

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

DECEMBER 31, 2005

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors
Bion Environmental Technologies, Inc.

We have audited the accompanying consolidated balance sheet of Bion Environmental Technologies, Inc. and subsidiaries as of December 31, 2005. This consolidated financial statement is the responsibility of the Company's management. Our responsibility is to express an opinion on this consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated balance sheet referred to above presents fairly, in all material respects, the financial position of Bion Environmental Technologies, Inc. and its subsidiaries as of December 31, 2005 in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated balance sheet has been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated balance sheet, the Company has an accumulated deficit at December 31, 2005 that raises substantial doubt about its ability to continue as a going concern. Management's plans in regard to this matter are also described in Note 1. The consolidated balance sheet does not include any adjustments that might result from the outcome of this uncertainty.



GHP Horwath, P.C.
Denver, Colorado
June 14, 2006

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES
Consolidated Balance Sheet As of December 31, 2005

ASSETS

Current assets:	
Cash and cash equivalents	\$ 1,763,058
Prepaid services	111,217
Total current assets	<u>1,874,275</u>
Property and equipment, net	72,622
Prepaid services and other assets	<u>20,946</u>
Total assets	<u><u>\$ 1,967,843</u></u>

LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)

Current liabilities	
Accounts payable and accrued expenses	\$ 380,856
Accrued payable - affiliate	41,647
Deferred compensation	<u>105,000</u>
Total current liabilities	<u>527,503</u>
Long-term liabilities:	
Convertible debt	30,437
Long-term convertible note – affiliate	1,006,838
Deferred compensation	<u>1,217,069</u>
Total long-term liabilities	<u>2,254,344</u>
Total liabilities	<u>2,781,847</u>
Stockholders' equity (deficit):	
Preferred stock, \$.01 par value, 10,000 shares authorized, no shares issued and outstanding	
Common stock, no par value, 100,000,000 shares authorized, 8,625,996 shares issued and outstanding	
Additional paid in capital	66,160,056
Accumulated deficit	<u>(66,974,060)</u>
Total stockholders' equity (deficit)	<u>(814,004)</u>
Total liabilities and stockholders' equity (deficit)	<u><u>\$ 1,967,843</u></u>

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED BALANCE SHEET

1. ORGANIZATION, NATURE OF BUSINESS AND MANAGEMENT'S PLANS:

Bion Environmental Technologies, Inc. ("Bion" or the "Company") was incorporated in 1987 in the State of Colorado.

Bion's patented and proprietary technology provides solutions for environmentally sound clean-up of the waste streams of large-scale animal farming operations ("confined animal feeding operations" or "CAFO's") (dairy, cattle feedlot, hogs and poultry) and creates economic opportunities for integration of alternative, renewable production (ethanol, methane, steam, etc.), sustainable animal husbandry and organic soil/fertilizer and feed production. Bion's technology also potentially allows direct integration with dairy end-users (bottling operations, cheese and ice cream plants, etc.) which integration can increase the profitability and quality control of each participant while mitigating the environmental impact of the entire integrated complex. The Company is in the process of finalizing engineering, design and economic modeling for applications and projects based on its second-generation technology.

Bion is currently evaluating sites in multiple states and anticipates selecting a site for its initial integrated project during its 2007 fiscal year. Bion is presently establishing its implementation management team with the intention of commencing development and construction of the initial project during early 2007. In addition, Bion intends to site additional projects from late 2006 through 2008 to create a pipeline of projects that will insure significant market share and profitability within 3-5 years (both regionally and nationally). Each project is to include: a) Bion waste treatment system, b) processing the CAFO waste stream from the equivalent of approximately 20-40,000 dairy cows, c) while producing renewable energy (methane, steam, etc.) for on-site use, d) solids to be marketed as feed and/or fertilizer e) which is integrated with a 20-40+M Gallon/Yr ethanol plant (though some smaller projects may be undertaken in appropriate situations). At the end of the 5-year period, Bion hopes to have numerous projects in various stages of development ranging from full operation to early construction stage.

Through 2001 the Company was primarily an environmental service company focused on the needs of CAFOs. Thereafter, Bion elected to cease sales of its first generation systems and focused its activities on development of its second-generation technology.

The consolidated balance sheet has been prepared assuming the Company will continue as a going concern. The Company has historically incurred losses and has an accumulated deficit of \$66,974,060 at December 31, 2005. These factors raise substantial doubt about the Company's ability to continue as a going concern. The accompanying consolidated balance sheet does not include any adjustments relating to the recoverability or classification of asset carrying amounts or the amounts and classification of liabilities that may result should the Company be unable to continue as a going concern. The following paragraphs describe management's plans with regard to these conditions.

Bion suffered from severe financial difficulties from approximately fall of 2002 through the closing of its operating subsidiary Bion Dairy Corporation's ("Dairy") Series C Note offering on September 30, 2005. These financial difficulties resulted in the resignation of nearly all of the Company's officers and directors during February and March of 2003, and the termination of most Company employees. New management was able to retain our core technical staff, but the Company drastically curtailed business activities to include only those activities that were directly needed to complete development and testing of the second-generation technology. On September 30, 2005, the Company, through Dairy, completed a \$1,917,500 placement of convertible debt all of which has been converted as of December 31, 2005.

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED BALANCE SHEET (CONTINUED)

1. ORGANIZATION, NATURE OF BUSINESS AND MANAGEMENT'S PLANS (CONTINUED):

The Company also completed a private placement of restricted common stock in December 2005, raising \$1,167,000. The Company continues to explore sources of additional financing to satisfy its current operating requirements.

While the Company currently does not face a severe working capital shortage, it is not currently generating any revenues. The Company will need to obtain additional capital to fund its operations and technology development, and to satisfy existing creditors. There is no assurance the Company will be able to obtain the funds that it needs to stay in business, complete its technology development or to successfully develop its business.

There can be no assurance that sufficient funds required during the next twelve months or thereafter will be generated from operations or those funds will be available from external sources such as debt or equity financings or other potential sources. The lack of additional capital resulting from the inability to generate cash flow from operations or to raise capital from external sources would force the Company to substantially curtail or cease operations and would, therefore, have a material adverse effect on its business. Further, there can be no assurance that any such required funds, if available, will be available on attractive terms or that they will not have a significantly dilutive effect on the Company's existing shareholders.

2. SIGNIFICANT ACCOUNTING POLICIES:

Principles of consolidation:

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Bion Technologies, Inc., BionSoil, Inc. and Bion Dairy Corporation and its 57.7% owned subsidiary, Centerpoint Corporation ("Centerpoint"). All significant intercompany accounts and transactions have been eliminated in consolidation.

Property and equipment:

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the related assets, generally five to ten years. The Company reviews its property and equipment for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

Income taxes:

The Company accounts for income taxes in accordance with the Statement of Financial Accounting Standards ("SFAS") No. 109, Accounting for Income Taxes, using the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statements carrying amount of existing assets and liabilities and their tax bases, as well as net operating losses. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets or liabilities of a change in tax rates is recognized in the period in which the tax change occurs. A valuation allowance is provided to reduce the deferred tax assets to a level, that more likely than not, will be realized.

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED BALANCE SHEET (CONTINUED)

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

Cash and cash equivalents:

The Company considers cash and all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Estimated fair value information:

SFAS No. 107, Disclosure about Fair Value of Financial Instruments, requires disclosure of the estimated fair value of an entity's financial instrument assets and liabilities, as defined, regardless of whether recognized in the financial statements of the reporting entity. The fair value information does not purport to represent the aggregate net fair value of the Company. The fair values of cash accounts and accounts payable approximate their carrying amounts due to their short-term maturity. It is not practicable to estimate the fair value of the convertible note and deferred compensation agreements due to the related party nature of the underlying transactions.

Use of estimates:

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

Concentrations of credit risk:

The Company's financial instruments that are exposed to concentrations of credit risk consist of cash and cash equivalents. The Company's cash and cash equivalents are in demand deposit accounts placed with federally insured financial institutions and selected brokerage accounts. Such deposit accounts at times may exceed federally insured limits. The Company has not experienced any losses on such accounts.

Stock-based compensation:

SFAS No. 123, Accounting for Stock-Based Compensation, establishes financial accounting and reporting standards for stock-based employee compensation plans. SFAS No. 123 encourages entities to adopt a fair-value-based method of accounting for stock compensation plans. However, SFAS No. 123 also permits entities to continue to measure compensation costs under Accounting Principles Board Opinion No. 25 ("APB 25"). The Company has elected to measure compensation costs under APB 25; accordingly, the Company uses the intrinsic value method to account for its stock-based employee compensation plans.

Recent accounting pronouncements:

In December 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 123 (R) Share Based Payment, which addresses the accounting for share-based payment transactions. SFAS No. 123 (R) eliminates the ability to account for share-based compensation transactions using APB No. 25, and generally requires instead that such transactions be accounted and recognized in the statement of income based on their fair values. SFAS No. 123 (R) will be effective for public companies that file as small business issuers as of the first interim period in fiscal years that begin after December 15, 2005. Management is evaluating the provisions of this standard. Depending upon the number and terms of options that may be granted in future periods, management believes that the implementation of this Standard could have a material impact on the Company's financial statements.

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED BALANCE SHEET (CONTINUED)

3. MINORITY INTEREST OF CENTERPOINT CORPORATION:

On January 15, 2002, Bion purchased a 57.7% majority interest in Centerpoint from a third party. As of December 31, 2005, the losses applicable to the minority interest in Centerpoint exceeded the minority interest in the equity capital of Centerpoint, therefore the losses attributable to the minority interest have been charged against the Company's earnings as there is no obligation of the minority interest to make good on such losses. If Centerpoint has future earnings, the Company shall be credited to the extent of the minority interest losses previously absorbed.

4. PREPAID SERVICES:

The Company has issued options to purchase Company stock to consultants in exchange for services. As of December 31, 2005, consultant options to purchase 625,833 shares of common stock were outstanding, of which 255,833 were fully vested. These options were valued using Black-Scholes option-pricing models. Prepaid services of \$72,163 in connection with fully vested options are being amortized on the straight-line method through December 31, 2007. The Company also issued stock to a consultant in exchange for services to be performed through June 30, 2007, of which \$60,000 is deferred as of December 31, 2005. As of December 31, 2005, these prepaid services are classified as follows:

Current	\$ 111,217
Non-current	<u>20,946</u>
	<u>\$ 132,163</u>

The remaining 370,000 options include service conditions and have graded vesting schedules through May 1, 2009. Generally for these agreements, the measurement date of the services occurs when the options vest. In accordance with Emerging Issues Task Force Issue ("EITF") 96-18, recognition of compensation cost for reporting periods prior to the measurement date is based on the then current fair value of the options. Any subsequent changes in fair value is recorded on the measurement date. Compensation cost in connection with options that are not fully vested as of December 31, 2005 is being recognized on a straight-line basis over the requisite service period for the entire award.

5. PROPERTY AND EQUIPMENT:

Property and equipment consists of the following as of December 31, 2005:

Equipment	\$ 339,868
Less accumulated depreciation and amortization	<u>267,246</u>
	<u>\$ 72,622</u>

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED BALANCE SHEET (CONTINUED)

6. DEFERRED COMPENSATION:

Effective April 1, 2003, the Company entered into a deferred compensation agreement with its president, Mark A. Smith. The agreement was subsequently extended through March 31, 2007. Under the agreement, the president earns compensation of \$150,000 annually, all of which has been deferred to date. Sums accrued through March 31, 2006 accrue interest at 6% per annum. The agreement allows for the conversion of the deferred compensation accrued through March 31, 2006 into the Company's common stock at the lower of the current market value at the time of conversion, or \$2.00 per share. Through July 1, 2007, conversions may occur by mutual agreement between Bion and the president. Bion may convert the deferred compensation, in whole or in part, at any date after July 1, 2007 and the convertible deferred compensation owed the president is mandatorily converted to common stock of the Company on July 1, 2009. The Company is accounting for this employee stock-based agreement under APB 25. At December 31, 2005 compensation due to the president was \$326,271 and the market value of the Company's common stock was \$4.00 per share. Therefore the Company has recorded the intrinsic value of the deferred compensation agreement at \$652,552 as of December 31, 2005.

Prior to March 31, 2003, the Company incurred management fees under various management agreements, with the D2 LLC Deferred Compensation Trust ("Trust") for management and consulting services. These fees totalled \$564,517, including interest at 6%, as of December 31, 2005. The services were provided in part by Dominic Bassani, the general manager of Dairy, who beneficially owns 50% of the Trust. In November 2005, the Trust agreed to accept payment on March 31, 2007, by conversion of the deferred compensation into common stock of the Company at the higher of the average price of the Company's common stock during the ten trading days ending March 27, 2007, or \$4.00 per share. At December 31, 2005, the market value of the Company's common stock was \$4.00, therefore the conversion feature had no intrinsic value at that date.

As of December 31, 2005, the Company has also recorded deferred compensation liabilities of \$105,000 to two consultants. This deferred compensation does not accrue interest and is non-convertible. Payment is to be made at the earlier of a date that the Company has in excess of \$2,000,000 in cash and cash equivalents or as decided by the Board of Directors.

As of December 31, 2005, the Company has deferred compensation as follows:

Current	\$ 105,000
Long-term (convertible)	<u>1,217,069</u>
	<u>\$ 1,322,069</u>

7. CONVERTIBLE NOTE – AFFILIATE:

As of December 31, 2005, the Company has a \$503,419 note payable to Bright Capital, Ltd. ("Brightcap"), for services provided to the Company by Dominic Bassani between March 31, 2003 and September 30, 2005. Effective March 31, 2005, Brightcap entered into an agreement to continue to provide Mr. Bassani's services to the Company through March 31, 2009. Under the agreement Brightcap earns compensation of \$300,000 annually with payment deferred. The note accrues interest at 6% per annum and allows for the conversion of compensation earned through September 30, 2005 into the Company's common stock at the lower of the current market value at the time of conversion or \$2.00 per share. Through January 1, 2007 conversions may occur by mutual agreement between Bion and Brightcap. Bion may convert the deferred compensation, in whole or in part, at any date after January 1, 2007 and, on July 1, 2009, the Company's obligation owed Brightcap is mandatorily convertible to common stock of the Company. The Company is accounting for this employee stock-based agreement under APB 25. At December 31, 2005, compensation due to Brightcap was \$503,419 and the market value of the Company's common stock was \$4.00 per share. Therefore the Company has recorded the intrinsic value of the deferred compensation agreement at \$1,006,838 as of December 31, 2005.

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED BALANCE SHEET (CONTINUED)

8. STOCKHOLDERS' EQUITY:

Common stock:

Holders of common stock are entitled to one vote per share on all matters to be voted on by common stockholders. In the event of liquidation, dissolution or winding up of the Company, the holders of common stock are entitled to share in all assets remaining after liabilities have been paid in full or set aside. Common stock has no preemptive, redemption or conversion rights. The rights of holders of common stock are subject to, and may be adversely affected by, the rights of the holders of any other series of preferred stock the Company may designate in the future.

Warrants:

As of December 31, 2005 the Company had the following common stock warrants outstanding:

	<u>Number of Shares</u>	<u>Exercise Price</u>	<u>Expiration Date</u>
Class J/SLAV	10,573	\$ 6.00	August 31, 2006
Class SVDB 1-6	800,000	\$ 3.00	July 31, 2013
Class SVDM-1	387,343	\$ 5.00	July 31, 2008
Class DB-1	600,000	\$ 1.00	January 31, 2014
Class A 1-3	600,000	\$ 2.50	May 14, 2015
Class SVMAS-1	67,500	\$ 3.50	May 31, 2009
Class SVMAS-1A	40,000	\$ 3.50	October 11, 2009
Class SVMAS-2	32,500	\$ 2.50	September 30, 2009
Class SVMAS-3	40,000	\$ 2.50	September 30, 2015
Class SVB 1-3	50,000	\$ 2.50	April 30, 2015
Class SVB-4	75,000	\$ 2.50	April 30, 2015
Class SVC 1-5	125,000	\$ 4.25	December 31, 2012
Class SV-SEI 1-2	41,667	\$ 1.50	June 30, 2009
Class C, D, E	725,000	\$ 2.50	April 30, 2015
Class O	<u>100,000</u>	\$ 3.00	December 31, 2008
	3,694,583		

The weighted average exercise for the outstanding warrants is \$2.73 and the weighted average life as of December 31, 2005 is 7.5 years.

Stock options:

The Company has various incentive plans (the "Plans") which provide for incentive stock options to be granted to selected employees and directors of the Company, and selected non-employee advisors to the Company. Options to purchase a stated number of the Company's common stock may be granted under the Plans. Terms of exercise and expiration of options granted under the Plans may be established at the discretion of an administrative committee appointed to administer the Plans, but no option may be exercisable for more than five-ten years. As of December 31, 2005, options outstanding under the Plans are summarized as follows:

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED BALANCE SHEET (CONTINUED)

8. STOCKHOLDERS' EQUITY (CONTINUED):

Stock options (continued):

<u>Incentive Plan</u>	<u>Options available under the Plan</u>	<u>Maximum Option Life in years</u>	<u>Options outstanding as of December 31, 2005</u>
2000	100,000	5	42,500
2001	150,000	10	20,000
2002	300,000	10	110,000
2003	750,000	10	478,833
2005	<u>750,000</u>	10	<u>714,500</u>
	<u>2,050,000</u>		<u>1,365,833</u>

There were 739,593 options exercisable as of December 31, 2005.

The Company applies APB Opinion 25 and related interpretations in accounting for equity instruments issued to employees. Accordingly, no compensation cost has been recognized for its employee stock options as all options had an exercise price equal to or greater than the market value of the Company's common stock at the date of grant.

The following table presents information relating to stock options outstanding as of December 31, 2005:

<u>Range of Exercise Prices</u>	<u>Shares</u>	<u>Weighted- Average Remaining Contractual Life-</u>	<u>Weighted- Average Exercise Price-</u>	<u>Shares</u>	<u>Weighted- Average Exercise Price</u>
\$2.00 - \$2.50	812,500	8.2	\$ 2.41	191,250	\$ 2.18
\$3.00 - \$3.50	420,333	2.6	\$ 3.00	415,333	\$ 3.00
\$4.00 - \$4.50	37,500	5.0	\$ 4.25	37,500	\$ 4.25
<u>\$5.00 - \$7.50</u>	<u>95,500</u>	<u>2.4</u>	<u>\$ 5.52</u>	<u>95,500</u>	<u>\$ 5.52</u>
	1,365,833	6.0	\$ 2.86	739,583	\$ 3.18

The Company had 925,752 options reserved for future issuance under all of the incentive plans as of December 31, 2005.

9. INCOME TAXES:

The Company has net operating loss carry-forwards ("NOLs") for tax purposes of approximately \$30,100,000 as of December 31, 2005. These NOLs expire on various dates between 2009 to 2025.

The utilization of the NOLs may be limited under Section 382 of the Internal Revenue Code.

The Company's deferred tax assets as of December 31, 2005, are estimated as follows:

	<u>December 31, 2005</u>
NOLs	\$ 10,200,000
Deferred compensation	<u>650,000</u>
	10,850,000
Valuation allowance	<u>(10,850,000)</u>
Net deferred tax assets	<u>\$ -</u>

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED BALANCE SHEET (CONTINUED)

9. INCOME TAXES (CONTINUED):

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

The Company has provided a valuation allowance of 100% of its net deferred tax asset due to the uncertainty of generating future profits that would allow for the realization of such deferred tax asset.

10. COMMITMENTS AND CONTINGENCIES:

Employment and consulting agreements:

The Company has an employment agreement with its president, Mark A. Smith, through March 31, 2007 providing \$150,000 per year compensation (See Note 6).

Effective March 31, 2005, an agreement with Brightcap, through which the services of the general manager of Dairy, Dominic Bassani, are provided, was extended through March 31, 2009. Under the terms of the agreement, Brightcap will be paid \$300,000 annually for Mr. Bassani's services (See Note 7).

Effective May 1, 2005, the Company entered into a four year consulting/employment agreement with a former officer and director of the Company, Salvatore Zizza. As of January 1, 2006, the former officer and director assumed the position of Chairman and director of Dairy, with an annual salary of \$300,000.

Effective May 1, 2005, the Company entered into a four year consulting/employment agreement with Jeff Kapell. Under the terms of the agreement, Mr. Kapell will provide part-time services to the Company for a period of 6 months during which the Company may elect to make him a full-time consultant/senior manager of the Company at a rate of \$120,000 per year. In April 2006, Mr. Kapell was appointed the Company's Vice President of Renewables.

On May 15, 2005 the Company declared contingent deferred stock bonuses of 640,000 shares to its key employees and consultants. The stock bonuses of 492,500 and 147,500 shares are contingent upon the Company's stock price exceeding \$10.00 and \$20.00 per share, respectively, and the grantees still being employed by or providing services to the Company at the time the target prices are reached.

During February and March of 2003, four members of the Company's core technical staff who had previously been terminated, returned to the Company to work at reduced compensation. While the Company does not have a legal obligation to pay the difference between the original compensation and the reduced compensation, if and when the Company has sufficient financial resources, it is the Company's intention to provide bonuses, over a one to two year period, to compensate for the reduced wages. As of December 31, 2005 the amount of reduced compensation amounted to approximately \$130,000.

Claims Contingency:

On May 6, 2002, Arab Commerce Bank Ltd. ("ACB"), an unaffiliated party, filed a complaint against the Company in the Supreme Court of the State of New York regarding \$100,000 of the Company's convertible bridge notes ("Notes") that were issued to ACB in March of 2000. The complaint includes breach of contract claim asserting that the Company owes ACB approximately \$285,400 plus interest or \$121,028 plus interest based on ACB's interpretation of the terms of the Notes and subsequent amendments. Effective June 30, 2001, the Company issued ACB 5,034 shares of common stock in full payment of the Notes based on the Company's interpretation of the Notes, as amended. The Company has filed an answer to the complaint denying the allegations. No activity has taken place on this lawsuit since early 2002. The Company believes that the ultimate resolution of this litigation will not have a material adverse effect on the Company, its operations or its financial condition.

BION ENVIRONMENTAL TECHNOLOGIES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED BALANCE SHEET (CONTINUED)

10. COMMITMENTS AND CONTINGENCIES (CONTINUED):

Claims Contingency (continued):

The Company, together with the former controlling persons of Centerpoint, and the Company's president are defendants in a class action derivative action lawsuit in Delaware Chancery Court (TCMP#3 Partners, LLP, et al v. Trident Rowan Group, Inc. et al, Civil Action No. 170-N). The claims against the Company primarily relate to a January 2002 financing transaction with Centerpoint, in which it is claimed the Company breached its fiduciary duties to Centerpoint and its shareholders and/or aided and abetted others in breaching their duties. Litigation is in the early stages of discover and motion practice. Settlement discussions are under way at the present time and the parties have participated in voluntary, non-binding mediation to attempt to resolve the disputed matters, which has led to a contingent settlement agreement. This agreement is contingent on settlement of a complaint to be filed by the Company against the former controlling shareholders of Centerpoint. Management believes the claims against the Company are without merit and intends to defend the claims if a settlement is not reached.

11. SUBSEQUENT EVENTS:

The Company granted options to a consultant on January 31, 2006 and March 1, 2006, to purchase 5,000 fully vested shares of the Company's common stock. 2,500 options are exercisable at \$4.75 per share and 2,500 are exercisable at \$6.00 per share and expire on December 31, 2009 and February 28, 2010, respectively.