



**Arrow Energy Ltd.**

**Q1 2008 Management's Discussion and Analysis**

## Management Discussion and Analysis

This Management Discussion and Analysis (“MD&A”), compared to the results for the three months ended March 31, 2007 is management’s assessment of financial condition and results of operations of Arrow Energy Ltd. (“Arrow” or the “Company”) for the 3-months ended March 31, 2008 and should be read in conjunction with the audited financial statements for the year ended December 31, 2007. These documents, along with other statutory filings, are available on SEDAR at [www.sedar.com](http://www.sedar.com) and at the Company’s Web site at [www.arrow-energy.com](http://www.arrow-energy.com). This MD&A has been approved by the Board of Directors and has been prepared with the oversight of the audit committee.

### Basis of Presentation

The financial data presented in this MD&A has been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”). The preparation of financial statements in conformity with GAAP requires management 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, and the reported amounts of revenues and expenses during the period. Actual results could differ from these estimates.

### Non-GAAP Measurements

This MD&A may contain the term “cash flow from operations”, which should not be considered an alternative to, or more meaningful than, cash flow from operating activities as determined in accordance with Canadian GAAP; it is used by Arrow to analyze operating performance, leverage and liquidity. Cash flow from operations as presented does not have any standardized meaning prescribed by Canadian GAAP and therefore may not be comparable with the calculation of similar measures by other entities. Cash flow from operations per share is calculated using the same weighted average number of shares outstanding used in the calculation of income per share. Cash flow from operations represents cash flow from operating activities expressed before changes in non-cash working capital and asset retirement costs and is reconciled to net loss on the Statement of Cash Flows.

Arrow also uses “operating netbacks” as a key performance indicator of field results by commodity. Operating netbacks do not have a standardized meaning prescribed by Canadian GAAP and therefore may not be comparable with the calculation of similar measures by other companies. Operating netbacks are determined by deducting royalties and operating, processing and transportation expenses from petroleum and natural gas sales.

Cash flow from operations and operating netbacks are not intended to represent operating profits, nor should they be viewed as an alternative to cash flow provided by operating activities, net earnings or other measures of financial performance calculated in accordance with Canadian GAAP.

### Forward Looking Statements

This disclosure includes forward-looking statements and assumptions respecting the Company’s strategies, future operations, expected financial results, financing sources, commodity prices, costs of production and quantum of oil and natural gas reserves and discusses certain issues, risks and uncertainties that can be expected to impact on any of such matters. By their nature, forward-looking statements are subject to numerous risks and uncertainties that can significantly affect future results. Actual future results may differ materially from those assumed or described in such forward-looking statements as a result of the impact of issues, risks and uncertainties whether described herein or not, which the Company may not be able to control. The reader is therefore cautioned not to place undue reliance on such forward-looking statements. The Company disclaims any intention or obligation to update or revise these forward-looking statements, as a result of new information, future events or otherwise.

## BOE Presentation

All barrels of oil equivalent ("BOE") conversions are based on the widely used conversion ratio of six thousand cubic feet ("Mcf") of natural gas to one barrel ("bbl") of oil. BOEs may be misleading, particularly if used in isolation. A BOE conversion ratio of 6 Mcf: 1 bbl is based upon an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

## Description of Business

Arrow Energy Ltd. was incorporated August 21, 2001. On May 3, 2004 Arrow Energy Ltd. amalgamated with 1095862 Alberta Ltd. and then with Red Chip Inc. Throughout these amalgamations, the Company retained the name Arrow Energy Ltd.

Tirmoil Energy Ltd., through a successful takeover bid, succeeded in acquiring control of Arrow Energy Ltd. effective September 1, 2006.

On September 28, 2007, by way of a Plan of Arrangement, Castle Rock Petroleum Ltd. became a wholly owned subsidiary of Arrow Energy Ltd.

Arrow is a Calgary, Alberta based public company engaged in the acquisition, exploration, development and production of petroleum and natural gas reserves in Alberta. The Company's common shares are listed on the TSX Venture Exchange "TSX-V" under the trading symbol "AOF".

## Quarterly Information

The following table summarizes revenue from petroleum and natural gas sales, net of royalties, cash flow from operations and net income for Arrow for the periods indicated.

Quarterly Financial Data (\$)	2008	2007				2006		
	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30
Production revenue, net of royalties	<b>747,575</b>	555,981	1,179,571	946,886	649,392	402,351	465,293	490,545
Pipeline revenue	<b>272,351</b>	325,252	356,990	383,046	253,017	-	-	-
Cash flow from operations <sup>(1)</sup>	<b>(262,426)</b>	(793,330)	495,472	267,101	(132,776)	(234,800)	(778,474)	(44,748)
Per share basic	<b>(\$0.01)</b>	(\$0.05)	\$0.03	\$0.02	(\$0.01)	(\$0.02)	(\$0.06)	\$0.00
Per share diluted <sup>(2)</sup>	<b>N/A</b>	N/A	N/A	N/A	N/A	N/A	N/A	\$0.00
Net income (loss)	<b>(594,676)</b>	(1,140,703)	(428,561)	(273,174)	(592,288)	(630,307)	(806,002)	(149,307)
Per share basic	<b>(\$0.02)</b>	(\$0.07)	(\$0.03)	(\$0.03)	(\$0.04)	(\$0.04)	(\$0.06)	(\$0.02)
Per share diluted <sup>(2)</sup>	<b>N/A</b>	N/A	N/A	N/A	N/A	N/A	N/A	N/A

(1) Cash flow from operations and cash flow per share are non-GAAP terms that represent cash generated from operating activities before changes in non-cash working capital and other operating items. Arrow's cash flow from operations may not be comparable to other companies'. Arrow considers cash flow a key measure of performance as it demonstrates Arrow's ability to generate the cash flow necessary to fund future capital investments.

(2) A diluted per-share calculation would be anti-dilutive and is therefore not applicable.

## Corporate Developments

On April 1, 2008, Arrow acquired a producing property near its Peavine core area in northern Alberta (Gift Lake area) from a private company for a total consideration of \$4.1 million. As the transaction was made effective October 1, 2007, the cash back to Arrow after adjustments at closing was approximately \$1.0MM. At the time of acquisition, production from the properties was approximately 97 barrels of oil equivalent per day, consisting of 94 percent oil and 6 percent natural gas. The acquisition represented development of the company's asset base in and around another one of Alberta's major Métis Settlements, Gift Lake Métis Settlement.

On April 2, 2008, Arrow reached an agreement with its lender to extend its credit facility from \$3.5MM to \$6.0MM. On May 21, 2008, the facility was again revised to \$6.5MM.

On April 16, 2008, Arrow announced the appointment of Richard Edgar, P. Geol. to the position of Executive Chairman, Richard Ballak, CGA to the position of Corporate Controller, and Jorge Aviles to the position of Coordinator of Corporate Affairs.

On May 2, 2008, the Company entered into an agreement relating to the disposition of certain oil and gas properties within the Hays Grand Forks area. The consideration received after adjustments totaled \$453,701.

## Results of Operations

\$	Q1 2008	Q1 2007	Q4 2007
<b>REVENUES</b>			
Petroleum and natural gas revenue	983,722	891,838	989,697
Royalties	(236,147)	(242,446)	(433,716)
Pipeline revenue	272,351	253,017	325,252
Other income	8,318	9,220	(5,838)
	<b>1,028,244</b>	911,629	875,395
<b>EXPENSES</b>			
Operating expense	466,160	305,552	550,452
Transportation expense	9,052	12,738	28,802
Pipeline expense	182,741	111,259	203,159
General and administrative expense	574,752	575,481	803,638
Depletion, depreciation and accretion expense	528,056	678,840	646,862
Interest and Part XII.6 tax	57,965	39,375	82,673
Stock-based compensation expense	13,400	19,790	53,304
	<b>1,832,126</b>	1,743,035	2,368,890
Loss from operations	<b>(803,882)</b>	(831,406)	(1,493,495)
Net loss before taxes	<b>(803,882)</b>	(831,406)	(1,493,495)
Future income tax recovery	<b>(209,206)</b>	(233,118)	(352,792)
Net loss	<b>(594,676)</b>	(598,288)	(1,140,703)
Net loss per share, basic and diluted	<b>(0.02)</b>	(0.04)	(0.07)

## Drilling Activity

The following table summarizes the results of the wells that Arrow drilled or participated in drilling for the quarter ended March 31, 2008 and 2007, respectively:

	Three Months ended March 31 2008		Three Months ended March 31 2007	
	Gross	Net	Gross	Net
Natural gas	-	-	1.00	0.18
Oil	-	-	1.00	0.25
Dry & abandoned	-	-	-	-
<b>Total</b>			<b>2.0</b>	<b>0.43</b>

## Oil and Natural Gas Wells

The following table summarizes Arrow's interest, as at March 31, 2008, in wells that are producing or which Arrow considers to be capable of production:

Producing Oil		Producing Natural Gas		Non Producing Natural Gas	
Gross	Net	Gross	Net	Gross	Net
5.00	1.45	9.00	4.10	9.00	4.10

## Undeveloped Land Holdings

The undeveloped land holdings of Arrow as at March 31, 2008 and 2007, respectively, are set forth in the following table:

	Undeveloped Land			
	Gross Acres		Net Acres	
	2008	2007	2008	2007
<b>Total</b>	<b>32,646</b>	<b>18,240</b>	<b>18,610</b>	<b>10,952</b>

## Production

Arrow's average production for the three months ended March 31, 2008 was 153 BOE/d compared with 181 BOE/d in the three months ended March 31, 2007. The 14-01-59-27 W4/0 Apache operated well which produces 45 BOE/d net to Arrow has been shut in for February and March of 2008. Arrow is in discussions with the operator to assume operatorship of this well and resume production in June of 2008. Arrow anticipates an exit production level for Q2 of 2008 of 300 BOE/d, of which 100 BOE/d is reflective of the Gift Lake acquisition from a private company, which closed April 2, 2008.

Volumes	Three months ended March 31	
	2008	2007
Oil (bbl/d)	82	83
Natural gas (Mcf/d)	429	591
<b>Total (BOE/d at 6:1)</b>	<b>153</b>	<b>181</b>

## Commodity Prices

For Q1 2008, the Company's average realized prices on natural gas increased by 8 percent from the prior comparable quarter from \$7.47/Mcf of natural gas to \$8.04/Mcf.

The average price per barrel of oil received in Q1 was \$96.58/BOE, compared with \$66.83/BOE in the prior-year period; an increase of 45%. The West Texas Intermediate ("WTI") oil price per barrel rose to an average of US\$97.86 in Q1 2008 from US\$58.09 in Q1 of 2007. Part of this significant quarter-over-quarter increase in oil prices, however, was offset by the stronger Canadian dollar.

Three months ended March 31		
Prices received	2008	2007
Oil (\$/bbl)	<b>\$96.58</b>	\$66.83
Natural gas (\$/Mcf)	<b>8.04</b>	7.47
Average (\$/BOE)	<b>73.59</b>	55.21
Benchmark prices		
WTI (US\$/bbl)	<b>\$97.86</b>	\$58.09
Cdn/US average exchange rate	<b>0.995</b>	0.853
Edmonton Par (\$/BOE)	<b>98.08</b>	67.61
Alberta spot (\$/Mcf)	<b>7.77</b>	7.26

## Revenue

For Q1, petroleum and natural gas revenue increased 10 percent to \$983,722 from \$891,838 for the same period in 2007 due to higher prices received.

Three months ended March 31			
	2008	2007	Change
Natural Gas sales	<b>\$ 299,318</b>	\$ 397,506	-24.7%
Crude Oil sales	<b>660,107</b>	486,945	35.56%
Natural Gas liquids sales	<b>24,297</b>	7,387	228.9%
Petroleum & Natural Gas revenue	<b>\$ 983,722</b>	\$ 891,838	10.3%

Pipeline income for the first quarter of 2008 totaled \$272,351 versus \$253,017 for the months of February and March of 2007. The total volume of oil that passed through the pipeline for Q1, 2008 was 145,856 BOE, versus 135,504 BOE for Q1, 2007, at an average tariff of \$1.87 per BOE. Arrow acquired this asset effective February 1, 2007. On March 26, 2008, the company announced that it had received approval from Alberta Sustainable Resource Development, subject to filing normal course regulatory documentation to begin construction of the "Peavine Connector Road". The Arrow owned and operated oil pipeline on Peavine is currently operating at 25% capacity and will directly benefit from oil being able to be transported to and processed at its pipeline battery. Arrow intends to add infrastructure to its current facility to handle significantly more volume from the oilfields directly north of Peavine that would be easily accessed from the connector road.

## Royalties

Royalty expenses increased 3 percent from \$242,446 (\$16.99/BOE) in the first quarter of 2007 to \$236,147 (\$14.88/BOE) in the first quarter of 2008. The increase of 3% relates to a higher proportionate share of production within the Dawson area, which is subject to gross overriding royalties.

Royalties by Commodity	Three months ended March 31	
	2008	2007
Oil	\$141,667	\$141,638
Natural Gas	84,896	96,011
NGLs	9,584	4,797
Totals	\$236,147	\$242,446

Royalties by Type	Three months ended March 31	
	2008	2007
Crown	\$177,591	\$221,961
Gross overriding	58,556	20,485
	\$236,147	\$242,446
\$/BOE	\$16.99	\$14.88
As a percent of Revenue	24%	27%

## Interest and Other Income

The Company earned other income, primarily from royalty revenue. Other income for the first quarter of 2008 amounted to \$8,318, with \$9,220 reported for the comparable prior quarter of 2007.

## Operating and Transportation Expense and Pipeline Costs

Operating expenses for the first quarter increased to \$466,160 (\$33.54/BOE) from \$305,552 (\$18.76/BOE) in the first quarter of 2007. The operating costs relating to the Hays Grand Forks 9-30-12-14 W4M were \$98,462 (\$62.48/BOE) due to hauling and trucking costs associated with its high water cut. This property has since then been sold in the second quarter of 2008. Excluding the costs associated from this well, the Company's overall operating costs would have decreased to \$29.84/BOE. For the year 2007, the operating costs averaged \$32.51/BOE.

Transportation costs were \$9,052 (\$0.65/BOE) in the first quarter, compared with \$12,738 (\$0.78/BOE) in the prior-year's first period.

	Three months ended March 31	
	2008	2007
\$ Operating costs per BOE <sup>1</sup>	34.19	19.54

1) includes transportation costs

Pipeline expenses were \$182,741 (\$1.25/BOE) for the first quarter of 2008 compared to \$111,259 (\$0.83/BOE) for February and March, 2007. This increase in pipeline expenses is due to a natural decline in oil production within the Peavine area and an increase in field related costs. Arrow acquired the pipelines on February 1, 2007.

*(Operating and Transportation Expense and Pipeline Costs – continued)*

	Three months ended March 31	
	2008	2007
Pipeline expenses	\$ 182,741	\$111,259
Through-put per BOE	145,856	135,504
Pipeline expenses per BOE	\$1.25	\$0.83

### General and Administrative (“G&A”) Expense

The total General and Administrative Expense during the first quarter of 2008 amounted to \$574,752 (\$41.36/BOE) compared to \$575,481 (\$35.33/BOE) during the equivalent period of fiscal 2007. The largest portion of cash G&A is comprised of consulting fees of \$211,026. These costs have been reduced in Q2 due to the transition of consultants into full-time positions, to meet the Company’s staffing requirements. These consultants’ fees, as reported in Q1 of 2008, are being replaced by a charge of \$31,400 per month or \$94,200 per quarter to salary expense. On April 11, 2008, the Company terminated an office rental agreement that was to expire September 1, 2008, and as a result, the monthly rent decreased by \$16,000.

### Stock-Based Compensation

The Corporation accounts for its stock-based compensation program using the fair-value method. Under this method, compensation expense related to this program is recorded in the statement of operations over the vesting term of the options. During the first quarter of fiscal 2008, \$13,420 of stock-based compensation expense was recognized as compared to \$19,790 during the first quarter of 2007.

The Stock-Based Compensation expense decreased in the first quarter of 2008, due to the cancelation of options granted to certain individuals.

	Three months ended March 31	
\$	2008	2007
Stock-Based Compensation	\$13,400	\$19,790
\$/BOE	\$0.96	\$1.21

### Netbacks

	Three months ended March 31	
	2008	2007
Realized price	\$ 73.59	\$ 55.21
Royalties	16.99	14.88
Transportation expense	0.65	0.78
Operating expense	33.54	18.76
Operating netback	22.41	20.79
Other income	0.60	0.57
G&A expense	41.36	35.33
Interest expense	4.17	2.42
Cash netback	\$ (22.52)	\$ (16.39)

## Depletion, Depreciation and Accretion (“DD&A”) Expense

Arrow’s DD&A expense for the first quarter of 2008 totaled \$528,056 compared with \$678,840 for the first quarter of 2007. The oil pipeline, a considerable asset to the Company, is being depreciated over a twenty-five year term; starting February 1, 2007. The decrease in DD&A expense for the first quarter was due to the 15% decrease in production. On a unit of production basis, DD&A expense decreased by 9% to \$38.00 per BOE from \$41.67 per BOE in 2007.

	Three months ended March 31	
	2008	2007
DD&A expense, gross	\$ 528,056	\$ 678,840
DD&A expense, per BOE, net	\$ 38.00	\$ 41.67

## Future Income Taxes

The future income tax recovery for the three months ended March 31, 2008 was \$209,206 compared with \$233,188 for the three months ended March 31, 2007.

## Capital Expenditures

	Three months ended March 31	
	2008	2007
Land	\$ 4,208	\$ 16,791
Geological and geophysical	50,791	-
Drilling and completions	299,438	676,423
Production equipment and facilities	5,275	240,059
Property acquisition	-	6,285,211
Furniture and Fixtures	47,652	-
	\$ 407,364	\$ 7,128,484

During the first quarter of 2008, the Corporation recorded \$407,364 of capital expenditures, compared to \$7,128,484 during the first quarter of 2007. During the current quarter, capital expenditures were focused on the purchase of 3D seismic, and completing, equipping, and tie-in of the Compass 4-2-12-14-W4 and the Hays Grand Forks well 9-30-12-12 W4M.

## Share Capital and Option Activity

As at March 31, 2008, the Company has 27,233,727 shares outstanding, including 1,250,000 shares issued on a flow-through basis for gross proceeds of \$500,000 on December 31, 2007.

	Number of Shares	Amount
Balance, December 31, 2007	27,223,727	\$ 14,126,407
Balance, March 31, 2008	27,223,727	\$ 14,126,407

  

	March 31, 2008	
	Number of Warrants	Amount
Balance, December 31, 2007	5,142,958	\$ 612,276
Balance, March 31, 2008	5,142,958	\$ 612,276

## 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.

	Number of Options	Weighted average exercise price
Balance at December 31, 2007	2,190,178	\$ 0.40
Forfeited during the period	-	-
Granted during the period	-	-
Broker options issued	-	-
Balance at March 31, 2008	2,190,178	\$ 0.40

The following table summarizes information about stock options outstanding as at March 31, 2008:

Exercise Price	Options Outstanding	Exercisable	Weighted Average Years to Expiry
\$0.45	893,750	657,813	3.35
\$0.38	725,000	725,000	4.26
\$0.35	571,428	571,428	1.5
Total	2,190,178	1,954,241	3.37

The total stock options exercisable at March 31, 2008 was 1,954,241 (2007 – 1,902,678) at a weighted average exercise price of \$0.39 (2007 - \$0.39).

Subject to the approval of TSX Venture Exchange and the shareholders, the Company has granted incentive stock options to certain directors, officers, and employees of the Company to procure up to 1,480,000 common shares in the capital stock of the Company. The options have a term of five (5) years and are exercisable at an exercise price of 22¢ per share. The stock option agreement was dated April 24, 2008.

## Working Capital, Liquidity, and Capital Resources

At March 31, 2008, Arrow had a working capital deficiency of \$4,333,102, which included bank indebtedness of \$2,254,547.

At December 31, 2007, the Company had established a demand loan facility in the amount of \$3,500,000 with the lender. Interest on this facility is charged monthly at the bank's prime rate plus 50 basis points. The credit facility is secured by a fixed and floating charge on the assets of the Company and is subject to annual review. Arrow has recently completed the renegotiation with the lender for an increase in the demand loan facility from \$6,000,000 to \$6,500,000 due to additional reserves as evaluated by the external reserve engineers.

## **Commitments and Contingencies**

The Company has remaining lease commitments for office space of \$80,000 and \$919,581 which expire on August 31, 2008 and July 1, 2012, respectively.

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

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. As at March 31, 2008, the Company has expended \$148,698 relating to these commitments.

## **Related-Party Transactions**

For the period ended March 31, 2008, Arrow has \$27,171 (December 31, 2007: \$13,574) 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.

At March 31, 2008 the Company has a payable to the Peavine Métis Settlement in the amount of \$73,219, to the Métis Settlement General Council in Trust for Peavine for \$193,159 and \$128,239 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 significant shareholder of Arrow Energy Ltd.

## **Adoption of New Policies**

The Company adopted the following new CICA Handbook Sections, which were effective beginning January 1, 2008:

- Section 3862 – “Financial Instruments – Disclosures”, describes the required disclosure for the assessment of the significance of financial instruments for an entity's financial position and performance and of the nature and extent of risks arising from financial instruments to which the entity is exposed and how the entity manages those risks. This section and Section 3863, “Financial Instruments – Presentation” replaced Section 3861, “Financial Instruments – Disclosure and Presentation”.
- Section 3863 – “Financial Instruments – Presentation”, establishes standards for presentation of financial instruments and non-financial derivatives.
- Section 1535 – “Capital Disclosures”, establishes standards for disclosing information about an entity's capital and how it is managed. It describes the disclosure requirements of the entity's objectives, policies, and processes for managing capital, the quantitative data relating to what the entity regards as capital, whether the entity has complied with capital requirements, and, if it has not complied, the consequences of such non-compliance.
- Section 3031 – “Inventories”, which replaces Section 3031. This section is harmonized with International Accounting Standards and provides additional guidance on the measurement and disclosure requirements for inventories. This New standard did not have an impact on the Company's financial statements.
- The CICA has amended Section 1400, “General Standards of Financial Statement Presentation”, which include requirements to assess and disclose the Company's ability to continue as a going concern. The adoption of this new section did not have an impact on the financial statements.

## Accounting Pronouncements

- Section 3064 – “Goodwill and Intangible Assets”, will be adopted on January 1, 2009. These sections establish 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. The Company is currently evaluating the impact of the adoption of this new Section on its financial statements but does not expect that the adoption of this new Section will have a material impact on its financial statements.

## Future Accounting Pronouncements

As of January 1, 2008, Arrow has adopted two new Canadian Institute of Chartered Accountants (“CICA”) standards:

- Section 3862, “Financial Instruments – Disclosures”, and
- Section 3863, “Financial Instruments – Presentation”

These replace Section 3861, “Financial Instruments – Disclosure and Presentation”. The new disclosure standard increases the emphasis on the risks associated with both recognized and unrecognized financial instruments and how those risks are managed. The new presentation standard carries forward the former presentation requirements. The new financial instruments presentation and disclosure requirements were issued in December 2006, and the Company is assessing the impact on its financial statements.

AS of January 1, 2008, the Company has adopted CICA Section 1535, “Capital Disclosures”, which requires additional disclosures of objectives, policies and processes for managing capital. In addition, disclosures include whether companies have complied with externally imposed capital requirements. The new capital disclosure requirements were issued in December 2006, and the Company is assessing the impact on its financial statements.

## Critical Accounting Estimates

The Company’s financial and operating results contain estimates made by management in the following areas:

1. capital expenditures are based on estimates on projects in various stages of completion;
2. revenues, royalties and operating costs are based on estimates for which revenue had not yet been received and costs had not yet been realized;
3. depletion, depreciation and accretion are based on estimates of oil and natural gas reserves that the Company expects to recover in the future;
4. asset retirement obligations are based on estimates of future costs and timing of expenditures; and
5. the future recoverable value of capital assets is also based on estimates that the Company expects to realize in the future.

Management’s assumptions are based on factors that, in management’s opinion, are relevant and appropriate. Management’s assumptions may change over time as operating conditions change.

## Oil and Natural Gas Reserves Determination

The process of estimating reserves is complex. It requires significant judgments and decisions based on available geological, geophysical, engineering and economic data. Reserve estimates are based on current production forecasts, prices and economic conditions. These estimates may change substantially as additional data from ongoing development and production activities becomes available and as economic conditions impact oil and natural gas prices and costs.

### Depletion Expense

The Company uses the full-cost method of accounting for exploration and development activities. In accordance with this method of accounting, all costs associated with exploration and development activities, whether successful or not, are capitalized. The aggregate of net capitalized costs (less costs of unproved properties) and estimated future development costs (less estimated salvage values) is amortized using the unit-of-production method based on estimated proved oil and natural gas reserves. An increase in estimated proved oil and natural gas reserves or a decrease in estimated future development costs would each result in a corresponding reduction in depletion and depreciation expense.

### Impairment of Petroleum and Natural Gas Assets

The Company is required to review the carrying value of all petroleum and natural gas assets for potential impairment. Impairment is indicated if the carrying amount of the oil and natural gas property and equipment is not recoverable by the future undiscounted funds flows. If impairment is indicated, the amount by which the carrying value exceeds the estimated fair value of the property and equipment is charged to earnings. The assessment of impairment is dependent on estimates of reserves, production rates, prices, future costs and other relevant assumptions.

### Stock-Based Compensation

Under the fair-value method of accounting for stock options, compensation expense is determined on the date of grant using the Black-Scholes option pricing model. The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options that are fully transferable and have no vesting restrictions. Arrow's stock options are not transferable, cannot be traded and are subject to vesting restrictions that would tend to reduce value. The Black-Scholes model requires the input of several variables including estimated volatility of Arrow's stock price over the life of the option, estimated forfeitures and the estimated life of the option. Changes in these estimates would alter the option's fair value and the related expense as determined by the Black-Scholes model.

### Asset Retirement Obligations

The Company is required to provide for future removal and restoration costs. The Company must estimate these costs in accordance with existing laws, contracts or other policies. The fair value of the liability for the Company's asset retirement obligations is recorded in the period in which it is expected to be incurred, discounted to its present value using the Company's risk-adjusted interest rate and the expected inflation rate. The offset to the liability is recorded in the carrying amount of property and equipment. The liability amount is increased each reporting period due to the passage of time, and the amount of accretion is charged to earnings in the period. Revisions to the estimated timing of cash flows or to the original estimated undiscounted cost could also result in an increase or decrease to the obligation. Actual costs incurred upon settlement of the retirement obligation are charged against the obligation to the extent of the liability recorded.

### Income Tax Accounting

The determination of the Company's income and other tax liabilities requires interpretation of complex laws and regulations. All tax filings are subject to audit and potential re-assessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded by management.

### Internal Control Reporting

Effective for periods ending on or after December 31, 2007, CSA issued blanket orders or similar allowing venture issues to file “Venture Issuer Basic Certificates.”

On April 18, 2008, the CSA published the proposed new rule N152-109 that is intended to become effective December 15, 2008. Under this proposed new rule, venture issuers will not be required to certify the design or effectiveness of disclosure controls or internal control over financial reporting.

### Risk Factors

There are a number of risk factors facing companies that participate in the Canadian oil and gas industry. A summary of certain risk factors relating to our business are provided in the Risk Factors section of our Annual Information Form, filed on SEDAR.

### Additional Information

Additional information regarding the Company is available on SEDAR at [www.sedar.com](http://www.sedar.com) or can be obtained by contacting Arrow Energy Ltd., Suite 350, 703 – 6<sup>th</sup> Avenue SW, Calgary, AB T2P 0T9 or on the Company’s Web site at [www.arrow-energy.com](http://www.arrow-energy.com).