



Arrow Energy Ltd.

2007 Consolidated Financial Statements

CONSOLIDATED FINANCIAL STATEMENTS

MANAGEMENT'S RESPONSIBILITY STATEMENT

The consolidated financial statements of Arrow Energy Ltd. and all information in this report are the responsibility of management and have been approved by the Board of Directors. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The consolidated financial statements include amounts that are based on estimates, which have been objectively developed by management using all relevant information. All financial and operating data in this report is consistent with the information in the consolidated financial statements.

Arrow Energy Ltd. maintains appropriate systems of internal control to give reasonable assurance that transactions are appropriately authorized, assets are safeguarded from loss or misuse and financial records are properly maintained to provide reliable information for the preparation of financial statements. Arrow Energy Ltd. has effective disclosure controls and procedures to ensure timely and accurate disclosure of material information relating to the Company which complies with the current requirements of Canadian securities legislation.

Deloitte and Touche LLP, an independent firm of chartered accountants, has been engaged to examine the financial statements and provide their auditor's report. Their report is presented with the consolidated financial statements.

The Board of Directors are responsible for ensuring that management fulfils its responsibilities for financial reporting and internal control. The Board of Directors carries out this responsibility principally through its Audit Committee. The Audit Committee is comprised entirely of independent directors and meets regularly with management and with the Company's external auditors to discuss the results of their audit examination and to review issues related thereto. The external auditors have full access to the Audit Committee with and without the presence of management. The Audit Committee reviews the consolidated financial statements and Management's Discussion and Analysis and recommends their approval to the Board of Directors.

Signed "*Chris Tesarski*"

Chris Tesarski
President & CEO

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Arrow Energy Ltd. as at December 31, 2007 and 2006 and the consolidated statements of operations, comprehensive loss and deficit and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance 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.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Calgary, Canada
April 23, 2008

Signed "Deloitte & Touche LLP"
Chartered Accountants

Consolidated Balance Sheets

Years Ended December 31

	2007	2006
ASSETS		
Current:		
Cash	\$ 155,692	\$ -
Accounts receivable	1,765,956	399,795
Deposits and prepaid expenses	236,566	127,596
	<u>2,158,214</u>	<u>527,391</u>
Capital assets (Note 5)	20,081,782	10,328,370
	<u>\$ 22,239,996</u>	<u>\$ 10,855,761</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES:		
Current:		
Accounts payable and accrued liabilities	\$ 2,783,684	\$ 1,081,688
Bank Loan (Note 8)	3,037,838	1,667,975
	<u>5,821,522</u>	<u>2,749,663</u>
Future income taxes (Note 10)	324,490	1,244,460
Asset retirement obligation (Note 6)	1,081,877	234,050
	<u>7,227,889</u>	<u>4,228,173</u>
SHAREHOLDERS' EQUITY:		
Share capital (Note 7)	14,738,683	9,743,897
Contributed surplus (Note 7(b))	6,306,827	482,368
Deficit	(6,033,403)	(3,598,677)
	<u>15,012,107</u>	<u>6,627,588</u>
	<u>\$ 22,239,996</u>	<u>\$ 10,855,761</u>

Commitments and contingencies (Note 11)
 Subsequent events (Note 14)
 Basis of Presentation – Going concern (Note 2)

APPROVED ON BEHALF OF THE BOARD:

(signed) "Richard Edgar", Director

(signed) "Jason Pack", Director

See accompanying notes to the financial statements

Consolidated Statements of Operations, Comprehensive Loss and Deficit

Years Ended December 31

	2007	2006
Revenue		
Petroleum and natural gas sales	\$ 4,532,810	2,405,769
Royalties	(1,200,980)	(451,322)
	<u>3,331,830</u>	<u>1,954,447</u>
Pipeline revenue	1,318,305	-
Other income	43,353	42,523
	<u>4,693,488</u>	<u>1,996,970</u>
Expenses		
Production and transportation	1,168,183	807,484
Pipeline	860,511	-
General and administrative	2,595,221	1,053,772
Reorganization costs	-	941,706
Interest	233,106	69,726
Stock based compensation (Note 7a)	288,833	183,579
Depletion, depreciation and accretion (Notes 5 and 6)	2,902,330	1,396,614
	<u>8,048,184</u>	<u>4,452,881</u>
Loss from operations	(3,354,696)	(2,455,911)
Loss on disposal of office equipment	-	8,388
Loss before income taxes	(3,354,696)	(2,464,299)
Income tax recovery		
Future	(919,970)	(743,650)
Net loss and comprehensive loss	(2,434,726)	(1,720,649)
Deficit, beginning of period	(3,598,677)	(1,880,885)
Interest receivable on share purchase loans	-	2,857
Deficit, end of period	<u>\$ (6,033,403)</u>	<u>\$ (3,598,677)</u>
Net loss per share		
Basic and diluted	\$ (0.14)	\$ (0.12)
Weighted average common shares (outstanding)		
Basic and diluted	17,079,862	14,138,914

See accompanying notes to the financial statements.

Consolidated Statements Cash Flows

Years Ended December 31

	2007	2006
CASH FLOWS RELATED TO THE FOLLOWING ACTIVITIES		
OPERATING:		
Net loss	\$ (2,434,726)	\$ (1,720,649)
Items not involving cash:		
Loss on disposal of office equipment	-	8,388
Depletion, depreciation and accretion	2,902,330	1,396,614
Stock compensation expense	288,833	183,579
Future income tax recovery	(919,970)	(743,650)
Abandonment expenditures	-	(32,195)
	<u>(163,533)</u>	<u>(907,913)</u>
Changes in non-cash working capital (Note 12)	(119,442)	146,244
	<u>(282,975)</u>	<u>(761,669)</u>
FINANCING:		
Increase in bank loan	1,369,863	1,667,975
Share purchase loan	(100,000)	56,826
Proceeds from issuance of share capital	2,480,021	-
Share issue costs	(196,729)	-
	<u>3,553,155</u>	<u>1,724,801</u>
INVESTING:		
Additions to capital assets	(2,038,402)	(1,458,981)
Disposal of capital assets	120,000	4,335
Acquisition of oil & gas assets (Note 4)	(1,542,393)	-
Changes in non-cash working capital(Note 12)	346,307	(322,186)
	<u>(3,114,488)</u>	<u>(1,776,832)</u>
Net increase (decrease) in cash	155,692	(813,700)
Cash, beginning of period	-	813,700
Cash, end of year	\$ 155,692	\$ -

See accompanying notes to the financial statements

Notes to Financial Statements

For the years ended December 31, 2007 and 2006

1. Nature of Operations

The principal business of Arrow Energy Ltd. (the "Company" or "Arrow") is the exploration for, exploitation, development and production of oil and natural gas reserves. All activity is conducted in Western Canada and comprises a single business segment.

2. Significant Accounting Policies

Basis of Presentation

The financial statements have been prepared using Canadian generally accepted accounting principles applicable to a going concern, which assumes Arrow will continue operations in the foreseeable future and be able to realize assets and satisfy liabilities in the normal course of business. The Company had negative cash flow from operations in the amount of \$282,975 and a working capital deficiency of \$3,663,308 as at December 31, 2007. The Company's ongoing ability to continue as a going concern is dependent on its ability to generate future profitable operations, secure additional sources of financing, and on the continued support of its lenders, creditors, and shareholders. The outcome of all these matters cannot be predicted at this time. The financial statements do not reflect adjustments to the carrying values and classification of assets and liabilities that might be necessary should the Company be unable to continue its operations.

Basis of Accounting

The consolidated financial statements include the accounts of Arrow Energy Ltd. and its wholly owned subsidiary, Castle Rock Petroleum Ltd. All inter-entity transactions and balances have been eliminated.

Cash and Cash Equivalents

The Company considers all highly liquid investments with maturities of three months or less at the date of purchase to be called cash and cash equivalents.

Exploration and Development Costs

The Company follows the full cost method of accounting for petroleum and natural gas properties whereby all costs relating to the acquisition, exploration and development of petroleum and natural gas reserves are capitalized in one Canadian cost centre and charged against income, as set out below. Such costs may include lease and land acquisition costs, geological and geophysical expenses, lease rentals and other costs on non-producing properties, costs of drilling and completing both productive and non-productive wells, production equipment and corporate expenses directly related to acquisition, exploration and development activities. These costs along with estimated future capital costs in the current reserve report related to the development of proved reserves (net of salvage values) are included in the depletion calculation.

Costs of acquiring and evaluating unproved properties may be excluded from the depletion base until it is determined whether proved reserves are attributable to the properties or impairment has occurred.

Significant Accounting Policies (continued)

Depletion of petroleum and natural gas properties and depreciation of production equipment is provided on the unit-of-production basis using estimated gross (before royalties) proved oil and natural gas reserves as determined by independent reservoir engineers. Natural gas reserves and production are converted, at a ratio of six thousand cubic feet of natural gas to one barrel of oil, for depletion and depreciation purposes.

Proceeds from the sale of properties are applied against capitalized costs, with no gain or loss recognized, unless such a sale would alter the rate of depletion and depreciation by 20% or more.

The Company calculates a ceiling test by comparing the carrying value of its property, plant and equipment to the sum of undiscovered cash flows expected to result from the future production of the Company's proved reserve base. If the sum of the undiscounted cash flows does not exceed the carrying value, the Company would then measure the amount of the impairment by comparing the carrying values of the petroleum and natural gas properties and equipment to the net present value of future cash flows from proved reserves. A risk-free interest rate is used to arrive at the net present value of future cash flows. Any excess of the carrying value over the Company's future cash flows would be recorded as a permanent impairment.

Asset Retirement Obligation

The Company recognizes the fair value of its asset retirement obligation (ARO) in the period in which it is incurred and when a reasonable estimate of fair value can be made. The fair value of the estimated ARO is recorded as a long-term liability with a corresponding increase in the carrying amount of the related asset. The capitalized amount is amortized on a unit-of-production basis over the life of the reserve. The liability is increased each period due to the passage of time and the amount of accretion is charged against earnings for that period. Increases or decreases to the ARO can also result from revisions to the original timing or amount of the estimated undiscounted cash flows.

Joint Venture Activities

Substantially all of the Company's exploration and development activities are conducted jointly with others and, accordingly, the financial statements reflect only the Company's proportionate interest in such activities.

Depreciation

Non-oil and gas assets are depreciated over their respective estimated useful lives using the declining-balance method at annual rates of 20% and 30%. Leasehold improvements are amortized on a straight-line basis over the lease.

The pipeline is amortized on a straight-line basis over 25 years.

Future Income Taxes

The Company accounts for future income taxes using the liability method. Under this method, future income tax assets and liabilities are measured based upon temporary differences between the carrying values of assets and liabilities and their tax basis. Future income tax expense is computed based on the change during the year in the future tax assets and liabilities. Effects of changes in tax laws and tax rates are recognized when substantively enacted.

Financial Instruments

The fair market value of financial instruments consisting of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate their carrying value due to their short term to maturity. The Company's bank loan also approximates its carrying value as the credit facility bears interest at the prevailing interest rate.

Significant Accounting Policies (continued)

Stock Based Compensation Plan

The fair value calculated related to stock options granted is deferred and charged against earnings, as stock compensation expense, over the vesting period of the stock options with a corresponding increase in contributed surplus.

Consideration paid to the Company upon the exercise of the stock options is recorded as an increase to share capital, and an adjustment is made to transfer to share capital the compensation expense previously recognized in contributed surplus for the specific stock options exercised.

The Company has not incorporated an estimated forfeiture rate for stock options in determining the stock option fair value in order to calculate its compensation expense, as the Company has assumed that all stock options granted will vest. Accordingly, forfeitures are accounted for as they occur and are treated as a change in estimate. The cumulative effect of the change on current and prior periods is recognized in the period of the change in estimate for unvested options that are forfeited or cancelled.

Revenue Recognition

Petroleum and natural gas sales are recognized when title passes from the Company to the purchaser. Pipeline revenue is recognized when the services have been provided.

Measurement Uncertainty

The amounts recorded for depletion and depreciation of petroleum and natural gas properties and equipment, the asset retirement obligation and the amount used for the ceiling test calculation are based on estimates of proven reserves, production rates, oil and natural gas prices, future costs and other relevant assumptions.

The amounts disclosed relating to the fair value of stock options issued are based on estimates of the expected lives of the options, expected stock price volatility, expected dividends and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty, and the effect of changes in such estimates on the financial statements of future periods could be significant.

Per Share Information

Per share information is calculated using the weighted average number of shares outstanding during the year. The treasury stock method is used in calculating diluted earnings per share. This method assumes that only "in-the-money" stock options and warrants are exercised and that any proceeds and unrecognized stock based compensation expense would be used to purchase common shares at the average market price during the year.

3. Changes in Accounting Policies

On January 1, 2007, the Company adopted three new standards issued by the CICA relating to the accounting for and disclosure of financial instruments. Section 3855 – "Financial Instruments – Recognition and Measurement" prescribes when a financial asset, financial liability, or non-financial derivative is to be recognized on the balance sheet as well as its measurement amount depending on its classification. This Section also specifies how gains and losses on financial instruments are to be presented. Section 3865 – "Hedges" expands on and replaces Accounting Guideline 13 – "Hedging Relationships" by specifying how hedge accounting is to be applied and what disclosures are necessary when it is applied. Section 1530 – "Comprehensive Income" introduces new standards for reporting and disclosure of comprehensive income. Comprehensive income is the change in equity of the Company during that period from transactions and other events and circumstances from non-owner sources including changes in the fair value of financial instruments designated as cash flow hedges as well as foreign currency translation amounts related to self-sustaining foreign operations.

Changes in Accounting Policies (continued)

At January 1, 2007 and December 31, 2007 the Company's financial instruments included cash, accounts receivable, bank loan, and accounts payable and accrued liabilities. Cash is classified as held for trading and is measured at fair value, accounts receivable is classified as loans and receivables and is measured at amortized cost. The financial liabilities are all classified as other liabilities and are measured at amortized cost. The fair value of these financial instruments approximate their carrying value due to their short-term maturity or, as with the bank loan, it bears interest at the prevailing interest rate.

The Company does not hold any derivative financial instruments or any embedded derivatives and does not apply hedge accounting under Section 3865. The Company selected January 1, 2003 as its transition date for accounting of any potential embedded derivatives.

The Company has adopted these sections retroactively without restatement. The classification of the Company's opening balances for financial instruments as at January 1, 2007 has resulted in no material gains or losses that require either separate presentation in other comprehensive income or recognition in earnings (losses).

The Company adopted CICA Handbook Section 1506, Accounting Changes, the only effect of which is to provide disclosure and the resulting impact to the Company when an entity has not applied a new source of generally accepted accounting principles that has been issued but is not yet effective.

This applies to CICA Handbook Sections 3862, "Financial Instruments Disclosure," and 3863, "Financial Instruments Presentation," which are required to be adopted for fiscal years on or after October 1, 2007. The Company intends to adopt these standards January 1, 2008 and it is expected that the only effect on the Company's consolidated financial statements will be incremental disclosures regarding the significance of financial instruments for the entity's financial position and performance; and the nature, extent and management of risks to which the entity is exposed arising from financial instruments.

As of January 1, 2008, the Company is required to adopt CICA Handbook Section 1535, Capital Disclosures, which requires entities to disclose their objectives, policies, and processes for managing capital, and in addition, whether the entity has complied with any externally imposed capital requirements. The Company is assessing the impact of this new standard on its consolidated financial statements.

In February 2008, the CICA issued Section 3064 *Goodwill and Other Intangible Assets*, replacing Section 3062 *Goodwill and Other Intangible Assets* and Section 3450 *Research and Development Costs*. Various other changes have been made to other sections of the CICA Handbook for consistency. The new Section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Corporation will adopt the new standard for its fiscal year beginning January 1, 2009. The new Section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. This will have no material impact on the Company.

In January 2006, the CICA Accounting Standards Board (AcSB) adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards in Canada for public companies are expected to converge with International Financial Reporting Standards (IFRS) by the end of 2011. Arrow continues to monitor and assess the impact of convergence of Canadian GAAP and IFRS.

4. Property Acquisition

On February 1, 2007, the Company acquired the oil and gas assets of Tirmoil, a related party. Tirmoil owned at the time of acquisition approximately 65% of all of the outstanding common shares of Arrow Energy Ltd. The acquisition included \$450,172 of assumed debt and \$592,221 of

Property acquisition (continued)

purchase price adjustments. The Company commenced reporting production from the acquisition date on February 1, 2007. The acquisition was accounted for as a related party transaction and measured in these financial statements at the carrying amount of the oil and gas assets as previously recognized in the accounts of Tirmoil. The difference between the amount paid of \$1,042,393 and the carrying amount of \$6,431,518 has been credited to contributed surplus (Note 7(b)).

On October 25, 2007, the Company entered into an agreement whereby the Company acquired from two private vendors (the "Vendors") 100% of their jointly owned petroleum and natural gas interests in the vicinity of Carstairs, Alberta. In consideration for this acquisition, Arrow paid to the Vendors a total of \$1,800,000 as follows: (a) \$700,000 paid by cash (\$350,000 on closing and \$350,000 plus interest at 8% six months from closing); and (b) \$1,100,000 by issuance of 2,000,000 units of Arrow at a price of \$0.55 per unit. Each unit is comprised of one (1) common share and one (1) warrant entitling the holder to purchase on flow through common share at a price of \$0.70 per common share exercisable until June 30, 2008. The fair value of the warrants has been calculated using the Black Scholes pricing model based on the following assumptions: risk-free of 4.5%, expected life of 0.67 years, no dividends and expected volatility of 75%.

Business Acquisition

On September 28, 2007 Arrow acquired all the outstanding shares of Castle Rock Petroleum Ltd., a public company trading on the TSX Venture Exchange. Arrow issued 4,180,325 common shares valued at \$1,755,737 before transaction costs. Arrow exchanged one Arrow Common Share for every five Castle Rock "A" Shares and one Arrow Common Share for each one half of a Castle Rock B Share.

The acquisition has been accounted for using the purchase-price method. Management has estimated the fair market value on September 28, 2007 based on currently available information as follows:

Consideration:	
Common Shares	\$ 1,755,737
Transaction costs	54,598
	<hr/>
	\$ 1,810,335
<hr/>	
Net Assets Received at Estimated Fair Value	
Cash	\$ 381,745
Accounts receivable	381,083
Prepaid	29,827
Property, plant & equipment	1,559,127
Accounts payable	(453,556)
Asset retirement obligation	(87,891)
	<hr/>
	\$ 1,810,335

In relation to the Castle Rock Acquisition, the Company has made its best estimate as to the net assets acquired and the consideration given. The final purchase price adjustment has not yet been determined by the Company and the vendor, and all costs have not yet been finalized. Therefore, the above amount may be subject to adjustment.

These financial statements incorporate the operations of the Castle Rock Acquisition from September 28, 2007 forward.

5. Capital Assets

	December 31, 2007		
	Cost	Accumulated Depletion and Depreciation	Net Book Value
Petroleum and natural gas properties	\$23,032,566	\$6,663,254	\$16,369,312
Pipeline	3,740,798	112,225	3,628,573
Office equipment and furniture	121,045	37,148	83,897
	\$26,894,409	\$6,812,627	\$20,081,782
	December 31, 2006		
	Cost	Accumulated Depletion and Depreciation	Net Book Value
Petroleum and natural gas properties	\$14,253,636	\$3,944,999	\$10,308,637
Office equipment and furniture	45,575	25,842	19,733
	\$14,299,211	\$3,970,841	\$10,328,370

Petroleum and natural gas properties as at December 31, 2007 include costs of \$2,353,420 (December 31, 2006 - \$1,040,310) relating to undeveloped land, which has been excluded from the amounts subject to depletion.

The pipeline which was included in the Tirmoil Acquisition is not included in the full-cost pool as it is amortized on a straight-line basis over 25 years.

The ceiling test was applied in accordance with the full cost accounting guidelines and no impairment resulted. The future prices used in the ceiling test calculation are based on the December 31, 2007 benchmark commodity price forecast of our independent reserve evaluators as follows:

Year	Price Forecast	
	Oil (CDN \$/Bbl)	Natural Gas (CDN \$/Mcf)
2008	88.17	6.51
2009	84.54	7.22
2010	83.16	7.69
2011	81.26	7.70
2012	80.73	7.61
2013	81.25	7.78
2014	82.88	7.96
2015	84.55	8.14
Thereafter (inflation %)	+2%/yr	+2%/yr

6. Asset Retirement Obligation

The total future asset retirement obligation was estimated by management based on the Company's net ownership interest in all wells and facilities, estimated costs to reclaim and abandon the wells and facilities, and the estimated timing of the costs to be incurred in future periods. The Company has estimated the net present value of its total asset retirement obligation to be \$1,081,877 as at December 31, 2007 (December 31, 2006 - \$234,050) based on a total future liability of \$4,855,639 (December 31, 2006 - \$449,985). These payments are expected over the next 20 years with the majority of costs incurred between 2010 and 2026. The Company's credit adjusted risk free rate of 8.0% and an inflation rate of 2.0% were used to calculate the present value of the asset retirement obligation.

A reconciliation of the asset retirement obligation is provided below:

	December 31, 2007	December 31, 2006
Carrying amount, beginning of period	\$ 234,050	\$ 245,836
Increase in obligations	223,615	6,468
Pipeline	563,666	-
Settlement of liabilities	-	(32,195)
Accretion expense	60,546	19,871
Change in estimate	-	(5,930)
Carrying amount, end of period	\$ 1,081,877	\$ 234,050

7. Share Capital

	Number of Shares	Amount
Balance, December 31, 2005 and 2006	14,138,914	\$ 9,743,897
Shares deposited into treasury	(50,000)	(34,500)
Shares issued for acquisition	4,180,325	1,755,737
Units issued for private placement		
Shares issued net of costs	5,714,488	1,181,273
Shares issued on a flow through basis net of cost basis	1,250,000	480,000
Note Receivable on flow through issue	-	(100,000)
Shares issued for a P&NG acquisition	2,000,000	1,100,000
Balance, December 31, 2007	27,233,727	\$ 14,126,407

	Number of Warrants	Amount
Balance, December 31, 2006	-	-
Units issued for private placement		
Broker warrants	285,714	\$ 46,286
Warrants	2,857,244	463,731
Warrants issued for a P&NG acquisition	2,000,000	102,259
Balance, December 31, 2007	5,142,958	\$ 612,276

Share Capital (continued)

(I) On September 28, 2007 Arrow acquired all the outstanding shares of Castle Rock Petroleum Ltd. ("Castle Rock") a public company trading on the TSX Venture Exchange. Arrow issued 4,180,325 common shares valued at \$1,755,736 before transaction costs. Arrow exchanged one Arrow Common Share for every five Castle Rock A Shares and one Arrow Common Share for each one-half of a Castle Rock B Share.

(II) On September 28, 2007 Arrow issued 5,714,488 units ("Units") at a price of \$0.35 per Unit for proceeds of \$2,000,020. Each Unit is comprised of one (1) common share ("Common Share") and one-half (½) Common Share purchase warrant. Each whole warrant entitles the holder to purchase one (1) additional Common Share at a price of \$0.50 per Common Share for a period of twenty-four (24) months following the date of closing; however, if after four months and one day following the closing date the closing price of the Common Shares is equal to or exceeds \$0.75 for 20 consecutive days, then the warrants shall automatically accelerate to expire on the date which is 30 days after the 20 days. The securities issued have a four (4) month hold period which expired on January 29, 2008.

In connection with the private placement, Arrow paid fees totaling \$196,729 and issued Broker Options exercisable for a total of 571,428 Units ("Broker Unit") at a price of \$0.35 for a period of twenty-four (24) months from the closing date. Each unit has an option and warrant attached. If the option is exercised, the warrant can then be exercised. The fair value of the option is \$112,001. The fair value of the warrant is \$46,286. Each Broker Unit is exercisable at the same price and on the same terms and conditions as the Units. The fair value has been calculated using the Black Scholes pricing model based on the following assumptions: risk-free rate of 4.5%, expected life of two years, no dividends and expected volatility of 90%.

(III) On November 20, 2007 and in connection with a P&NG acquisition, Arrow issued to two private vendors 2,000,000 units of Arrow at a price of \$0.55 per unit. Each unit is comprised of one (1) common share and one (1) warrant entitling the holder to purchase one (1) flow through common share at a price of \$0.70 per common share exercisable until June 30, 2008. The fair value of these warrants is \$102,259.

(IV) On December 31, 2007 Arrow issued 1,250,000 shares on a flow-through basis for gross proceeds of \$500,000 on December 31, 2007 and for which Arrow paid fees totaling \$20,000 to Northern Securities Inc.

(a) Stock Options

Under the Company's stock option plan, options may be granted in such numbers and with such vesting provisions as the Board of Directors may determine. At the time an option is granted, the Board will determine the exercise price of the option. The aggregate number of shares that may be available for issuance, from time to time, under the plan shall not exceed 20% of outstanding shares. In addition, the aggregate number of shares so available for issuance under the plan to any one person in any 12 month period shall not exceed 5% of the issued shares calculated at the time of grant of the option.

The Company incurred stock-based compensation expense of \$288,833 for the full year, compared with \$183,579 for 2006.

	Number of Options	Weighted average exercise price
Balance at December 31, 2005	840,000	\$ 0.80
Granted during the period	1,210,000	0.45
Expired during the period	(155,000)	0.75
Cancelled during the period	(685,000)	0.82
Balance at December 31, 2006	1,210,000	\$ 0.45
Forfeited during the period	(635,000)	0.45

	Number of Options	Weighted average exercise price
Granted during the period	1,043,750	0.40
Broker options issued	571,428	0.35
Balance at December 31, 2007	2,190,178	\$ 0.40

The following table summarized information about stock options outstanding as at December 31, 2007:

Exercise Price	Options Outstanding	Exercisable	Weighted Average Years to Expiry
\$0.45	893,750	606,250	4.1
\$0.38	725,000	725,000	4.5
\$0.35	571,428	571,428	1.8
Total	2,190,178	1,902,678	3.6

The total stock options exercisable at December 31, 2007 was 1,902,678 (2006 – 293,334) at a weighted average exercise price of \$0.39 (2006 - \$0.45). The weighted average fair market value of options granted during the year ended December 31, 2007 was \$0.27 (2006 – \$0.29) per option. The fair value of each option granted and broker option was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	December 31, 2007	December 31, 2006
Risk-free interest rate	4.5%	4.03%
Estimated hold period prior to exercise (years)	5	5
Volatility in the price of the Company's common shares	90.0%	94.3%

(b) Contributed Surplus

A summary of the change in the Company's contributed surplus balance for the year ended December 31, 2007 is as follows:

Balance, December 31, 2005	\$ 298,789
Stock-based compensation expense	183,579
Balance, December 31, 2006	\$ 482,368
Acquisition of oil and gas assets (Note 4)	5,389,125
Cancellation of shares	34,500
Stock-based compensation expense	288,833
Fair value of common shares included in broker units	112,001
Balance December 31, 2007	\$6,306,827

8. Operating Line

During the third quarter of 2007, Arrow re-negotiated its loan facility from \$4,200,000 to \$3,500,000 with an institutional bank. The formal agreement was not signed until November 28, 2007. The facility bears interest at the bank's prime lending rate plus 50 basis points, payable monthly and is secured by a fixed and floating charge on the assets of the Company. The credit facility is subject to annual review. On April 2, 2008, the facility was renegotiated and the loan facility increased from \$3,500,000 to \$6,000,000. This increase reflects the recognition by the bank of the Company's higher reserve base at December 31, 2007, as evaluated by Sproule & Associates Ltd, an

Operating Line (continued)

independent engineering firm based in Calgary, Alberta. At December 31, 2007 Arrow was not in compliance with their debt covenants relating to working capital. However, the Alberta Treasury Branch has acknowledged that Arrow Energy Ltd. was in default of the established working capital covenant with a ratio of 0.94:1 and has waived this breach.

9. Financial Instruments

Commodity Price Risk

The Company has commodity price risk associated with its sale of oil and gas.

Credit Risk

A substantial portion of the Company's accounts receivable are with customers and joint venture participants in the oil and natural gas industry and are subject to normal industry credit risks.

Interest Rate Risk

Arrow is exposed to interest rate cash flow risk on floating interest rate bank debt due to fluctuations in market interest rates. The remainder of the Company's financial assets and liabilities are not exposed to interest rate risk.

Financial Instruments

Financial instruments of the Company carried on the balance sheet consist mainly of cash, accounts receivable, accounts payable and accrued liabilities, bank loan.

At December 31, 2007 there were no significant differences between the carrying value of these financial instruments and their estimated fair value.

10. Income Taxes

The future income tax recovery for 2007 and 2006 varies from the amount that would be computed by applying the combined federal and provincial income tax rates of 32.12% (2006 – 34.49%) to the loss before income taxes as shown below:

	December 31, 2007	December 31, 2006
Computed income tax recovery	\$ (1,077,207)	\$ (849,933)
Changes resulted from:		
Resource allowance		6,823
Permanent difference	98,688	49,475
Rate adjustment and other	58,549	49,985
Income tax (recovery) provision	\$ (919,970)	\$ (743,650)

Income Taxes (continued)

The major components of the future income tax liability at December 31, 2007 and 2006 using the combined federal and provincial income tax rates of 25.00% (2006 – 31.47%) are as follows:

	December 31, 2007	December 31, 2006
Property and equipment	\$ (953,054)	\$ (1,571,464)
Share issue costs deductible for tax purposes	65,580	59,117
Asset retirement obligation	270,469	73,660
Non-capital losses carried forward	292,515	194,227
	\$ (324,490)	\$ (1,244,460)

The Company has a non-capital loss for income tax purposes of \$ 1,170,061, which can be used to offset income in future periods. This loss expires in 2027.

11. Commitments and Contingencies

(a) The Company has remaining lease commitments for office space of \$128,000, and \$973,674 which expire on August 31, 2008, and July 1, 2012 respectively.

(b) The Company is involved in a legal claim associated with the normal course of business. At this time, in the opinion of management, this matter is not reasonably expected to result in a material adverse effect on the Company's financial position.

(c) In 2007 the Company committed to renounce \$500,000 of exploration expenses pursuant to a flow-through share issue completed December 31, 2007. Arrow has until December 31, 2008 to incur these exploration expenditures. The Corporation will be subject to a Part XII.6 tax based on the prescribed rate and the balance of exploration expenditures not yet incurred.

12. Supplementary Cash Flow Information

The following table details the components of non-cash working capital provided by (used in) operations.

	December 31, 2007	December 31, 2006
Accounts receivable	\$ (1,366,161)	\$ 1,172,390
Deposits and prepaid expenses	(108,970)	(45,361)
Accounts payable and accrued liabilities	1,701,996	(1,302,971)
	226,865	(175,942)
Operating	(119,442)	146,244
Investing	\$ 346,307	\$ (322,186)

13. Related-Party Transactions

For the year ended December 31, 2007, Arrow has \$13,574 (December 31, 2006: \$37,906) included in legal fees and accounts payable to Parlee McLaws LLP of which a director of Arrow is a partner. Parlee McLaws is legal council for Arrow Energy Ltd.

At December 31, 2007, the Company entered into a loan agreement with the President of the Company to provide a loan in the amount of \$100,000 for the purchase of flow-through shares of the Company. The loan agreement is secured by 250,000 common shares of the Company.

Related-Party Transactions (continued)

At December 31, 2007 the Company has a payable to the Peavine Métis Settlement in the amount of \$71,899, to the Métis Settlement General Council in Trust for Peavine for \$165,104 and \$146,307 to Tirmoil Energy Ltd. These payables relate to revenues earned on land from participation in joint ventures. The Peavine Métis Settlement owns 100% of Tirmoil Energy Ltd. Tirmoil Energy Ltd. is the controlling shareholder of Arrow Energy Ltd.

14. Subsequent Events

Arrow has entered into an agreement to acquire from a private oil and gas company, producing properties in northern Alberta. The purchase price for these fixed assets was \$4,100,000 and closed on April 1, 2008.