



## 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 2010 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, 2010, 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, 2010, 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, 2010 and 2009, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2010 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, 2010, 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 7, 2011

**FX ENERGY, INC., AND SUBSIDIARIES**  
**Consolidated Balance Sheets**  
**As of December 31, 2010 and 2009**  
(in thousands)

	<b>2010</b>	<b>2009</b>
<b>ASSETS</b>		
<b>Current assets:</b>		
Cash and cash equivalents .....	\$ 19,740	\$ 4,225
Receivables:		
Accrued oil and gas sales .....	2,617	2,875
Joint interest and other receivables .....	2,013	918
VAT receivable .....	392	--
Inventory .....	242	232
Other current assets .....	293	394
Total current assets .....	25,297	8,644
<b>Property and equipment, at cost:</b>		
Oil and gas properties (successful efforts method):		
Proved .....	38,528	32,700
Unproved .....	3,320	3,403
Other property and equipment .....	8,853	7,654
Gross property and equipment .....	50,701	43,757
Less accumulated depreciation, depletion and amortization .....	(12,327)	(11,466)
Net property and equipment .....	38,374	32,291
<b>Other assets:</b>		
Certificates of deposit .....	406	406
Loan fees .....	2,527	729
Total other assets .....	2,933	1,135
<b>Total assets</b> .....	<b>\$ 66,604</b>	<b>\$ 42,070</b>

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

**FX ENERGY, INC., AND SUBSIDIARIES**  
**Consolidated Balance Sheets**  
**As of December 31, 2010 and 2009**  
(in thousands, except share data)  
-Continued-

	<b>2010</b>	<b>2009</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current liabilities:</b>		
Accounts payable .....	\$ 5,742	\$ 3,569
VAT payable .....	--	575
Accrued liabilities .....	1,343	1,048
Total current liabilities .....	7,085	5,192
<b>Long-term liabilities:</b>		
Notes payable .....	35,000	25,000
Asset retirement obligation .....	682	1,133
Total long-term liabilities .....	35,682	26,133
Total liabilities .....	42,767	31,325
<b>Commitments and Contingencies (Note 6)</b>		
<b>Stockholders' equity:</b>		
Preferred stock, \$0.001 par value, 5,000,000 shares authorized as of December 31, 2010 and 2009; no shares outstanding .....	--	--
Common stock, \$0.001 par value, 100,000,000 shares authorized as of December 31, 2010 and 2009; 45,284,527 and 43,037,540 shares issued and outstanding as of December 31, 2010 and 2009, respectively .....	45	43
Additional paid-in capital .....	171,167	160,594
Cumulative translation adjustment .....	14,013	10,738
Accumulated deficit .....	(161,388)	(160,630)
Total stockholders' equity .....	23,837	10,745
<b>Total liabilities and stockholders' equity .....</b>	<b>\$ 66,604</b>	<b>\$ 42,070</b>

**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, 2010, 2009, and 2008**  
(in thousands, except per share amounts)

	<u>2010</u>	<u>2009</u>	<u>2008</u>
<b>Revenues:</b>			
Oil and gas sales .....	\$ 22,914	\$ 12,772	\$ 13,494
Oilfield services .....	2,099	1,892	4,347
Total revenues .....	<u>25,013</u>	<u>14,664</u>	<u>17,841</u>
<b>Operating costs and expenses:</b>			
Lease operating expenses.....	3,473	3,478	3,441
Exploration costs.....	3,038	4,829	15,389
Impairment of oil and gas properties .....	564	1,864	14,746
Asset retirement obligation gain .....	(264)	(529)	--
Oilfield services costs .....	1,550	1,412	2,751
Depreciation, depletion and amortization (DD&A) .....	2,626	1,602	1,720
Accretion expense .....	92	41	84
Stock compensation .....	1,379	1,693	2,367
Bad debt expense .....	--	--	460
General and administrative costs (G&A).....	7,973	7,257	7,030
Total operating costs and expenses .....	<u>20,431</u>	<u>21,647</u>	<u>47,988</u>
<b>Operating income (loss) .....</b>	<u>4,582</u>	<u>(6,983)</u>	<u>(30,147)</u>
<b>Other income (expense):</b>			
Interest expense.....	(1,936)	(654)	(672)
Interest and other income.....	829	54	394
Foreign exchange gain (loss) .....	(4,233)	7,053	(24,279)
Total other income (expense).....	<u>(5,340)</u>	<u>6,453</u>	<u>(24,557)</u>
<b>Net loss .....</b>	<u>\$ (758)</u>	<u>\$ (530)</u>	<u>\$ (54,704)</u>
<b>Basic and diluted net loss per common share .....</b>	<u>\$ (0.02)</u>	<u>\$ (0.01)</u>	<u>\$ (1.35)</u>
<b>Basic and diluted weighted average number of shares outstanding .....</b>			
	<u>43,387</u>	<u>42,529</u>	<u>40,420</u>

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, 2010, 2009, and 2008**  
(in thousands)

	<u>2010</u>	<u>2009</u>	<u>2008</u>
<b>Net loss</b> .....	\$ (758)	\$ (530)	\$ (54,704)
<b>Other comprehensive income (loss)</b>			
Foreign currency translation adjustment .....	3,275	(6,399)	13,584
Increase (decrease) in market value of marketable securities ..	<u>--</u>	<u>--</u>	<u>1</u>
<b>Comprehensive income (loss)</b>	<u>\$ 2,517</u>	<u>\$ (6,929)</u>	<u>\$ (41,119)</u>

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, 2010, 2009, and 2008**  
(in thousands)

	<b>2010</b>	<b>2009</b>	<b>2008</b>
<b>Cash flows from operating activities:</b>			
Net loss .....	\$ (758)	\$ (530)	\$ (54,704)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation, depletion and amortization.....	2,626	1,602	1,720
Impairment of oil and gas properties.....	564	1,864	14,746
Accretion expense .....	92	41	84
(Gain) loss on property dispositions.....	--	--	(5)
Stock compensation .....	1,379	1,693	2,367
Foreign exchange (gains) losses.....	4,238	(8,296)	22,306
Common stock issued for services (G&A).....	636	694	498
Asset retirement obligation gain .....	(264)	(529)	--
Loan fee amortization .....	971	242	210
Increase (decrease) from changes in working capital items:			
Receivables .....	(1,809)	1,682	(3,056)
Inventory .....	(10)	(21)	(33)
Other current assets .....	101	58	(85)
Other assets .....	(143)	(128)	(136)
Accounts payable and accrued liabilities .....	(289)	(4,025)	1,840
Asset retirement obligations settled .....	(85)	(176)	--
Net cash provided by (used in) operating activities.....	7,249	(5,829)	(14,248)
<b>Cash flows from investing activities:</b>			
Additions to oil and gas properties .....	(6,475)	(7,666)	(21,808)
Additions to other property and equipment .....	(1,339)	(983)	(1,077)
Additions to marketable securities .....	--	(11)	(186)
Proceeds from maturities of marketable securities .....	--	4,661	11,284
Proceeds from sale of assets .....	--	--	15
Net cash used in investing activities.....	(7,814)	(3,999)	(11,772)
<b>Cash flows from financing activities:</b>			
Proceeds from issuance of common stock, net of offering costs .....	8,403	--	--
Proceeds from notes payable, net of deferred loan fees .....	32,532	--	25,000
Payments of notes payable.....	(25,000)	--	--
Proceeds from loan related to auction-rate securities.....	--	--	3,354
Payments on loan related to auction-rate securities .....	--	(2,808)	(546)
Proceeds from exercise of stock options and warrants .....	157	132	12,313
Net cash provided by (used in) financing activities.....	16,092	(2,676)	40,121
Effect of exchange rate changes on cash .....	(12)	141	(1,775)
Net increase (decrease) in cash .....	15,515	(12,363)	12,326
Cash and cash equivalents at beginning of year .....	4,225	16,588	4,262
<b>Cash and cash equivalents at end of year .....</b>	<b>\$ 19,740</b>	<b>\$ 4,225</b>	<b>\$ 16,588</b>

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, 2010, 2009, and 2008**  
(in thousands)

	Preferred Stock	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders' Equity (Deficit)
		Shares Issued	\$0.001 Par Value				
<b>Balance as of December 31, 2007</b> .....	--	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)
<b>Balance as of December 31, 2008</b> .....	--	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)
<b>Balance as of December 31, 2009</b> .....	--	43,038	\$ 43	\$ 160,594	\$ 10,738	\$ (160,630)	\$ 10,745
Issuance of common stock .....	--	1,500	1	8,402	--	--	8,403
Common stock issued for services and other .....	--	594	1	635	--	--	636
Exercise of stock options and warrants .....	--	153	--	157	--	--	157
Stock compensation .....	--	--	--	1,379	--	--	1,379
Other comprehensive income .....	--	--	--	--	3,275	--	3,275
Net loss for year .....	--	--	--	--	--	(758)	(758)
<b>Balance as of December 31, 2010</b> .....	--	45,285	\$ 45	\$ 171,167	\$ 14,013	\$ (161,388)	\$ 23,837

**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 (“PGNiG”), 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, 2010, 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 and Nonfinancial Assets and Liabilities*

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. The accounting standards for fair value measurements provide 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.

*Concentration of Credit Risk*

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 PGNiG 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, 2010 and 2009. 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, 2010 and 2009, 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 2010, production ceased at our Kleka well in western Poland. We impaired the remaining capitalized costs of the well of \$564,000. During 2009, production ceased at our Wilga well in eastern Poland. We impaired the remaining capitalized costs of the well of \$1,864,000.

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.

During 2010, we recorded a gain of approximately \$772,000 attributable to the sale of tubing associated with our Grundy-1 well, which was drilled and abandoned during 2008. The gain is included in interest and other income.

The following table reflects the net changes in capitalized exploratory well costs, which are capitalized pending the determination of proved reserves, during 2010, 2009, and 2008.

	December 31,		
	2010	2009	2008
	(In thousands)		
Beginning balance at January 1 .....	\$ --	\$ 2,390	\$ 669
Additions to capitalized exploratory well costs			
pending the determination of proved reserves .....	3,614	1,766	2,390
Reclassifications to wells, facilities and equipment			
based on the determination of proved reserves .....	--	(4,156)	--
Capitalized exploratory well costs charged to expense .....	--	--	(669)
Ending balance at December 31 .....	<u>\$ 3,614</u>	<u>\$ --</u>	<u>\$ 2,390</u>

The 2010 activity includes costs associated with the Lisewo-1 well, which was drilling at year-end 2010 and was determined to be a commercial well subsequent to year-end. Activity during 2009 and 2008 included 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 2008 charge to expense of \$669,000 was related to the Grundy well in Poland, the costs of which were impaired in 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,		Estimated Useful Life (in years)
	2010	2009	
	(In thousands)		
<b>Other property and equipment:</b>			
Drilling rigs .....	\$ 7,104	\$ 5,980	6
Other vehicles .....	424	355	5
Building .....	110	110	40
Office equipment and furniture .....	1,215	1,209	3 to 6
Total cost .....	8,853	7,654	
Accumulated depreciation .....	(6,039)	(5,355)	
Net other property and equipment .....	<u>\$ 2,814</u>	<u>\$ 2,299</u>	



### *New Accounting Standards*

In January 2010, the Financial Accounting Standards Board issued new standards intended to improve disclosures about fair value measurements. The new standards require details of transfers in and out of Level 1 and 2 fair value measurements and the gross presentation of activity within the Level 3 fair value measurement roll forward. The new disclosures are required of all entities that are required to provide disclosures about recurring and nonrecurring fair value measurements. We adopted these new rules effective January 1, 2010, except for the gross presentation of the Level 3 fair value measurement roll forward, which we adopted December 31, 2010.

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, 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 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, our wholly owned subsidiary, is adjusted to reflect the difference between the exchange rate when the asset or liability was first recorded 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, 2010 and 2009, the CTA balance was \$14.0 million and \$10.7 million, respectively. 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 2010, we identified a misclassification between intercompany equity and intercompany debt. This misclassification resulted in an overstatement of foreign exchange loss of \$145,000 in 2008 and an overstatement of foreign exchange gain of \$29,000 in 2009 with corresponding misstatements in the cumulative translation adjustment. This error had no impact on total stockholders' equity (deficit) or the Statement of Cash Flows. The net impact of correcting this error in the fourth quarter of 2010 resulted in a decrease in the cumulative translation adjustment and a decrease in foreign exchange loss and net loss of \$116,000 with no impact to earnings per share. We concluded that the impact of the error is immaterial to the financial statements in the periods in which it occurred as well as to the period in which it was corrected.

During 2010, we recorded foreign currency transaction losses of approximately \$4.2 million. We recorded a loss of approximately \$4.2 million attributable to increases 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, as well as dollar-denominated notes payable held by FX Energy Poland. There was a corresponding credit to other comprehensive income for the losses attributable to the dollar-denominated loans, notes payable, and unpaid interest, which was then offset by translation adjustments of approximately \$1.0 million related to our other balance sheet accounts as discussed above. The total amount of outstanding intercompany loans and accrued interest at December 31, 2010, was approximately \$103 million.

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, 2010 and 2009:

	<u>Year Ended December 31, 2010</u>	<u>Year Ended December 31, 2009</u>
Beginning balance .....	\$ 10,738	\$ 17,137
Increase (decrease) related to losses (gains) on dollar-denominated loans and notes payable .....	4,238	(8,297)
Increase (decrease) related to translation adjustments....	(963)	1,898
Ending balance .....	<u>\$ 14,013</u>	<u>\$ 10,738</u>

Future transaction gains or losses may be significant given the amount of dollar-denominated intercompany loans and notes payable and the volatility of exchange rates. 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, 2010 and 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, stock-based compensation, 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, 2010, 2009, and 2008, were as follows:

	<u>Options, Warrants and Unvested Restricted Stock</u>	<u>Price Range</u>
<b>Balance sheet date:</b>		
December 31, 2010 .....	1,578,730	\$0.00 - \$10.65
December 31, 2009 .....	2,209,976	\$0.00 - \$10.65
December 31, 2008 .....	2,694,862	\$0.00 - \$10.65

We recorded net losses in 2010, 2009, and 2008. 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 \$91,624, \$41,296, and \$83,739 in 2010, 2009, and 2008, respectively. At December 31, 2010, 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, 2010 and 2009:

	<u>December 31,</u>	
	<u>2010</u>	<u>2009</u>
	(In thousands)	
<b>Asset retirement obligations:</b>		
Beginning balance.....	\$ 1,492	\$ 1,932
Current year additions.....	--	193
Current year revisions.....	(343)	(529)
Liabilities settled.....	(7)	(169)
Foreign exchange adjustments.....	(30)	24
Accretion expense.....	92	41
Ending balance.....	<u>\$ 1,204</u>	<u>\$ 1,492</u>

When the present value of a future asset retirement obligation changes due to the increase or decrease of the estimated plugging costs of that asset, we adjust the related asset retirement cost. During both 2010 and 2009, the economic lives of our United States oil wells were increased, as higher oil prices resulted in more economic barrels. This change resulted in a decrease in the net present value of the retirement obligations, which in turn resulted in gains associated with those obligations, as the related asset retirement costs had been previously written off.

### Note 3: Other Assets

As of December 31, 2010 and 2009, 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, 2010 and 2009, were comprised of the following:

	December 31,	
	2010	2009
(In thousands)		
<b>Accrued liabilities:</b>		
Credit facility commitment fees .....	\$ 79	\$ --
Partner share of oil & gas revenue and joint operating costs .....	--	127
Compensation-related costs .....	533	449
Interest expense .....	78	15
Current portion of asset retirement obligation .....	522	359
Oilfield equipment installment note .....	131	98
Total.....	<u>\$ 1,343</u>	<u>\$ 1,048</u>

#### Note 5: Notes Payable

On August 5, 2010, we refinanced our existing facility by executing an expanded credit facility with The Royal Bank of Scotland, ING Bank N.V., and KBC Bank NV. The expanded credit facility calls for a periodic interest rate of LIBOR plus an interest margin of 4.0% and has a term of five years, with semi-annual borrowing base reductions of \$11 million each beginning on June 30, 2013. The expanded credit facility is an interest-only facility until June 2013. Unamortized deferred financing costs of approximately \$577,000 associated with our prior credit facility were charged to interest expense during the third quarter of 2010. Payment of the expanded credit facility is secured by our assets in Poland and guaranteed by the Company. As of December 31, 2010, the total amount drawn under the expanded credit facility was \$35 million. The year-end 2010 interest rate was 4.26% per annum.

We have access to \$40 million under the expanded credit facility until our Kromolice-1, Sroda-4, and Kromolice-2 wells have been on production for 30 days, at which time the full \$55 million becomes available. Proceeds from the expanded credit facility are intended to support our development, production, and operating activities in Poland.

In consideration for the expanded credit facility, we paid various arrangement, structuring, legal, and other fees totaling approximately \$2.5 million. These fees, which were paid by increasing the amount of debt drawn under the expanded credit facility, have been capitalized as deferred financing costs and are being amortized over the five-year term of the loan, beginning in the third quarter of 2010. An annual unused commitment fee of one-half of the applicable interest margin is charged quarterly based on the average daily unused portion of the expanded credit facility. There are no financial covenants associated with the expanded credit facility. The carrying value of the long-term debt at December 31, 2010, approximates its fair value.

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

	Year Ended December 31, 2010	Year Ended December 31, 2009
Beginning balance.....	\$ 25,000	\$ 25,000
Payments of notes payable.....	(25,000)	--
Proceeds from borrowing.....	35,000	--
Ending balance.....	<u>\$ 35,000</u>	<u>\$ 25,000</u>

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 2010, with no change in the borrowing base amount.

## Note 6: Commitments and Contingencies

On December 20, 2010, the United States District Court for the District of Utah dismissed all claims in the matter *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, which asserted derivative claims on our behalf against certain of our current and former directors and certain of our current and former executive officers.

## Note 7: Fair Value Measurements and Marketable Securities

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. We had no Level 3 assets as of December 31, 2010 or 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, 2010 and 2009 (in thousands):

	<u>December 31, 2010</u>	<u>Level 1<sup>(1)</sup></u>	<u>Level 2<sup>(2)</sup></u>	<u>Level 3<sup>(3)</sup></u>
Cash equivalents:				
Money market funds .....	\$ 8,290	\$ 8,290	--	--
	<u>December 31, 2009</u>	<u>Level 1<sup>(1)</sup></u>	<u>Level 2<sup>(2)</sup></u>	<u>Level 3<sup>(3)</sup></u>
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.

## 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 8: Income Taxes

We recognized no income tax benefit from the losses generated during 2010, 2009, and 2008. The components of the net deferred tax asset as of December 31, 2010 and 2009, are as follows:

	<u>December 31,</u>	
	<u>2010</u>	<u>2009</u>
	(In thousands)	
<b>Deferred tax liability:</b>		
Property and equipment basis differences .....	\$ (977)	\$ (577)
<b>Deferred tax asset:</b>		
Net operating loss carryforwards:		
United States.....	31,503	31,411
Poland.....	3,058	6,396
Oil and gas properties.....	2,802	4,807
Accrued interest expense.....	7,078	6,492
Foreign exchange translation losses .....	3,787	2,675
Options issued for services.....	423	1,194
Asset retirement obligation.....	305	411
Valuation allowance .....	(47,979)	(52,809)
Total.....	<u>\$ --</u>	<u>\$ --</u>

The change in the valuation allowance during 2010, 2009, and 2008 is as follows:

	<u>Year Ended December 31,</u>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
	(In thousands)		
<b>Valuation allowance:</b>			
Balance, beginning of year .....	\$ (52,809)	\$ (50,217)	\$ (36,938)
Change in property and equipment basis differences .....	2,405	2,288	(6,193)
Decrease (increase) due to foreign exchange translation loss.....	(1,112)	1,376	(4,051)
Change in accrued interest expense .....	(586)	(2,223)	(4,269)
Decrease (increase) due to net operating loss .....	3,246	(4,405)	1,465
Other .....	877	372	(231)
Total.....	<u>\$ (47,979)</u>	<u>\$ (52,809)</u>	<u>\$ (50,217)</u>

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, 2010, 2009, and 2008. 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, 2010, we had net operating loss (“NOL”) carryforwards in the United States of approximately \$84,460,000 available to offset future taxable income. The carryforwards begin to expire in 2011 and will fully expire in 2030. 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 \$23,128,000 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, 2010, we had NOL carryforwards in Poland totaling approximately \$16,092,000. The NOLs begin to expire in 2011 and will be fully expired in 2013. 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:

	<u>United States</u>	<u>Poland</u>
	<u>(In thousands)</u>	
<b>Year of NOL expiration:</b>		
2011 .....	\$ 8,368	\$ 5,302
2012 .....	4,995	--
2013 .....	6,145	10,790
2014 .....	2,938	--
2015 and thereafter .....	62,014	--

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

	<u>Year Ended December 31,</u>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
	<u>(In thousands)</u>		
Domestic .....	\$ (4,433)	\$ (8,727)	\$ (11,230)
Foreign .....	3,675	8,197	(43,474)
Total .....	<u>\$ (758)</u>	<u>\$ (530)</u>	<u>\$ (54,704)</u>

### **Note 9: Stockholders' Equity**

In December 2010, we sold 1,500,000 shares of common stock in a registered-direct offering at a price of \$6.00 per share. After offering costs, our net proceeds from the offering were \$8,403,000.

Also during 2010, option holders exercised a total of 39,507 outstanding options at a price of \$3.98 per share, resulting in proceeds to us of \$157,000. Additionally, option holders exercised a total of 598,602 outstanding options at prices ranging from \$3.14 to \$3.98 per share by surrendering currently owned shares to pay the exercise price. As a result of this exercise, we issued 152,892 incremental shares.

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.

During 2008, we received proceeds from the exercise of 3,648,369 stock options and warrants of \$12,312,649.

We issued 216,977, 228,100, and 110,090 shares in 2010, 2009, and 2008, respectively, as contributions to our employee benefit plan. In addition, we issued 6,000, 21,000, and 7,000 shares in 2010, 2009, and 2008, respectively, to consultants for services.

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 10: 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, 2010:

	Number of Shares Authorized Under Plan	Weighted Average Exercise Price of Outstanding Options	Number of Options Available for Future Issuance
<b>Equity compensation plans approved by stockholders:</b>			
1995 Stock Option and Award Plan .....	500,000	\$8.49	--
1996 Stock Option and Award Plan .....	500,000	--	--
1997 Stock Option and Award Plan .....	500,000	8.37	--
1998 Stock Option and Award Plan .....	500,000	8.37	--
1999 Stock Option and Award Plan .....	500,000	8.37	--
2000 Stock Option and Award Plan .....	600,000	--	--
2001 Stock Option and Award Plan .....	600,000	8.37	--
2003 Long Term Incentive Plan .....	800,000	8.37	30,479
2004 Long Term Incentive Plan .....	1,000,000	8.43	125,203
Total .....	<u>5,500,000</u>	<u>\$8.42</u>	<u>155,682</u>

All stock option and award plans are administered by the Compensation Committee, consisting of the independent members of the board of directors. At its discretion, the Compensation 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 2010, 2009, and 2008:

	2010		2009		2008	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
<b>Options outstanding:</b>						
Beginning of year .....	1,470,441	\$6.47	1,980,441	\$5.65	2,315,441	\$5.19
Granted .....	--	--	--	--	--	--
Exercised .....	(638,109)	3.92	(435,000)	2.40	(335,000)	2.44
Cancelled .....	--	--	(75,000)	8.58	--	--
Expired .....	--	--	--	--	--	--
End of year .....	<u>832,332</u>	\$8.42	<u>1,470,441</u>	\$6.47	<u>1,980,441</u>	\$5.65
Exercisable at year-end .....	<u>832,332</u>	\$8.42	<u>1,470,441</u>	\$6.47	<u>1,980,441</u>	\$5.65

The following table summarizes information about stock options outstanding as of December 31, 2010:

Exercise Price Range	Outstanding			Exercisable	
	Number of Options Outstanding	Weighted Average Remaining Contractual Life (in years)	Weighted Average Exercise Price	Number of Options Exercisable	Weighted Average Exercise Price
\$6.06 - \$6.06 .....	4,167	0.07	6.06	4,167	6.06
\$8.37 - \$8.37 .....	793,165	0.67	8.37	793,165	8.37
\$9.00 - \$10.65 .....	35,000	1.35	9.89	35,000	9.89
Total .....	<u>832,332</u>	0.69	\$8.42	<u>832,332</u>	\$8.42

The aggregate intrinsic value of outstanding stock options at December 31, 2010, was \$375.

In 2008, we recognized \$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, 2010 and 2009. All options outstanding at December 31, 2010, are fully vested.

### ***Restricted Stock***

The following table summarizes restricted stock activity during 2010, 2009, and 2008:

	2010	2009	2008
	Number of Shares	Number of Shares	Number of Shares
<b>Unvested restricted stock outstanding:</b>			
Beginning of year .....	739,535	714,421	679,788
Issued .....	373,500	379,500	367,000
Forfeited .....	(2,382)	(18,798)	(8,690)
Vested .....	(364,255)	(335,588)	(323,677)
End of year .....	<u>746,398</u>	<u>739,535</u>	<u>714,421</u>

The aggregate intrinsic value of unvested restricted stock at December 31, 2010, was \$4,590,348. The aggregate intrinsic value represents the total pretax intrinsic value, based on our stock price of \$6.15 as of December 31, 2010, 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. The weighted average period over which stock compensation expense related to the restricted stock awards will be recognized is 2.0 years.

During 2010, we issued 373,500 shares of restricted stock, resulting in deferred compensation of \$2,259,675, which will be amortized ratably over a three-year vesting period. Expense recognized during 2010 totaled \$26,899.

During 2009, we issued 379,500 shares of restricted stock, resulting in deferred compensation of \$1,043,625, which is being amortized ratably over a three-year vesting period. Expense recognized during 2010 and 2009 totaled and \$347,253 and \$10,269, respectively.

During 2008, we issued 367,000 shares of restricted stock, resulting in deferred compensation of \$1,005,580, which is being amortized ratably over a three-year vesting period. Expense recognized for these shares during 2010, 2009, and 2008 totaled \$331,330, \$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 is being amortized ratably over a three-year vesting period. Expense recognized for these shares during 2010, 2009, and 2008 totaled \$673,626, \$761,649, and \$761,805, respectively.

In December of 2006, we issued 318,400 shares of restricted stock, resulting in deferred compensation of \$2,053,680, which was amortized ratably over a three-year vesting period. Expense recognized for these shares during 2010, 2009, and 2008 totaled \$0, \$585,398, and \$684,608, respectively.

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

### ***Warrants***

The following table summarizes warrant activity during 2008:

	<u>2008</u>	
	<u>Number of Shares</u>	<u>Price Range</u>
<b>Warrants outstanding and exercisable:</b>		
Beginning of year .....	3,325,373	\$3.60--\$6.00
Issued .....	--	--
Exercised .....	(3,215,373)	\$3.66
Expired .....	<u>(110,000)</u>	\$6.00
End of year .....	<u>          --</u>	

There were no warrants issued and outstanding during 2010 and 2009.

### **Note 11: 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 PGNiG or its affiliated companies. Over 90% of our oil sales in the United States were to Cenex during 2010, 2009, and 2008. 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 PGNiG-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 2010, 2009, and 2008 is summarized as follows:

	<b>2010</b>			
	(In thousands)			
	<b>Exploration &amp; Production</b>		<b>Oilfield Services</b>	<b>Total</b>
	<b>U.S.</b>	<b>Poland</b>		
<b>Operations summary:</b>				
Revenues .....	\$ 4,184	\$ 18,730	\$ 2,099	\$ 25,013
Lease operating expense .....	(2,449)	(1,024)	--	(3,473)
Oilfield services costs .....	--	--	(1,550)	(1,550)
Exploration expense .....	(30)	(3,008)	--	(3,038)
Impairment expense .....	--	(564)	--	(564)
Accretion expense .....	(70)	(22)	--	(92)
Asset retirement obligation gain .....	264	--	--	264
DD&A expense .....	(81)	(1,723)	(743)	(2,547)
Operating income (loss) .....	<u>\$ 1,818</u>	<u>\$ 12,389</u>	<u>\$ (194)</u>	<u>\$ 14,013</u>
<b>Identifiable net property and equipment:</b>				
Unproved properties .....	\$ 24	\$ 3,296	\$ --	\$ 3,320
Proved properties .....	1,124	31,116	--	32,240
Equipment and other .....	--	20	2,746	2,766
Total .....	<u>\$ 1,148</u>	<u>\$ 34,432</u>	<u>\$ 2,746</u>	<u>\$ 38,326</u>
<b>Net Capital Expenditures:</b>				
Property and equipment .....	\$ 513	\$ 8,584	\$ 1,334	\$ 10,431
Total .....	<u>\$ 513</u>	<u>\$ 8,584</u>	<u>\$ 1,334</u>	<u>\$ 10,431</u>
<b>2009</b>				
(In thousands)				
<b>Exploration &amp; Production</b>		<b>Oilfield Services</b>	<b>Total</b>	
<b>U.S.</b>	<b>Poland</b>			
<b>Operations summary:</b>				
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 .....	--	(1,864)	--	(1,864)
Accretion expense .....	(13)	(28)	--	(41)
Asset retirement obligation gain .....	529	--	--	529
DD&A expense .....	(64)	(851)	(597)	(1,512)
Operating income (loss) .....	<u>\$ 1,033</u>	<u>\$ 1,141</u>	<u>\$ (117)</u>	<u>\$ 2,057</u>
<b>Identifiable net property and equipment:</b>				
Unproved properties .....	\$ 20	\$ 3,383	\$ --	\$ 3,403
Proved properties .....	695	25,895	--	26,590
Equipment and other .....	--	101	2,102	2,203
Total .....	<u>\$ 715</u>	<u>\$ 29,379</u>	<u>\$ 2,102</u>	<u>\$ 32,196</u>
<b>Net Capital Expenditures:</b>				
Property and equipment .....	\$ 498	\$ 6,533	\$ 929	\$ 7,960
Total .....	<u>\$ 498</u>	<u>\$ 6,533</u>	<u>\$ 929</u>	<u>\$ 7,960</u>

	2008			
	(In thousands)			
	Exploration & Production		Oilfield Services	Total
	U.S.	Poland		
<b>Operations summary:</b>				
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) .....	<u>\$ (1,847)</u>	<u>\$ (19,548)</u>	<u>\$ 725</u>	<u>\$ (20,670)</u>
<b>Identifiable net property and equipment:</b>				
Unproved properties .....	\$ 20	\$ 2,750	\$ --	\$ 2,770
Proved properties .....	261	21,839	--	22,100
Equipment and other .....	--	101	1,772	1,873
Total .....	<u>\$ 281</u>	<u>\$ 24,690</u>	<u>\$ 1,772</u>	<u>\$ 26,743</u>
<b>Net Capital Expenditures:</b>				
Property and equipment .....	\$ 1,828	\$ 22,811	\$ 1,020	\$ 25,659
Total .....	<u>\$ 1,828</u>	<u>\$ 22,811</u>	<u>\$ 1,020</u>	<u>\$ 25,659</u>

A reconciliation of the segment information to the consolidated totals for 2010, 2009, and 2008 follows:

	2010	2009	2008
	(In thousands)		
<b>Revenues:</b>			
Reportable segments .....	\$ 25,013	\$ 14,664	\$ 17,841
Non-reportable segments .....	--	--	--
Total revenues .....	<u>\$ 25,013</u>	<u>\$ 14,664</u>	<u>\$ 17,841</u>
<b>Net loss:</b>			
Operating income (loss), reportable segments .....	\$ 14,013	\$ 2,057	\$ (20,670)
Expense or (revenue) adjustments:			
Corporate DD&A expense .....	(79)	(90)	(80)
General and administrative costs (G&A) .....	(7,973)	(7,257)	(7,030)
Amortization of deferred compensation (G&A) .....	(1,379)	(1,693)	(2,367)
Total net operating income (loss) .....	4,582	(6,983)	(30,147)
Non-operating income:			
Interest income (net of interest expense) and other income .....	(1,107)	(600)	(278)
Foreign exchange gain (loss) .....	(4,233)	7,053	(24,279)
Net loss .....	<u>\$ (758)</u>	<u>\$ (530)</u>	<u>\$ (54,704)</u>
<b>Net property and equipment:</b>			
Reportable segments .....	\$ 38,326	\$ 32,196	\$ 26,743
Corporate assets .....	48	95	130
Net property and equipment .....	<u>\$ 38,374</u>	<u>\$ 32,291</u>	<u>\$ 26,873</u>
<b>Property and equipment capital expenditures:</b>			
Reportable segments .....	\$ 10,431	\$ 7,960	\$ 25,659
Corporate assets .....	3	27	20
Total property and equipment capital expenditures .....	<u>\$ 10,434</u>	<u>\$ 7,987</u>	<u>\$ 25,679</u>

## Note 12: Quarterly Financial Data (Unaudited)

Summary quarterly information for 2010 and 2009 is as follows:

	Quarter Ended			
	December 31	September 30	June 30	March 31
<b>2010:</b>				
Revenues.....	\$ 6,100	\$ 6,648	\$ 6,093	\$ 6,172
Net operating income (loss).....	207	2,266	23	2,086
Net income (loss).....	(1,756)	22,152	(22,083)	929
Basic and diluted net income (loss) per common share.....	\$(0.04)	\$ 0.51	\$ (0.51)	\$ 0.02
<b>2009:</b>				
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)

The net loss for 2010 includes a foreign exchange loss of \$4.2 million primarily related to FX Energy Poland's dollar-denominated intercompany loans from FX Energy, Inc., and notes payable. The net loss for 2009 includes a foreign exchange gain of \$7.1 million primarily related to FX Energy Poland's dollar-denominated intercompany loans from FX Energy, Inc.

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**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, 2010 and 2009, are summarized as follows:

	<u>United States</u>	<u>Poland</u>	<u>Total</u>
	(In thousands)		
<b>December 31, 2010:</b>			
Proved properties .....	\$ 4,520	\$ 34,008	\$ 38,528
Unproved properties .....	24	3,296	3,320
Total gross properties.....	4,544	37,304	41,848
Less accumulated depreciation, depletion and amortization.	(3,396)	(2,892)	(6,288)
	<u>\$ 1,148</u>	<u>\$ 34,412</u>	<u>\$ 35,560</u>
<b>December 31, 2009:</b>			
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.	(3,316)	(2,794)	(6,110)
	<u>\$ 716</u>	<u>\$ 29,277</u>	<u>\$ 29,993</u>

*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 2010, 2009, and 2008 were \$3,473, \$3,478, and \$3,441, respectively.

*Property Acquisition, Exploration and Development Activities*

Costs incurred in property acquisition, exploration, and development activities during 2010, 2009, and 2008, whether capitalized or expensed, are summarized as follows:

	<u>United States</u>	<u>Poland</u>	<u>Total</u>
	(In thousands)		
<b>Year ended December 31, 2010:</b>			
Acquisition of unproved properties .....	\$ 3	\$ 44	\$ 47
Exploration costs .....	30	6,622	6,652
Development costs.....	509	4,937	5,446
Total.....	<u>\$ 542</u>	<u>\$ 11,603</u>	<u>\$ 12,145</u>
<b>Year ended December 31, 2009:</b>			
Acquisition of unproved properties .....	\$ --	\$ 525	\$ 525
Exploration costs .....	204	6,411	6,615
Development costs.....	498	3,722	4,220
Total.....	<u>\$ 702</u>	<u>\$ 10,658</u>	<u>\$ 11,360</u>

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	<u>United States</u>	<u>Poland</u> (In thousands)	<u>Total</u>
<b>Year ended December 31, 2008:</b>			
Acquisition of unproved properties .....	\$ 67	\$ 1,810	\$ 1,877
Exploration costs .....	691	35,436	36,127
Development costs .....	1,760	126	1,886
Total .....	<u>\$ 2,518</u>	<u>\$ 37,372</u>	<u>\$ 39,890</u>

***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):

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Impairment of properties	\$564	\$1,864	\$14,746

***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 2010.

**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. The most significant amendments to the requirements included the following:

- *Commodity Prices* – Economic producibility of reserves and discounted cash flows are now based on the use of unweighted, 12-month first day of the month historical average prices adjusted for basis and quality differentials, rather than year-end prices.
- *Disclosure of Unproved Reserves* – Probable and possible reserves may be disclosed separately on a voluntary basis.

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- *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.

Application of the current 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 current rules, resulted in a decrease in proved developed oil reserves of approximately 990,000 cubic feet of natural gas equivalent. We did not calculate the impact of the current rules on our 2010 reserves. 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 current 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 expiration of the contracts providing the right to operate, 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.

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*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:

	<b>Crude Oil</b>		<b>Natural Gas</b>	
	<b>United States</b>	<b>Poland</b>	<b>United States</b>	<b>Poland</b>
	(In thousand barrels of oil)		(In millions of cubic feet)	
December 31, 2010 .....	639	--	--	31,683
December 31, 2009 .....	463	--	--	20,409
December 31, 2008 .....	45	47	--	7,873

***Total Proved Reserves:***

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

	<b>Crude Oil</b>		<b>Natural Gas</b>	
	<b>United States</b>	<b>Poland</b>	<b>United States</b>	<b>Poland</b>
	(In thousand barrels of oil)		(In millions of cubic feet)	
<b>December 31, 2010:</b>				
Beginning of year .....	463	--	--	47,668
Extensions or discoveries .....	--	--	--	--
Revisions of previous estimates <sup>(1)</sup> .....	237	--	--	(4,236)
Production .....	(61)	--	--	(3,473)
End of year .....	<u>639</u>	<u>--</u>	<u>--</u>	<u>39,959</u>
<b>December 31, 2009:</b>				
Beginning of year .....	45	47	--	45,312
Extensions or discoveries <sup>(2)</sup> .....	--	--	--	6,333
Revisions of previous estimates <sup>(3)</sup> .....	482	(47)	--	(2,095)
Production .....	(64)	--	--	(1,882)
End of year .....	<u>463</u>	<u>--</u>	<u>--</u>	<u>47,668</u>

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	Crude Oil		Natural Gas	
	United States	Poland	United States	Poland
	(In thousand barrels of oil)		(In millions of cubic feet)	
<b>December 31, 2008:</b>				
Beginning of year .....	482	14	--	31,116
Extensions or discoveries <sup>(4)</sup> .....	--	--	--	11,295
Revisions of previous estimates <sup>(5)</sup> .....	(371)	37	--	4,152
Production .....	(66)	(4)	--	(1,251)
End of year .....	45	47	--	45,312

- (1) Upward oil revisions in the United States attributable to higher average oil prices during 2010 compared to average 2009 oil prices. Downward gas revisions in Poland due to the reduction of proved reserves calculated at the Roszkow well based on new pressure data and cessation of production at the Kleka well
- (2) Volume increase in Poland attributable to new Kromolice-2 and Grabowka wells drilled or recompleted during 2009.
- (3) Upward oil revisions in the United States attributable to higher average oil prices during 2009 compared to year-end 2008 oil prices. Downward gas revisions due to the cessation of production at the Wilga well in Poland.
- (4) Volume increase in Poland attributable to new Kromolice-1 well drilled during 2008.
- (5) Upward gas revisions in Poland attributable to Sroda-4 and Zaniemysl-3 wells due to additional technical data acquired during 2008. Downward oil revisions due to lower 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 gas sales contracts we have with PGNIG.

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The components of SMOG are detailed below:

	<u>United States</u>	<u>Poland</u> (In thousands)	<u>Total</u>
<b>December 31, 2010:</b>			
Future cash flows .....	\$ 43,553	\$ 226,310	\$ 269,863
Future production costs .....	(26,762)	(15,130)	(41,892)
Future development costs .....	--	(12,580)	(12,580)
Future income tax expense .....	--	(28,134)	(28,134)
Future net cash flows .....	<u>16,791</u>	<u>170,466</u>	<u>187,257</u>
10% annual discount for estimated timing of cash flows.....	<u>(7,122)</u>	<u>(52,798)</u>	<u>(59,920)</u>
Discounted net future cash flows .....	<u>\$ 9,669</u>	<u>\$ 117,668</u>	<u>\$ 127,337</u>
<b>December 31, 2009:</b>			
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 .....	<u>5,716</u>	<u>205,419</u>	<u>211,135</u>
10% annual discount for estimated timing of cash flows.....	<u>(2,217)</u>	<u>(63,095)</u>	<u>(65,312)</u>
Discounted net future cash flows .....	<u>\$ 3,499</u>	<u>\$ 142,324</u>	<u>\$ 145,823</u>
<b>December 31, 2008:</b>			
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 .....	<u>593</u>	<u>178,920</u>	<u>179,513</u>
10% annual discount for estimated timing of cash flows.....	<u>(275)</u>	<u>(61,670)</u>	<u>(61,945)</u>
Discounted net future cash flows .....	<u>\$ 318</u>	<u>\$ 117,250</u>	<u>\$ 117,568</u>

The principal sources of changes in SMOG are detailed below:

	<u>Year Ended December 31,</u>		
	<u>2010</u>	<u>2009</u>	<u>2008</u>
	(In thousands)		
<b>SMOG sources:</b>			
Balance, beginning of year .....	\$ 145,823	\$ 117,568	\$ 102,968
Sale of oil and gas produced, net of production costs .....	(19,442)	(9,294)	(10,053)
Net changes in prices and production costs .....	200	14,530	(9,220)
Acquisition of minerals in place .....	--	--	--
Extensions and discoveries, net of future costs.....	--	18,200	27,000
Changes in estimated future development costs .....	728	(367)	(4,940)
Previously estimated development costs incurred during the year	4,670	3,656	--
Revisions in previous quantity estimates .....	(13,839)	(1,671)	10,383
Accretion of discount.....	14,582	11,757	10,297
Net change in income taxes .....	3,944	(3,906)	(7,941)
Changes in rates of production and other.....	(9,329)	(4,650)	(926)
Balance, end of year.....	<u>\$ 127,337</u>	<u>\$ 145,823</u>	<u>\$ 117,568</u>

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Subsequent to December 31, 2010, we completed drilling and testing at the Lisewo-1 well in western Poland. Based on a reserve report issued by our independent petroleum reservoir engineers, the Lisewo-1 well contains proved reserves of 12,733 million cubic feet of gas, net to our 49% working interest, and increased our year-end discounted net present values, discounted at 10%, by approximately \$16.0 million.