FX ENERGY, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
As of December 31, 2009 and 2008
(in thousands, except share data)
-Continued-

	2009	2008
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 3,569	$ 7,779
VAT payable	575	--
Accrued liabilities	1,048	4,937
Total current liabilities	5,192	12,716
Long-term liabilities:		
Notes payable	25,000	25,000
Asset retirement obligation	1,133	1,932
Total long-term liabilities	26,133	26,932
Total liabilities	31,325	39,648
Commitments and Contingencies (Note 6)		
Stockholders' equity:		
Preferred stock, $0.001 par value, 5,000,000 shares authorized as of December 31, 2009 and 2008; no shares outstanding	--	--
Common stock, $0.001 par value, 100,000,000 shares authorized as of December 31, 2009 and 2008; 43,037,540 and 42,202,878 shares issued and outstanding as of December 31, 2009 and 2008, respectively	43	42
Additional paid in capital	160,594	158,075
Cumulative translation adjustment	10,738	17,137
Accumulated deficit	(160,630)	(160,100)
Total stockholders' equity	10,745	15,154
Total liabilities and stockholders' equity	$ 42,070	$ 54,802

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

FX ENERGY, INC. AND SUBSIDIARIES
Consolidated Statements of Operations
For the years ended December 31, 2009, 2008 and 2007
(in thousands, except per share amounts)

	2009	2008	2007
Revenues:			
Oil and gas sales	$ 12,772	$ 13,494	$ 14,903
Oilfield services	1,892	4,347	3,093
Total revenues	14,664	17,841	17,996
Operating costs and expenses:			
Lease operating expenses	3,478	3,441	3,538
Exploration costs	4,829	15,389	10,624
Impairment of oil and gas properties	1,335	14,746	2,299
Oilfield services costs	1,412	2,751	1,998
Depreciation, depletion and amortization (DD&A)	1,602	1,720	2,064
Accretion expense	41	84	78
Stock compensation	1,693	2,367	2,604
Bad debt expense	--	460	--
General and administrative costs (G&A)	7,257	7,030	7,061
Total operating costs and expenses	21,647	47,988	30,266
Operating loss	(6,983)	(30,147)	(12,270)
Other income (loss):			
Interest income (net of interest expense) and other income (expense)	(600)	(278)	433
Foreign exchange gain (loss)	7,053	(24,279)	146
Total other income (expense)	6,453	(24,557)	579
Net loss	$ (530)	$ (54,704)	$ (11,691)
Basic and diluted net loss per common share	$ (0.01)	$ (1.35)	$ (0.32)
Basic and diluted weighted average number of shares outstanding	42,529	40,420	36,694

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

FX ENERGY, INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Loss
For the years ended December 31, 2009, 2008 and 2007
(in thousands)

	2009	2008	2007
Net loss	$ (530)	$ (54,704)	$ (11,691)
Other comprehensive income (loss)			
Foreign currency translation adjustment	(6,399)	13,584	--
Increase (decrease) in market value of marketable securities	--	1	71
Comprehensive loss	$ (6,929)	$ (41,119)	$ (11,620)

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

FX ENERGY, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
For the years ended December 31, 2009, 2008 and 2007
(in thousands)

	2009	2008	2007
Cash flows from operating activities:			
Net loss	$ (530)	$ (54,704)	$ (11,691)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation, depletion and amortization	1,602	1,720	2,064
Impairment of oil and gas properties	1,864	14,746	2,299
Accretion expense	41	84	78
(Gain) loss on property dispositions	--	(5)	--
Stock compensation (G&A)	1,693	2,367	2,604
Foreign exchange (gains) losses	(8,296)	22,306	--
Common stock issued for services (G&A)	694	498	242
Loan fee amortization	242	210	183
Increase (decrease) from changes in working capital items:			
Receivables	1,682	(3,056)	(583)
Inventory	(21)	(33)	28
Other current assets	58	(85)	(43)
Other assets	(128)	(136)	(239)
Accounts payable and accrued liabilities	(4,025)	1,840	3,479
Asset retirement obligation	(705)	--	(2)
Net cash used in operating activities	(5,829)	(14,248)	(1,581)
Cash flows from investing activities:			
Additions to oil and gas properties	(7,666)	(21,808)	(7,517)
Additions to other property and equipment	(983)	(1,077)	(966)
Additions to marketable securities	(11)	(186)	(9,610)
Proceeds from maturities of marketable securities	4,661	11,284	4,941
Proceeds from sale of assets	--	15	--
Net cash used in investing activities	(3,999)	(11,772)	(13,152)
Cash flows from financing activities:			
Proceeds from issuance of common stock, net of offering costs	--	--	12,436
Proceeds from loan related to auction-rate securities	--	3,354	--
Payments on loan related to auction-rate securities	(2,808)	(546)	--
Proceeds from notes payable	--	25,000	--
Proceeds from exercise of stock options and warrants	132	12,313	1,915
Net cash provided by (used in) financing activities	(2,676)	40,121	14,351
Effect of exchange rate changes on cash	141	(1,775)	--
Net increase (decrease) in cash	(12,363)	12,326	(382)
Cash and cash equivalents at beginning of year	16,588	4,262	4,644
Cash and cash equivalents at end of year	$ 4,225	$ 16,588	$ 4,262

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

FX ENERGY, INC. AND SUBSIDIARIES
Consolidated Statement of Stockholders' Equity (Deficit)
For the years ended December 31, 2009, 2008 and 2007
(in thousands)

	Preferred Stock	Common Stock Shares Issued	Common Stock $0.001 Par Value	Additional Paid in Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders' Equity (Deficit)
Balance as of December 31, 2006	--	35,561	$ 36	$ 125,706	$ (72)	$ (93,705)	$ 31,965
Common stock issued for services and other	--	463	--	242	--	--	242
Exercise of stock options and warrants	--	672	1	1,915	--	--	1,916
Issuance of common stock	--	1,500	1	12,434	--	--	12,435
Stock compensation	--	--	--	2,604	--	--	2,604
Other comprehensive income	--	--	--	--	71	--	71
Net loss for year	--	--	--	--	--	(11,691)	(11,691)
Balance as of December 31, 2007	--	38,196	$ 38	$ 142,901	$ (1)	$ (105,396)	$ 37,542
Common stock issued for services and other	--	488	--	498	--	--	498
Exercise of stock options and warrants	--	3,519	4	12,309	--	--	12,313
Stock compensation	--	--	--	2,367	--	--	2,367
Cumulative translation adjustment due to change in functional currency at October 1, 2008	--	--	--	--	3,553	--	3,553
Other comprehensive income	--	--	--	--	13,585	--	13,585
Net loss for year	--	--	--	--	--	(54,704)	(54,704)
Balance as of December 31, 2008	--	42,203	$ 42	$ 158,075	$ 17,137	$ (160,100)	$ 15,154
Common stock issued for services and other	--	610	1	694	--	--	695
Exercise of stock options and warrants	--	225	--	132	--	--	132
Stock compensation	--	--	--	1,693	--	--	1,693
Other comprehensive income	--	--	--	--	(6,399)	--	(6,399)
Net loss for year	--	--	--	--	--	(530)	(530)
Balance as of December 31, 2009	--	43,038	$ 43	$ 160,594	$ 10,738	$ (160,630)	$ 10,745

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

FX ENERGY, INC. AND SUBSIDIARIES
Notes to the Consolidated Financial Statements

Note 1: Summary of Significant Accounting Policies

Organization

FX Energy, Inc., a Nevada corporation, and its subsidiaries (collectively referred to hereinafter as "us," "we," "our," or "the Company"), is an independent oil and gas exploration and production company with principal production, reserves, and exploration in Poland and oil production and oilfield service activities in the United States. In Poland, we have projects involving the exploration and exploitation of oil and gas prospects in partnership with the Polish Oil and Gas Company ("POGC"), other industry partners, and for our own account. In the United States, we explore for and produce oil from fields in Montana and Nevada, and we have an oilfield services company in northern Montana that performs contract drilling and well-servicing operations.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries and its undivided interests in Poland. All significant intercompany accounts and transactions have been eliminated in consolidation. At December 31, 2009, we owned 100% of the voting common stock or other equity securities of our subsidiaries.

Cash and Cash Equivalents and Marketable Securities

We consider all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. We determine the appropriate classification of our investments in cash and cash equivalents and marketable securities at the time of purchase and reevaluate such designation at each balance sheet date.

Fair Value of Financial Instruments

The carrying amounts of our financial instruments, including cash and cash equivalents, marketable securities, accounts receivable, accounts payable, and accrued liabilities, approximate fair value because of their generally short maturities.

Concentration of Credit Risk

Excluding the 2008 receivable for Input VAT, which was due from the State Treasury Office of Poland, the majority of our receivables are within the oil and gas industry, primarily from the purchasers of our oil and gas, and fees generated from oilfield services and our industry partners. Substantially all of our domestic receivables are with Cenex, a regional refiner and marketer, and substantially all of our Polish receivables are with POGC or one of its affiliates. The receivables are not collateralized. To date, we have experienced minimal bad debts and have no allowance for doubtful accounts at December 31, 2009 and 2008. The majority of our cash and cash equivalents are held by four financial institutions in Utah, Montana, and Poland.

Derivative Instruments

Accounting standards require derivative instruments to be recognized as either assets or liabilities in the balance sheet at fair value. The accounting for changes in the fair value of derivative instruments depends on their intended use and resulting hedge designation. For derivative instruments designated as hedges, the changes in fair value are recorded in the balance sheet as a component of accumulated other comprehensive income. Changes in the fair value of derivative instruments not designated as hedges are recorded in the Consolidated Statements of Operations, generally as a component of interest and other income (expense). At December 31, 2009 and 2008, we had no derivative instruments designated as hedges.

Inventory

Inventory consists primarily of tubular goods and production-related equipment and is valued at the lower of average cost or market.

Oil and Gas Properties

We follow the successful-efforts method of accounting for our oil and gas operations. Under this method of accounting, all property acquisition costs and costs of exploratory and development wells are capitalized when incurred, pending determination of whether an individual well has found proved reserves. If it is determined that an exploratory well has not found proved reserves, if the determination that proved reserves have been found cannot be made within one year, or if we are not making sufficient progress assessing the reserves and the economic and operating viability of the project, the costs of the well are expensed. The costs of development wells are capitalized whether productive or nonproductive. Geological and geophysical costs on exploratory prospects and the costs of carrying and retaining unproved properties are expensed as incurred. An impairment charge is provided to the extent that capitalized costs of unproved properties, on a property-by-property basis, are not considered to be realizable. Depletion, depreciation, and amortization ("DD&A") of capitalized costs of proved oil and gas properties is provided on a field-by-field basis using the units-of-production method. The computation of DD&A takes into consideration the anticipated proceeds from equipment salvage. An impairment loss is recorded if the net capitalized costs of proved oil and gas properties exceed the aggregate undiscounted future net revenues determined on a field-by-field basis. The impairment loss recognized equals the excess of net capitalized costs over the related fair value determined on a property-by-property basis. Gains and losses are recognized on sales of entire interests in proved and unproved properties. Sales of partial interests are generally treated as a recovery of costs and any resulting gain or loss is recorded as other income.

During 2009, production ceased at our Wilga well in eastern Poland. We impaired the remaining capitalized costs of the well in the amount of $1,864,000. This impairment was offset by $529,000 related to changes in the estimates of our asset retirement obligation.

Low year-end oil prices resulted in a negative revision to our oil reserves and their estimated future net revenues in the United States for 2008. As a result of the negative revisions, the net book value of our domestic oil properties was greater than their estimated future net revenues at December 31, 2008. In accordance with accounting standards, we recorded an impairment of capitalized costs in the amount of $3,774,000 in 2008. The impairment amount was calculated by reducing the net capitalized costs of the U.S. oil properties to their year-end fair value, which was equal to their remaining estimated discounted future net cash flows.

During 2008, we impaired the costs of the Grundy-1 and Sroda-6 wells. Accounting standards require capitalized costs of exploratory wells to be expensed if the enterprise is not making sufficient progress assessing the reserves and economic viability of the project. Under then-current economic conditions, we did not have firm plans to further develop these two wells. Accordingly, we recorded an impairment charge of $7,220,000 associated with the Grundy-1 well and $3,752,000 associated with the Sroda-6 well in 2008.

The Wilga well in Poland began to experience significant water encroachment from one of its three productive zones during the fourth quarter of 2007, and production engineering data suggested that the well might experience a decline in oil and gas production over the course of the succeeding 12-18 months as a result. As a consequence of the water encroachment, the proved reserves at Wilga were reduced at year-end 2007. We recorded an impairment of capitalized costs in the amount of $2,299,000 in 2007. The impairment amount was calculated by reducing the net capitalized costs of the well to its fair value at year-end. The fair value of the well was equal to its remaining estimated discounted future net cash flows.

The following table reflects the net changes in capitalized exploratory well costs, which are capitalized pending the determination of proved reserves, during 2009, 2008, and 2007.

	December 31, 2009	December 31, 2008	December 31, 2007
		(In thousands)	
Beginning balance at January 1	$ 2,390	$ 669	$ 2,386
Additions to capitalized exploratory well costs pending the determination of proved reserves	1,766	2,390	669
Reclassifications to wells, facilities and equipment based on the determination of proved reserves	(4,156)	--	(2,386)
Capitalized exploratory well costs charged to expense	--	(669)	--
Ending balance at December 31	$ --	$ 2,390	$ 669

The 2009 and 2008 activity includes costs associated with the Kromolice-2 well, which was drilling at year-end 2008. During 2009, the well was completed for production, and the determination of proved reserves was made. The 2007 balance includes equipment costs incurred for the Grundy well in Poland, which began drilling in early 2008. Accounting standards required the costs associated with this well, which included approximately $669,000 at year-end December 31, 2007, to be impaired at December 31, 2008.

Other Property and Equipment

Other property and equipment, including oilfield-servicing equipment, is stated at cost. Depreciation of other property and equipment is calculated using the straight-line method over the estimated useful lives (ranging from three to 40 years) of the respective assets. The costs of normal maintenance and repairs are charged to expense as incurred. Material expenditures that increase the life of an asset are capitalized and depreciated over the estimated remaining useful life of the asset. The cost of other property and equipment sold, or otherwise disposed of, and the related accumulated depreciation are removed from the accounts and any gain or loss is reflected in current operations.

The historical cost of other property and equipment, presented on a gross basis with accumulated depreciation, is summarized as follows:

	December 31, 2009	December 31, 2008	Estimated Useful Life (in years)
	(In thousands)		
Other property and equipment:			
Drilling rigs	$ 5,980	$ 5,101	6
Other vehicles	355	309	5
Building	110	108	40
Office equipment and furniture	1,209	1,149	3 to 6
Total cost	7,654	6,667	
Accumulated depreciation	(5,355)	(4,663)	
Net other property and equipment	$ 2,299	$ 2,004	

Supplemental Disclosure of Cash Flow Information

Noncash investing and financing transactions not reflected in the consolidated statements of cash flows include the following:

	Year Ended December 31,		
	2009	2008	2007
	(In thousands)		
Noncash investing transactions:			
Additions to properties included in current liabilities	$327	$1,927	$428

	Year Ended December 31,		
	2009	2008	2007
	(In thousands)		
Cash paid for interest:			
Cash paid during the year for interest	$415	$418	$125

Cash paid for interest in 2008 includes $188,715 in commitment fees on our Senior Facility Agreement. Cash paid for interest in 2007 includes $119,040 in commitment fees paid on our Senior Facility Agreement.

Revenue Recognition

Revenues associated with oil and gas sales are recorded when title passes, which is upon delivery to the pipeline or other purchaser, and are net of royalties. Oilfield service revenues are recognized when the related service is performed.

Stock-Based Compensation

We maintain several share-based incentive plans. Under these plans, we may issue options or restricted stock awards. Options are granted at an option price equal to the market value of the stock at the date of grant, have terms ranging from five to seven years, and vest in three equal annual installments. Restricted stock awards have similar terms and vesting requirements. Accounting standards require share-based compensation costs to be measured at the grant date, based on the estimated fair value of the award, and are recognized as expense over the employee's requisite service period.

Income Taxes

Deferred income taxes are provided for the differences between the tax bases of assets or liabilities and their reported amounts in the consolidated financial statements. Such differences may result in taxable or deductible amounts in future years when the asset or liability is recovered or settled, respectively.

We did not have any unrecognized tax benefits at December 31, 2009. We are subject to audit in the United States by the Internal Revenue Service and various states for the prior three years and in Poland by Polish tax authorities for the prior five years. We do not believe there will be any material changes in our unrecognized tax positions over the next 12 months. Our policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. No tax-related interest expense was recognized during the year ended December 31, 2009.

New Accounting Standards

Recent SEC Rule-Making Activity

In December 2008, the Securities and Exchange Commission announced that it had approved revisions designed to modernize the oil and gas company reserves reporting requirements. The most significant amendments to the requirements included the following:

- *Commodity Prices* – Economic producibility of reserves and discounted cash flows are now based on a 12-month average commodity price unless contractual arrangements designate the price to be used, rather than a year-end price.

- *Disclosure of Unproved Reserves* – Probable and possible reserves may be disclosed separately on a voluntary basis.

- *Proved Undeveloped Reserves Guidelines* – Reserves may be classified as proved undeveloped if there is a high degree of confidence that the quantities will be recovered and they are scheduled to be drilled within the next five years, unless the specific circumstances justify a longer time.

- *Third-Party Reserves Preparation* – If a company represents that its estimates of reserves are prepared or audited by a third party, the company must file a report of the third party as an exhibit to the relevant registration statement or report.

- *Use of Probabilistic Methods* – Reserves may be estimated using probabilistic methods in which there is at least a 90% probability of recovery of "proved" reserves, at least a 50% probability of recovery of "probable" reserves, and at least a 10% probability of recovery of "possible" reserves.

- *Disclosure by Geographic Area* – Reserves in foreign countries or continents must be presented separately if they represent more than 15% of total oil and gas proved reserves.

We adopted the rules effective December 31, 2009. See Supplemental Oil and Gas Information (Unaudited) for the impact of adoption on oil and gas reserves.

In addition, in January 2010, the FASB issued new standards to provide consistency with the new Securities and Exchange Commission rules. The principal revisions under the new authoritative guidance include changing the manner in which oil and gas reserves are estimated. We adopted the new standards effective December 31, 2009. This change in accounting has been applied prospectively and treated in these financial statements as a change in accounting principle that is inseparable from a change in accounting estimate. See also Supplemental Oil and Gas Information (Unaudited).

On January 1, 2009, we adopted a new accounting standard regarding derivative instruments and hedging activities. The new standard requires enhanced disclosure about: (1) how and why an entity uses derivative instruments; (2) how derivative instruments and related hedged items are accounted for; and (3) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows.

In April 2009, the FASB issued three amendments to the accounting and disclosure requirements regarding fair value measurements and impairments of securities. These amendments provide guidelines for making fair value measurements more consistent with the principles presented in prior pronouncements, enhance consistency in financial reporting by increasing the frequency of fair value disclosures, and provide additional guidance designed to create greater clarity and consistency in accounting for and presenting impairment losses on securities. We adopted these amendments for the period ended June 30, 2009.

In June 2009, the FASB issued the FASB Accounting Standards Codification (Codification). The Codification will become the single source for all authoritative GAAP recognized by the FASB to be applied to financial statements issued for periods ending after September 15, 2009. The adoption of the Codification does not change GAAP.

In May 2009, the FASB issued new standards that establish the accounting for and disclosure of events that occur after the balance sheet date, but before financial statements are issued. In particular, the new standards set forth:

- the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements (through the date that the financial statements are issued or are available to be issued);

- the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; and

- the disclosures that an entity should make about events or transactions that occurred after the balance sheet date.

We adopted the new standards as of June 30, 2009. We have evaluated subsequent events after the balance sheet date of December 31, 2009, through the time of filing with the Securities and Exchange Commission.

In October 2008, the FASB issued an amendment to the accounting and disclosure requirements regarding the determination of the fair value of a financial asset when the market for that asset is not active. This amendment was effective October 10, 2008.

In all cases referenced above, the adoption of the new rules or standards did not have a material impact on our results of operations and financial condition. We have reviewed all other recently issued, but not yet adopted or applicable, accounting standards in order to determine their effects, if any, on our consolidated results of operations, financial position, and cash flows. Based on that review, we believe that none of these pronouncements will have a significant effect on current or future earnings, financial condition, or operations.

Foreign Operations

Effective October 1, 2008, we changed the functional currency of our Polish subsidiary from the U.S. dollar to the Polish zloty. The change in functional currency for the Polish subsidiary affects the amounts reported for Polish assets, liabilities, revenues, and expenses from those that would be reported had the U.S. dollar been maintained as the functional currency. The differences depend on changes in period-average and period-end exchange rates. Translation adjustments result from the process of translating the Polish subsidiary’s financial statements into the U.S. dollar reporting currency. Translation adjustments are not included in determining net income but are reported separately and accumulated in other comprehensive income. The accounting basis of the assets and liabilities of FX Energy Poland are adjusted to reflect the difference between the exchange rate when the asset or liability arose and the exchange rate on the date of the change. Upon the change in functional currency, we recorded a cumulative translation adjustment (“CTA”) of approximately $3.6 million. At December 31, 2008, the CTA had increased to approximately $17.1 million, and it decreased to $10.7 million at December 31, 2009. Because of the fluctuation in exchange rates between reporting periods and changes in certain account balances, the CTA will change from period to period.

During 2009, we recorded foreign currency transaction gains of approximately $7.1 million. We recorded a gain of approximately $8.3 million attributable to decreases in the amount of Polish zlotys necessary for FX Energy Poland to satisfy outstanding intercompany dollar-denominated loans and unpaid interest to FX Energy, Inc. There was a corresponding debit to other comprehensive income for the gains attributable to the intercompany loans and unpaid interest, which was then offset by translation adjustments of approximately $1.9 million related to our other balance sheet accounts as discussed above. The remaining $1.2 million loss was primarily attributable to the settlement of outstanding zloty forward-purchase contracts and the translation of period-end cash balances.

The following table provides a summary of changes in CTA (in thousands) for the years ended December 31, 2009 and 2008:

	Year Ended December 31, 2009	Year Ended December 31, 2008
Beginning balance	$ 17,137	$ --
Cumulative translation adjustment due to change in functional currency	--	3,553
Increase (decrease) related to losses (gains) on intercompany loans	(8,297)	22,373
Increase (decrease) related to translation adjustments	1,898	(8,789)
Ending balance	$ 10,738	$ 17,137

Future transaction gains or losses may be significant given the amount of intercompany loans and the volatility of the exchange rate. Future translation adjustments will also vary in concert with changes in exchange rates. These gains, losses, and adjustments are noncash items for U.S. reporting purposes and have no impact on our actual zloty-based revenues and expenditures in Poland.

We enter into various agreements in Poland denominated in the Polish zloty, which is subject to exchange-rate fluctuations. Our policy is to reduce currency risk by, under ordinary circumstances, transferring dollars to zlotys or fixing the exchange rate for future transfers of dollars to zlotys, on or about the occasion of making any significant commitment payable in Polish currency, taking into consideration the future timing and amounts of committed costs and the estimated timing and amounts of zloty-based revenues. We do not use derivative financial instruments for trading or speculative purposes. We have used forward-purchase contracts to buy zlotys at specified exchange rates. The fair value of these contracts is estimated based on period-end quoted market prices, and the resulting asset and expense are recognized in the consolidated financial statements. As of December 31, 2009, there were no outstanding zloty forward-purchase contracts.

The change in functional currency will have no impact on our actual zloty-based revenues and expenditures in Poland.

Use of Estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expense during the reporting period. Certain accounting policies involve judgments and uncertainties to such an extent that there is reasonable likelihood that materially different amounts could have been reported under different conditions or if different assumptions had been used. We evaluate our estimates and assumptions on a regular basis. We base our estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates and assumptions used in preparation of our financial statements. The most significant estimates with regard to these financial statements relate to the provision for income taxes, including uncertain tax positions, the outcome of pending litigation, stock-based compensation, valuation of derivative instruments, future development and abandonment costs, estimates to certain oil and gas revenues and expenses, and estimates of proved oil and natural gas reserve quantities used to calculate depletion, depreciation, and impairment of proved oil and natural gas properties and equipment.

Net Loss per Share

Basic earnings per share is computed by dividing the net loss applicable to common shares by the weighted average number of common shares outstanding. Diluted earnings per share is computed by dividing the net loss by the sum of the weighted average number of common shares and the effect of dilutive unexercised stock options, warrants, unvested restricted stock, and convertible preferred stock or debt.

Outstanding options, warrants, and unvested restricted stock as of December 31, 2009, 2008, and 2007, were as follows:

	Options, Warrants and Unvested Restricted Stock	Price Range
Balance sheet date:		
December 31, 2009	2,209,976	$0.00 - $10.65
December 31, 2008	2,694,862	$0.00 - $10.65
December 31, 2007	6,320,602	$0.00 - $10.65

We recorded net losses in 2009, 2008, and 2007. The above options, warrants, and unvested restricted stock were not included in the computation of diluted earnings per share for the years presented because the effect would have been antidilutive.

Note 2: Asset Retirement Obligation

We account for future site restoration costs by recording a liability for the fair value of asset retirement obligations ("ARO") when incurred, which is typically at the time the assets are placed in service. Amounts recorded for the related assets are increased by the amount of these obligations. Over time, the liabilities are accreted for the change in their present value and the initial capitalized costs are depreciated over the useful lives of the related assets. We use an expected cash flow approach to estimate our asset retirement obligations. We recorded accretion expense of $41,296, $83,739, and $78,087 in 2009, 2008, and 2007, respectively. At December 31, 2009, there were no assets legally restricted for purposes of settling asset retirement obligations.

Following is a reconciliation of the yearly changes in the asset retirement obligation at December 31, 2009 and 2008:

	December 31,	
	2009	2008
	(In thousands)	
Asset retirement obligations:		
Beginning balance	$ 1,932	$ 1,037
Current year additions	193	--
Current year revisions	(529)	811
Liabilities settled	(169)	--
Foreign exchange adjustments	24	--
Accretion expense	41	84
Ending balance	$ 1,294	$ 1,932

At year-end 2008, the economic life of our oil reserves in Montana was shortened considerably due to low year-end oil prices. Accordingly, we increased the asset retirement obligation to reflect the shortened period before plugging costs might be incurred. At year-end 2009, the economic life at most of our domestic properties was extended due to higher oil prices.

Note 3: Other Assets

As of December 31, 2009 and 2008, we had reclamation bonds with federal and state agencies with face amounts of $731,500, which were collateralized by certificates of deposit totaling $381,500. In addition, there are certificates of deposit totaling $25,000 covering performance bonds in other states.

Note 4: Accrued Liabilities

Our accrued liabilities as of December 31, 2009 and 2008, were comprised of the following:

	December 31,	
	2009	2008
	(In thousands)	
Accrued liabilities:		
Credit facility commitment fees	$ --	$ 2
Partner share of oil & gas revenue and joint operating costs	127	356
Compensation-related costs	449	841
Interest expense	15	42
Current portion of asset retirement obligation	359	--
Foreign currency derivative contracts	--	888
Oilfield equipment installment note	98	--
Loan related to auction-rate securities (Note 8)	--	2,808
Total	$ 1,048	$ 4,937

Note 5: Notes Payable

In November of 2006, we entered into a $25 million Senior Facility Agreement (the Facility) with The Royal Bank of Scotland plc (RBS). The Facility is provided to FX Energy Poland Sp. z o.o., a wholly owned subsidiary. Funds from the Facility, which became available to us in March 2007, are designated to cover infrastructure and development costs in connection with a variety of our Polish gas projects and are collateralized by our commercial wells and production in Poland. At December 31, 2009, we had drawn the full $25 million available under the Facility.

In consideration for the Facility, we paid a 1% origination fee and issued warrants to purchase 110,000 shares of common stock, valid for two years at an exercise price of $6.00 per share. The Black-Scholes value of these warrants (approximately $305,000), along with the loan origination fee and associated legal fees, have been capitalized as deferred financing costs and are being amortized over the six-year term of the loan, beginning in 2007. An annual unused commitment fee of one-half of the applicable margin is charged quarterly based on the average daily unused portion of the Facility.

In early 2010, we signed a Mandate Letter with RBS, authorizing it to proceed with a refinance of our existing Facility. As part of the refinance process, RBS reset the date of the first rescheduled principal reduction of our existing Facility to May 31, 2011. The Facility is an interest-only facility until that date.

The following table provides a summary of changes in notes payable (in thousands):

	For the Year Ended December 31, 2009
Balance at January 1, 2009	$25,000
Proceeds from borrowings	--
Balance at December 31, 2009	$25,000

Interest on borrowed funds is accrued at LIBOR plus 1.25%. The average interest rate on the outstanding balance at December 31, 2009, was 1.48% per annum. The carrying value of the long-term debt at December 31, 2009, approximates its fair value.

The borrowing base is redetermined twice a year, based on reserve volumes and values estimated by independent engineers as of the last day of the prior year. Our last redetermination was completed in December 2009, with no change in the borrowing base amount.

Note 6: Commitments and Contingencies

On June 26, 2009, the court dismissed all claims against all defendants for failure to state a claim upon which relief could be granted in the consolidated single matter, *In re FX Energy, Inc., Securities Litigation*, United States District Court, District of Utah, case no. 2:07-cv-00874. The lead plaintiff had alleged that the defendants violated the antifraud provisions of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder by making material misrepresentations and omissions between January 20, 2005, and January 5, 2006, regarding our Sroda-5 and Lugi-1 projects and sought damages to be determined at trial, interest, costs, and such other relief as the court may deem appropriate. The time for filing an appeal to this dismissal expired without an appeal being filed by plaintiff.

Another pending action filed in the United States District Court for the District of Utah entitled *Leilani York, derivatively on behalf of nominal defendant FX Energy, Inc., plaintiff, v. David N. Pierce, Dennis B. Goldstein, Arnold S. Grundvig, Jr., Richard Hardman, Tom Lovejoy, Jerzy Maciolek, Clay Newton, Andrew W. Pierce, and David Worrell, defendants, and FX Energy, Inc., nominal defendant*, case no. 2:08-cv-00143, asserts derivative claims on our behalf against certain of our current and former directors and certain of our current and former executive officers, arising out of the same set of facts. This action was stayed pending final resolution of the *In re FX Energy, Inc., Securities Litigation* matter, which has now been dismissed as noted above. There have been no further proceedings in the *Leilani York* matter.

Note 7: Liquidity

We have a history of operating losses and negative cash flow from operating activities. From our inception in January 1989 through December 31, 2009, we have incurred cumulative net losses of approximately $161 million. We expect that our exploration and production activities may continue to result in net losses through 2010 and possibly beyond, depending on the success of our drilling activities in Poland and the United States and whether we generate sufficient revenues to cover related operating expenses. While revenues from our operations exceed our fixed operating and overhead costs, we have reported negative cash flow from operating activities in each of the past three years.

With the establishment of proved reserves in Poland, in November 2006, we established a $25 million Senior Credit Facility with RBS to fund infrastructure and development costs in Poland. As of December 31, 2009, we had drawn down the full $25 million available under this Facility. At December 31, 2009, we had working capital of approximately $3.5 million. In early 2010, we signed a Mandate Letter with RBS, authorizing it to proceed with the expansion of our existing Facility to $50 million. As part of the refinance process, RBS reset the date of the first rescheduled principal reduction under our existing Facility to May 31, 2011. The Facility is an interest-only facility until that date.

While we did not experience significant impacts from the economic crisis during 2009, the global economy continues to be unsteady. Production from our Roszkow well should add significant, incremental revenues and cash flow during 2010. The strengthening of the Polish zloty against the U.S. dollar over the past few months will, if it continues, also have a positive impact on our U.S. dollar-denominated future revenues and operating profit; conversely, any U.S. dollar-denominated capital, exploration, and operating costs in Poland will increase at the same rate. Based on current conditions, we presently expect our exploration and development programs will continue in spite of the economic downturn; however, in recognition of the downturn, we plan to continue, as we did throughout 2009, matching capital spending with our discretionary cash flow, plus increased debt capacity if it becomes available. As of December 31, 2009, we had no firm commitments for future capital and exploration costs. We have the ability to control the timing and amount of all future capital and exploration costs. Despite the fact that we have no firm commitments, we are moving ahead with new production facilities in Poland. We expect the facilities to be complete and ready for production to begin in late 2010. Absent additional debt capacity, we will pay for the facilities from our projected cash flow in Poland.

Note 8: Fair Value Measurements and Marketable Securities

Fair Value Measurements

On January 1, 2009, we adopted a newly issued accounting standard for fair value measurements of all nonfinancial assets and nonfinancial liabilities not recognized or disclosed at fair value in the financial statements on a recurring basis. The adoption of this accounting standard for those assets and liabilities did not have a material impact on our financial position, results of operations, or liquidity. We did not have any significant nonfinancial assets or nonfinancial liabilities that would be recognized or disclosed at fair value on a recurring basis as of December 31, 2009.

Fair Value Hierarchy

The accounting standard for fair value measurements provides a framework for measuring fair value and requires expanded disclosures regarding fair value measurements. Fair value is defined as the price that would be received for an asset or the exit price that would be paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants on the measurement date. The accounting standard established a fair value hierarchy that requires an entity to maximize the use of observable inputs, where available. The following summarizes the three levels of inputs required as well as the assets and liabilities that we value using those levels of inputs.

- *Level 1*: Unadjusted quoted prices in active markets for identical assets and liabilities.
- *Level 2*: Observable inputs other than those included in Level 1. For example, quoted prices for similar assets or liabilities in active markets or quoted prices for identical assets or liabilities in inactive markets.
- *Level 3*: Unobservable inputs reflecting management's own assumptions about the inputs used in pricing the asset or liability.

A review of fair value hierarchy classifications is conducted on a quarterly basis. Changes in the observability of valuation inputs may result in a reclassification for certain financial assets or liabilities. During 2008, certain assets were classified as Level 3 assets. This classification primarily related to investments in auction-rate securities. We had no Level 3 assets as of December 31, 2009.

Recurring Fair Value

The following tables set forth the financial assets and liabilities that we measured at fair value on a recurring basis by level within the fair value hierarchy. We classify assets and liabilities measured at fair value in their entirety based on the lowest level of input that is significant to their fair value measurement.

Assets and liabilities measured at fair value on a recurring basis consisted of the following as of December 31, 2009 (in thousands):

	December 31, 2009	Level 1[(1)]	Level 2[(2)]	Level 3[(3)]
Cash equivalents:				
Money market funds	$ 783	$ 783	--	--
Treasury bills	254	254	--	--

(1) Quoted prices in active markets for identical assets.
(2) Significant other observable inputs.
(3) Significant unobservable inputs.

The following table provides a summary of changes in fair value of our Level 3 marketable securities (in thousands):

	For the Year Ended December 31, 2009
Balance at January 1, 2009	$ 4,650
Purchases, issuances and settlements	(4,650)
Balance at December 31, 2009	$ --

Marketable Securities

Marketable securities on the Consolidated Balance Sheets include investments we hold that are classified as trading securities as defined by accounting pronouncements. Prior to year-end 2008, these investments had historically been accounted for as available for sale. Our marketable securities as of December 31, 2009 and 2008, included $0 and $4,105,000, respectively, of auction-rate securities at their fair market value.

In August of 2008, UBS Financial Services ("UBS"), our financial advisor, announced a settlement plan to restore liquidity to its clients holding auction-rate securities. According to the terms of the settlement agreement, we had the ability to borrow from UBS up to 75% of the par value of our auction-rate securities at an interest rate that was equivalent to the yield of the underlying securities. As of December 31, 2008, we had borrowed a total of $2,808,000 from UBS, using certain auction-rate securities as collateral. These loans were included in accrued liabilities on the balance sheet. As individual auction-rate securities were redeemed by their issuers, the proceeds from those redemptions were used to reduce the loans.

As part of the settlement, we also received certain "put" rights, which enabled us to require UBS to purchase, at par value plus accrued interest, all of the auction-rate securities at fixed, future dates. At December 31, 2008, we had certain auction-rate securities with a market value of $2,535,000 that were eligible to be "put" to UBS on January 2, 2009, and certain other auction-rate securities with a market value of $1,570,000 that were eligible to be "put" to UBS on June 30, 2010. Subsequent to December 31, 2008, all auction-rate securities were redeemed at their full par value of $4,650,000. The proceeds from the redemptions were used to satisfy the loan relating to those securities at December 31, 2008, of $2,808,000.

We elected to determine a fair value for the UBS "put" rights at December 31, 2008. We determined the value of the "put" rights to be $545,000, which was the difference between the par value and the fair value of the auction-rate securities. This amount was recorded as a current receivable on the balance sheet, with a corresponding gain of $545,000 recorded as other income in the statement of operations.

In order to record the receivable associated with the "put" rights, we also changed the classification of our marketable securities from "available-for-sale" to "trading" securities. This change resulted in a loss of $545,000 associated with transferring the historical temporary losses related to auction-rate securities from other comprehensive income (loss) to earnings. The loss was recorded as other expense in the statement of operations. There was no cash impact on our balance sheet or statements of operations and cash flow associated with the gain and loss that resulted from these transactions.

Liabilities

At December 31, 2008, we had three outstanding zloty forward-purchase contracts denominated in U.S. dollars as follows: $2,500,000 that matured January 30, 2009; $2,100,000 that matured February 27, 2009; and $1,100,000 that matured March 31, 2009. All contracts were settled on their maturity dates.

Note 9: Income Taxes

We recognized no income tax benefit from the losses generated during 2009, 2008, and 2007. The components of the net deferred tax asset as of December 31, 2009 and 2008, are as follows:

	December 31,	
	2009	2008
	(In thousands)	
Deferred tax liability:		
Property and equipment basis differences	$ (577)	$ (288)
Deferred tax asset:		
Net operating loss carryforwards:		
United States	31,411	27,795
Poland	6,396	5,607
Oil and gas properties	4,807	6,806
Accrued interest expense	6,492	4,269
Foreign exchange translation losses	2,675	4,051
Options issued for services	1,194	1,256
Asset retirement obligation	411	721
Valuation allowance	(52,809)	(50,217)
Total	$ --	$ --

The change in the valuation allowance during 2009, 2008, and 2007 is as follows:

	Year Ended December 31,		
	2009	2008	2007
		(In thousands)	
Valuation allowance:			
Balance, beginning of year	$ (50,217)	$ (36,938)	$ (32,028)
Change in property and equipment basis differences	2,288	(6,193)	(1,249)
Decrease (increase) due to foreign exchange translation loss	1,376	(4,051)	--
Change in accrued interest expense	(2,223)	(4,269)	
Decrease (Increase) due to net operating loss	(4,405)	1,465	(2,179)
Other	372	(231)	(1,482)
Total	$ (52,809)	$ (50,217)	$ (36,938)

Accounting standards require that a valuation allowance be provided if it is more likely than not that some portion or all of a deferred tax asset will not be realized. Our ability to realize the benefit of our deferred tax asset will depend on the generation of future taxable income through profitable operations through expansion of our oil and gas producing activities. The risks associated with that growth requirement are considerable, resulting in our conclusion that a full valuation allowance be provided at December 31, 2009, 2008, and 2007. Due to the full valuation allowance, our effective income tax rate for all three years was zero percent. The statutory rate was increased by permanent differences relating to changes associated with stock options and that tax treatment of interest income, and reduced by adjustments for net operating losses expiring, exchange rate differences, and changes to deferred taxes related to temporary differences.

United States NOL

At December 31, 2009, we had net operating loss ("NOL") carryforwards in the United States of approximately $84,213,000 available to offset future taxable income. The carryforwards begin to expire in 2010 and will fully expire in 2029. The utilization of the NOL carryforwards against future taxable income in the United States may become subject to an annual limitation if there is a change in ownership. The NOL carryforwards in the United States include $20,472,000 relating to tax deductions resulting from the exercise of stock options. The tax benefit from adjusting the valuation allowance related to this portion of the NOL carryforward will be credited to additional paid-in capital.

Polish NOL

As of December 31, 2009, we had NOL carryforwards in Poland totaling approximately $33,665,000. The NOLs begin to expire in 2010 and will fully expire in 2014. The normal carryforward period in Poland is five years. However, in any given year, no more than 50% of the NOL carryforward may be applied against Polish income in succeeding years.

The following table lists the years of expiration for our net operating losses:

	United States	Poland
	(In thousands)	
Year of NOL expiration:		
2009	$ 3,565	$ 7,020
2010	8,368	11,027
2011	4,995	--
2012	6,145	11,621
2013 and thereafter	61,140	3,997

The domestic and foreign components of our net loss are as follows:

	Year Ended December 31,		
	2009	2008	2007
		(In thousands)	
Domestic	$ (8,727)	$ (11,230)	$ (6,078)
Foreign	8,197	(43,474)	(5,613)
Total	$ (530)	$ (54,704)	$ (11,691)

Note 10: Stockholders' Equity

In 2009, option holders exercised a total of 55,000 outstanding options at a price of $2.40 per share, resulting in proceeds to us of $132,000. Additionally, option holders exercised a total of 380,000 outstanding options at a price of $2.40 per share by surrendering currently owned shares to pay the exercise price. As a result of this exercise, we issued 169,860 incremental shares.

Also during 2009, we issued 228,100 shares for a 2008 contribution to our employee benefit plan. In addition, we issued 21,000 shares to consultants for services. During 2008, we issued 110,090 shares for a 2007 contribution to our employee benefit plan. In addition, we issued 7,000 shares to consultants for services. We received proceeds from the exercise of 3,648,369 stock options and warrants of $12,312,649 during 2008.

We have a stockholder rights plan, adopted in 2007, that may have the effect of discouraging unsolicited takeover proposals. The rights issued under the stockholder rights plan would cause substantial dilution to a person or group that attempts to acquire us on terms not approved in advance by our board of directors. In addition, our articles of incorporation and bylaws contain provisions that may discourage unsolicited takeover proposals that our stockholders may consider to be in their best interests.

Note 11: Stock Options, Warrants and Restricted Stock

Equity Compensation Plans

Our equity compensation consists of annual stock option and award plans that have been adopted by the board of directors and subsequently approved by the stockholders at an annual meeting.

The following table summarizes information regarding our stock option and award plans as of December 31, 2009:

	Number of Shares Authorized Under Plan	Weighted Average Exercise Price of Outstanding Options	Number of Options Available for Future Issuance
Equity compensation plans approved by stockholders:			
1995 Stock Option and Award Plan	500,000	$7.49	--
1996 Stock Option and Award Plan	500,000	3.55	--
1997 Stock Option and Award Plan	500,000	5.87	--
1998 Stock Option and Award Plan	500,000	5.63	--
1999 Stock Option and Award Plan	500,000	8.37	--
2000 Stock Option and Award Plan	600,000	2.61	--
2001 Stock Option and Award Plan	600,000	3.22	--
2003 Long Term Incentive Plan	800,000	6.64	1,627
2004 Long Term Incentive Plan	1,000,000	8.43	124,013
Total	5,500,000	$5.65	125,640

All stock option and award plans are administered by the Compensation Committee (the "Committee"), consisting of the independent members of the board of directors. At its discretion, the Committee may grant stock, incentive stock options, or non-qualified options to any employee, including officers. The granted options have terms ranging from five to seven years and vest in three equal annual installments. Under terms of the stock option award plans, we may also issue restricted stock.

The following table summarizes option activity for 2009, 2008, and 2007:

	2009		2008		2007	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Options outstanding:						
Beginning of year	1,980,441	$5.65	2,315,441	$5.19	2,836,833	$5.08
Granted	--	--	--	--	--	--
Exercised	(435,000)	2.40	(335,000)	2.44	(466,726)	4.13
Cancelled	(75,000)	8.58	--	0.00	(54,666)	8.42
Expired	--	--	--	--	--	--
End of year	1,470,441	$6.47	1,980,441	$5.65	2,315,441	$5.19
Exercisable at year-end	1,470,441	$6.47	1,980,441	$5.65	2,303,776	$5.16

During 2009, we issued 379,500 shares of restricted stock, resulting in deferred compensation of $1,043,625, which will be amortized ratably over the three-year vesting period. Expense recognized during 2009 totaled $10,269.

During 2008, we issued 367,000 shares of restricted stock, resulting in deferred compensation of $1,005,580, which will be amortized ratably over the three-year vesting period. Expense recognized for these shares during 2009 and 2008 totaled $335,214 and $9,184, respectively.

During 2007, we issued 370,925 shares of restricted stock, resulting in deferred compensation of $2,284,991, which will be amortized ratably over the three-year vesting period. Expense recognized for these shares during 2009, 2008, and 2007 totaled $761,649, $761,805, and $52,088, respectively.

In December of 2006, we issued 318,400 shares of restricted stock, resulting in deferred compensation of $2,053,680, which will be amortized ratably over the three-year vesting period. Expense recognized for these shares during 2009, 2008, and 2007 totaled $585,398, $684,608, and $684,557, respectively.

In November of 2005, we issued 298,950 shares of restricted stock, resulting in deferred compensation of $3,096,600, which will be amortized ratably over the three-year vesting period. Expense recognized for these shares during 2008 and 2007 totaled $895,805 and $1,024,862, respectively.

In 2009 and 2008, we recognized $0 and $15,508 in expense related to unvested stock options granted prior to the adoption of current accounting standards. There was no unamortized expense related to unvested options at December 31, 2009. All options outstanding at December 31, 2009, are fully vested.

The following table summarizes information about stock options outstanding as of December 31, 2009:

	Outstanding			Exercisable	
Exercise Price Range	Number of Options Outstanding	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price	Number of Options Exercisable	Weighted Average Exercise Price
$3.14 - $3.20	51,000	0.69	$3.19	51,000	$3.19
$3.98 - $3.98	587,109	0.82	3.98	587,109	3.98
$6.06 - $6.06	4,167	1.07	6.06	4,167	6.06
$8.37 - $8.37	793,165	1.67	8.37	793,165	8.37
$9.00 - $10.65	35,000	2.35	9.89	35,000	9.89
Total	1,470,441	1.31	$6.47	1,470,441	$6.47

The aggregate intrinsic value of outstanding stock options at December 31, 2009, was $0.

Restricted Stock

The following table summarizes restricted stock activity during 2009, 2008, and 2007:

	2009	2008	2007
	Number of Shares	Number of Shares	Number of Shares
Unvested restricted stock outstanding:			
Beginning of year	714,421	679,788	516,900
Issued	379,500	367,000	370,925
Forfeited	(18,798)	(8,690)	(4,020)
Vested	(335,588)	(323,677)	(204,017)
End of year	739,535	714,421	679,788

The aggregate intrinsic value of unvested restricted stock at December 31, 2009, was $2,107,675. The aggregate intrinsic value represents the total pretax intrinsic value, based on our stock price of $2.85 as of December 31, 2009, which would have been received by the restricted stock award holders had all in-the-money restricted stock awards and options been vested as of that date.

Warrants

The following table summarizes warrant activity during 2009, 2008, and 2007:

	2008		2007	
	Number of Shares	Price Range	Number of Shares	Price Range
Warrants outstanding and exercisable:				
Beginning of year	3,325,373	$3.60--$6.00	3,615,373	$3.60--$6.00
Issued	--	--	--	--
Exercised	(3,215,373)	$3.66	(290,000)	$3.60
Expired	(110,000)	$6.00		
End of year	--		3,325,373	$3.60--$6.00

There were no warrants issued and outstanding during 2009.

Note 12: Business Segments

We operate within two business segments of the oil and gas industry: exploration and production ("E&P") and oilfield services. Revenues associated with our E&P activities are comprised of oil and gas sales from our producing properties in Poland and oil sales from our producing properties in the United States. During the last three years, all sales of oil and gas in Poland were made to POGC or its affiliated companies. Over 90% of our oil sales in the United States were to Cenex during 2009, 2008, and 2007. Gas sales in Poland are sold pursuant to long-term sales contracts that obligate the buyer to purchase all gas produced. Individual oil sales are negotiated with POGC-affiliated entities and are not subject to sales contracts. We believe the purchasers of our oil production in the United States could be replaced, if necessary, without a loss in revenue.

E&P operating costs are comprised of: (1) exploration costs (geological and geophysical costs, exploratory dry holes, and proved property and non-producing leasehold impairments); and (2) lease operating costs (lease operating expenses and production taxes). Substantially all exploration costs are related to our operations in Poland. The majority of lease operating costs are related to our domestic production.

Revenues associated with our oilfield services segment are comprised of contract drilling and well-servicing fees generated by our oilfield-servicing equipment in Montana. Oilfield-servicing costs are comprised of direct costs associated with our oilfield services.

DD&A directly associated with a respective business segment is disclosed within that business segment. We do not allocate current assets, corporate DD&A, general and administrative costs, amortization of deferred compensation, interest income, interest expense, other income, or other expense to our operating business segments for management and business segment reporting purposes. All material intercompany transactions between our business segments are eliminated for management and business segment reporting purposes.

Information on our operations by business segment for 2009, 2008, and 2007 is summarized as follows:

	2009			
	Exploration & Production		Oilfield Services	Total (In thousands)
	U.S.	Poland		
Operations summary:				
Revenues	$ 3,313	$ 9,459	$ 1,892	$ 14,664
Lease operating expense	(2,528)	(950)	--	(3,478)
Oilfield services costs	--	--	(1,412)	(1,412)
Exploration expense	(204)	(4,625)	--	(4,829)
Impairment expense / ARO revision	529	(1,864)	--	(1,334)
Accretion expense	(13)	(28)	--	(41)
Asset retirement obligation gain	696	--	--	696
DD&A expense	(64)	(851)	(597)	(1,512)
Operating income (loss)	$ 1,033	$ 1,141	$ (117)	$ 2,057
Identifiable net property and equipment:				
Unproved properties	$ 20	$ 3,383	$ --	$ 3,403
Proved properties	695	25,895	--	26,590
Equipment and other	--	101	2,102	2,203
Total	$ 715	$ 29,379	$ 2,102	$ 32,196
Net Capital Expenditures:				
Property and equipment	$ 498	$ 6,533	$ 929	$ 7,960
Total	$ 498	$ 6,533	$ 929	$ 7,960

	2008			
	Exploration & Production		Oilfield Services	Total (In thousands)
	U.S.	Poland		
Operations summary:				
Revenues	$ 5,695	$ 7,799	$ 4,347	$ 17,841
Lease operating expense	(2,548)	(893)	--	(3,441)
Oilfield services costs	--	--	(2,751)	(2,751)
Exploration expense	(464)	(14,925)	--	(15,389)
Impairment expense	(3,774)	(10,972)	--	(14,746)
Accretion expense	(56)	(28)	--	(84)
Bad debt expense	--	--	(460)	(460)
DD&A expense	(700)	(529)	(411)	(1,640)
Operating income (loss)	$ (1,847)	$ (19,548)	$ 725	$ (20,670)
Identifiable net property and equipment:				
Unproved properties	$ 20	$ 2,750	$ --	$ 2,770
Proved properties	261	21,839	--	22,100
Equipment and other	--	101	1,772	1,873
Total	$ 281	$ 24,690	$ 1,772	$ 26,743
Net Capital Expenditures:				
Property and equipment	$ 1,828	$ 22,811	$ 1,020	$ 25,659
Total	$ 1,828	$ 22,811	$ 1,020	$ 25,659

	2007			
	Exploration & Production		Oilfield Services	Total (In thousands)
	U.S.	Poland		
Operations summary:				
Revenues	$ 4,336	$ 10,567	$ 3,093	$ 17,996
Lease operating expense	(2,390)	(1,148)	--	(3,538)
Oilfield services costs	--	--	(1,998)	(1,998)
Exploration expense	(52)	(10,572)	--	(10,624)
Impairment expense	--	(2,299)	--	(2,299)
Accretion expense	(50)	(28)	--	(78)
DD&A expense	(742)	(935)	(267)	(1,944)
Operating income (loss)	$ 1,102	$ (4,415)	$ 828	$ (2,485)
Identifiable net property and equipment:				
Unproved properties	$ 61	$ 1,940	$ --	$ 2,001
Proved properties	3,167	15,377	--	18,544
Equipment and other	--	--	1,178	1,178
Total	$ 3,228	$ 17,317	$ 1,178	$ 21,723
Net Capital Expenditures:				
Property and equipment	$ 494	$ 5,092	$ 893	$ 6,479
Total	$ 494	$ 5,092	$ 893	$ 6,479

A reconciliation of the segment information to the consolidated totals for 2009, 2008, and 2007 follows:

	2009	2008	2007
		(In thousands)	
Revenues:			
Reportable segments	$ 14,664	$ 17,841	$ 17,996
Non-reportable segments	--	--	--
Total revenues	$ 14,664	$ 17,841	$ 17,996
Net loss:			
Operating income (loss), reportable segments	$ 2,057	$ (20,670)	$ (2,485)
Expense or (revenue) adjustments:			
Corporate DD&A expense	(90)	(80)	(120)
General and administrative costs (G&A)	(7,257)	(7,030)	(7,061)
Amortization of deferred compensation (G&A)	(1,693)	(2,367)	(2,604)
Total net operating loss	(6,983)	(30,147)	(12,270)
Non-operating income:			
Interest income (net of interest expense) and other income	(600)	(278)	433
Foreign exchange gain (loss)	7,053	(24,279)	146
Net loss	$ (530)	$ (54,704)	$ (11,691)
Net property and equipment:			
Reportable segments	$ 32,196	$ 26,743	$ 21,723
Corporate assets	95	130	162
Net property and equipment	$ 32,291	$ 26,873	$ 21,885
Property and equipment capital expenditures:			
Reportable segments	$ 7,960	$ 25,659	$ 6,479
Corporate assets	27	20	73
Total property and equipment capital expenditures	$ 7,987	$ 25,679	$ 6,552

Note 13: Quarterly Financial Data (Unaudited)

Summary quarterly information for 2009 and 2008 is as follows:

	Quarter Ended			
	December 31	September 30	June 30	March 31
	(In thousands, except per share amounts)			
2009:				
Revenues	$ 6,607	$ 3,809	$ 2,466	$ 1,782
Net operating income (loss)	2,028	(2,649)	(2,543)	(3,819)
Net income (loss)	3,336	9,448	11,090	(24,404)
Basic and diluted net income(loss) per common share	$0.08	$ 0.22	$ 0.26	$ (0.57)
2008:				
Revenues	$ 3,325	$ 5,096	$ 5,195	$ 4,225
Net operating loss	(20,666)	(3,602)	(1,564)	(4,315)
Net loss	(45,236)	(3,688)	(1,488)	(4,292)
Basic and diluted net loss per common share	$ (1.09)	$ (0.09)	$ (0.04)	$ (0.11)

The net loss for 2009 includes a foreign exchange gain of $7.1 million primarily related to FX Energy Poland's intercompany loans from FX Energy, Inc. The net loss for 2008 includes a foreign exchange loss of $24.3 million primarily related to FX Energy Poland's intercompany loans from FX Energy, Inc. The net operating loss for the fourth quarter of 2008 includes a $7.2 million and $3.8 million impairment loss associated with the Grundy-1 and Sroda-6 wells in Poland and a $3.7 million impairment loss on properties located in Montana.

FX ENERGY, INC. AND SUBSIDIARIES
Supplemental Information

Disclosure about Oil and Gas Properties and Producing Activities (Unaudited)

Capitalized Oil and Gas Property Costs

Capitalized costs relating to oil and gas exploration and production activities as of December 31, 2009 and 2008, are summarized as follows:

	United States	Poland	Total
		(In thousands)	
December 31, 2009:			
Proved properties	$ 4,012	$ 28,688	$ 32,700
Unproved properties	20	3,383	3,403
Total gross properties	4,032	32,071	36,103
Less accumulated depreciation, depletion and amortization	(3,317)	(2,794)	(6,111)
	$ 715	$ 29,277	$ 29,992
December 31, 2008:			
Proved properties	$ 3,514	$ 25,086	$ 28,600
Unproved properties	20	2,750	2,770
Total gross properties	3,534	27,836	31,370
Less accumulated depreciation, depletion and amortization	(3,254)	(3,247)	(6,501)
	$ 280	$ 24,589	$ 24,869

Results of Operations

Results of operations are reflected in Note 12, Business Segments. There is no tax provision because we are not likely to pay, and have not received any benefit from, any federal or local income taxes due to our operating losses. Total production costs (in thousands) for 2009, 2008, and 2007 were $3,478, $3,441, and $3,538, respectively.

Property Acquisition, Exploration and Development Activities

Costs incurred in property acquisition, exploration, and development activities during 2009, 2008, and 2007, whether capitalized or expensed, are summarized as follows:

	United States	Poland	Total
		(In thousands)	
Year ended December 31, 2009:			
Acquisition of unproved properties	$ --	$ 525	$ 525
Exploration costs	204	6,411	6,615
Development costs	498	3,722	4,220
Total	$ 702	$ 10,658	$ 11,360
Year ended December 31, 2008:			
Acquisition of unproved properties	$ 67	$ 1,810	$ 1,877
Exploration costs	691	35,436	36,127
Development costs	1,760	126	1,886
Total	$ 2,518	$ 37,372	$ 39,890

	United States	Poland	Total
		(In thousands)	
Year ended December 31, 2007:			
Acquisition of unproved properties	$ 61	$ 744	$ 805
Exploration costs	77	14,884	14,961
Development costs	434	10	444
Total	$ 572	$ 15,638	$ 16,210

Impairment of Oil and Gas Properties

We recorded impairment charges in our E&P segment related to oil and gas properties as follows (in thousands):

	2009	2008	2007
Impairment of properties	$1,864	$14,746	$2,299

Exploratory Dry Hole Costs

Total dry hole costs in 2009 of $150,821 were related to a single dry hole drilled in the United States. Dry hole costs for 2008 included three wells plugged and abandoned in the United States in the amount of $463,744. There were no dry holes drilled in 2007.

Summary Oil and Gas Reserve Data (Unaudited)

The following disclosures about our crude oil and natural gas reserves and exploration and production activities are in accordance with accounting principles generally accepted in the United States of America for disclosures about oil and gas producing activities and Securities and Exchange Commission rules for oil and gas reporting disclosures.

Reserves

There are numerous uncertainties inherent in estimating quantities of proved crude oil and natural gas reserves. Crude oil and natural gas reserve engineering is a subjective process of estimating underground accumulations of crude oil and natural gas that cannot be precisely measured. The accuracy of any reserve estimate is a function of the quality of available data and of engineering and geological interpretation and judgment. Results of drilling, testing, and production subsequent to the date of the estimate may justify revision of such estimate. Accordingly, reserves estimates are often different from the quantities of crude oil and natural gas that are ultimately recovered.

Recent SEC and FASB Rule-Making Activity

In December 2008, the Securities and Exchange Commission announced that it had approved revisions designed to modernize the oil and gas company reserves reporting requirements. See Note 1. Summary of Significant Accounting Policies New Accounting Standards. We adopted the rules effective December 31, 2009, and the rule changes, including those related to pricing, are included in our reserves estimates.

In addition, in January 2010, the FASB issued new standards to provide consistency with the Securities and Exchange Commission's rules. See Note 1. Summary of Significant Accounting Policies – New Accounting Standards.

Application of the new rules resulted in the use of lower prices at December 31, 2009, for both oil and gas than would have resulted under the previous rules. Use of 12-month average pricing at December 31, 2009, as required by the new rules, resulted in a decrease in proved reserves of approximately 990,000 cubic feet of natural gas equivalents. Prior to 2009, oil and gas reserves were determined using year-end prices. Changes in the proved undeveloped reserves rules had no impact on our reserve quantities, as we do not include any reserves for undrilled locations.

Because we use year-end reserves and add back production to calculate DD&A, adoption of these new standards had an impact on fourth quarter 2009 DD&A expense. We estimate the impact of using 12-month average commodity prices, as required by the new standards, instead of year-end commodity prices, to be an increase in fourth quarter 2009 DD&A expense of approximately $14,000.

Definitions

The following definitions apply to the terms used in this disclosure:

Reserves Estimate—The determination of an estimate of a quantity of oil or gas reserves that are thought to exist at a certain date, considering existing prices and reservoir conditions.

Proved Oil and Gas Reserves—Proved oil and gas reserves are those quantities of oil and gas that by analysis of geoscience and engineering data can be estimated with reasonable certainty to be economically producible—from a given date forward, from known reservoirs, and under existing economic conditions, operating methods, and government regulations—prior to the time at which contracts providing the right to operate expire, unless evidence indicates that renewal is reasonably certain, regardless of whether deterministic or probabilistic methods are used for the estimation. The project to extract the hydrocarbons must have commenced or the operator must be reasonably certain that it will commence the project within a reasonable time.

Developed Oil and Gas Reserves—Proved developed oil and gas reserves are reserves that can be expected to be recovered through existing wells with existing equipment and operating methods or in which the cost of the required equipment is relatively minor compared with the cost of a new well.

Undeveloped Oil and Gas Reserves—Proved undeveloped oil and gas reserves are reserves that are expected to be recovered from new wells on undrilled acreage or from existing wells where a relatively major expenditure is required for recompletion or production facilities.

For complete definitions of proved natural gas, natural gas liquids, and crude oil reserves, refer to SEC Regulation S-X, Rule 4-10(a)(6), (22) and (31).

Reserves Estimates Preparation

Estimates of our proved Polish reserves were prepared by RPS Energy, an independent engineering firm in the United Kingdom. Estimates of our proved domestic reserves were prepared by Hohn Engineering, an independent engineering firm in Billings, Montana. The technical personnel responsible for calculating the reserve estimates at both RPS Energy and Hohn Engineering meet the requirements regarding qualifications, independence, objectivity, and confidentiality set forth in the Standards Pertaining to the Estimating and Auditing of Oil and Gas Reserves Information promulgated by the Society of Petroleum Engineers. Both RPS Energy and Hohn Engineering are independent firms of petroleum engineers, geologists, geophysicists, and petrophysicists; they do not own an interest in our properties and are not employed on a contingent fee basis.

Proved Developed Reserves:

The following unaudited summary of proved developed reserve quantity information represents estimates only and should not be construed as exact:

	Crude Oil (In thousand barrels of oil)		Natural Gas (In millions of cubic feet)	
	United States	Poland	United States	Poland
December 31, 2009	463	--	--	20,409
December 31, 2008	45	47	--	7,873
December 31, 2007	482	14	--	5,288

Total Proved Reserves:

The following unaudited summary of proved reserve quantity information represents estimates only and should not be construed as exact:

	Crude Oil (In thousand barrels of oil)		Natural Gas (In millions of cubic feet)	
	United States	Poland	United States	Poland
December 31, 2009:				
Beginning of year	45	47	--	45,312
Extensions or discoveries [1]	--	--	--	6,333
Revisions of previous estimates [2]	482	(47)	--	(2,095)
Production	(64)	--	--	(1,882)
End of year	463	--	--	47,668
December 31, 2008:				
Beginning of year	482	14	--	31,116
Extensions or discoveries [3]	--	--	--	11,295
Revisions of previous estimates [4]	(371)	37	--	4,152
Production	(66)	(4)	--	(1,251)
End of year	45	47	--	45,312
December 31, 2007:				
Beginning of year	382	202	--	19,264
Extensions or discoveries [5]	--	--	--	17,939
Revisions of previous estimates [6]	170	(163)	--	(4,247)
Production	(70)	(25)	--	(1,840)
End of year	482	14	--	31,116

(1) Volume increase in Poland attributable to new Kromolice-2 and Grabowka wells drilled or recompleted during 2009.
(2) Positive oil revisions in the United States attributable to higher average oil prices during 2009 compared to year-end 2008 oil prices. Negative gas revisions due to the cessation of production at the Wilga well in Poland.
(3) Volume increase in Poland attributable to new Kromolice-1 well drilled during 2008.
(4) Positive gas revisions in Poland attributable to Sroda-4 and Zaniemysl-3 wells due to additional technical data acquired during 2008. Negative oil revisions due to lower year-end oil prices in the United States.
(5) Volume increase in Poland attributable to new Roszkow-1 well drilled during 2007.
(6) Negative oil and gas revisions in Poland attributable to Wilga-4 well due to water encroachment. Positive oil revisions due to higher year-end oil prices in the United States.

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

Certain information concerning the assumptions used in computing the valuation of proved reserves and their inherent limitations are discussed below. We believe such information is essential for a proper understanding and assessment of the data presented. The assumptions used to compute the proved reserve valuation do not necessarily reflect our expectations of actual revenues to be derived from those reserves or their present worth. Assigning monetary values to the reserve quantity estimation process does not reduce the subjective and ever-changing nature of such reserve estimates. Additional subjectivity occurs when determining present values because the rate of producing the reserves must be estimated. In addition to errors inherent in predicting the future, variations from the expected production rates also could result directly or indirectly from factors outside our control, such as unintentional delays in development, environmental concerns, and changes in prices or regulatory controls. The reserve valuation assumes that all reserves will be disposed of by production. However, if reserves are sold in place, additional economic considerations also could affect the amount of cash eventually realized. Future development and production costs are computed by estimating expenditures to be incurred in developing and producing the proved oil reserves at the end of the period, based on period-end costs and assuming continuation of existing economic conditions. A discount rate of 10% per year was used to reflect the timing of the future net cash flows. The future net cash flows for our Polish reserves are based on a gas sales contracts we have with POGC.

The components of SMOG are detailed below:

	United States	Poland	Total
		(In thousands)	
December 31, 2009:			
Future cash flows	$ 22,050	$ 283,520	$ 305,570
Future production costs	(16,334)	(26,750)	(43,084)
Future development costs	--	(17,940)	(17,940)
Future income tax expense	--	(33,411)	(33,411)
Future net cash flows	5,716	205,419	211,135
10% annual discount for estimated timing of cash flows	(2,217)	(63,095)	(65,312)
Discounted net future cash flows	$ 3,499	$ 142,324	$ 145,823
December 31, 2008:			
Future cash flows	$ 1,103	$ 239,220	$ 240,323
Future production costs	(510)	(14,310)	(14,820)
Future development costs	--	(16,720)	(16,720)
Future income tax expense	--	(29,270)	(29,270)
Future net cash flows	593	178,920	179,513
10% annual discount for estimated timing of cash flows	(275)	(61,670)	(61,945)
Discounted net future cash flows	$ 318	$ 117,250	$ 117,568
December 31, 2007:			
Future cash flows	$ 39,056	$ 179,698	$ 218,754
Future production costs	(22,459)	(15,051)	(37,510)
Future development costs	--	(10,029)	(10,029)
Future income tax expense	--	(16,835)	(16,835)
Future net cash flows	16,597	137,783	154,380
10% annual discount for estimated timing of cash flows	(5,130)	(46,282)	(51,412)
Discounted net future cash flows	$ 11,467	$ 91,501	$ 102,968

The principal sources of changes in SMOG are detailed below:

	Year Ended December 31,		
	2009	**2008**	**2007**
		(In thousands)	
SMOG sources:			
Balance, beginning of year	$ 117,568	$ 102,968	$ 63,757
Sale of oil and gas produced, net of production costs	(9,294)	(10,053)	(11,364)
Net changes in prices and production costs	14,530	(9,220)	7,866
Acquisition of minerals in place		--	--
Extensions and discoveries, net of future costs	18,200	27,000	62,343
Changes in estimated future development costs	(367)	(4,940)	(5,022)
Previously estimated development costs incurred during the year	3,656	--	420
Revisions in previous quantity estimates	(1,671)	10,383	(13,561)
Accretion of discount	11,757	10,297	6,376
Net change in income taxes	(3,906)	(7,941)	(8,008)
Changes in rates of production and other	(4,650)	(926)	161
Balance, end of year	$ 145,823	$ 117,568	$ 102,968