



Arrow Energy Ltd.

Q3 2008 Consolidated Financial Statement

Consolidated Balance Sheets

(Unaudited)	September 30/08	December 31/07
ASSETS		
Current:		
Cash	\$ 113,343	\$ 155,692
Accounts receivable	1,136,960	1,765,956
Deposits and prepaid expenses	210,469	236,566
	<u>1,460,772</u>	<u>2,158,214</u>
Capital assets (Note 5)	22,201,269	20,081,782
	<u>\$ 23,662,041</u>	<u>\$ 22,239,996</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
LIABILITIES:		
Current:		
Accounts payable and accrued liabilities	\$ 1,422,813	\$ 2,783,684
Bank loan (Note 9)	6,264,077	3,037,838
	<u>7,686,890</u>	<u>5,821,522</u>
Future income taxes (Note 11)	17,565	324,490
Convertible debenture (Note 10)	150,827	–
Asset retirement obligation (Note 6)	1,321,345	1,081,877
Non-controlling interest (Note 4)	128,289	–
	<u>9,304,916</u>	<u>7,227,889</u>
SHAREHOLDERS' EQUITY:		
Deferred subscriptions (Note 8)	650,000	–
Share capital (Note 7)	14,576,946	14,738,683
Equity component of convertible debenture (Note 10)	49,173	–
Contributed surplus (Note 7)	6,694,064	6,306,827
Deficit	(7,613,058)	(6,033,403)
	<u>14,357,125</u>	<u>15,012,107</u>
	<u>\$ 23,662,041</u>	<u>\$ 22,239,996</u>

Commitments and contingencies (Note 12)
Basis of Presentation – Going concern (Note 1)

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 & Deficit

For the periods ended September 30

(Unaudited)	3 months 2008	3 months 2007	9 months 2008	9 months 2007
Revenue				
Petroleum and natural gas sales	\$ 1,858,420	\$ 1,370,492	\$ 5,020,773	\$ 3,543,113
Royalties	(418,917)	(190,921)	(1,082,994)	(767,264)
	<u>1,439,503</u>	<u>1,179,571</u>	<u>3,937,779</u>	<u>2,775,849</u>
Pipeline revenue	242,865	356,990	777,268	993,053
Other income	41,648	25,532	48,642	49,191
	<u>1,724,016</u>	<u>1,562,093</u>	<u>4,763,689</u>	<u>3,818,093</u>
Expenses				
Production and transportation	559,818	219,007	1,413,607	588,929
Pipeline	267,803	246,598	673,982	657,352
General and administrative	853,436	540,136	2,094,165	1,791,583
Interest	76,654	60,880	261,591	150,433
Stock based compensation	180,986	195,949	384,979	235,529
Depletion, depreciation and accretion	667,910	895,981	1,969,447	2,255,468
	<u>2,606,607</u>	<u>2,158,551</u>	<u>6,797,771</u>	<u>5,679,294</u>
Loss from operations	<u>(882,591)</u>	<u>(596,458)</u>	<u>(2,034,082)</u>	<u>(1,861,201)</u>
Loss before income taxes	<u>(882,591)</u>	<u>(596,458)</u>	<u>(2,034,082)</u>	<u>(1,861,201)</u>
Income tax recovery				
Future	(176,487)	(173,896)	(454,427)	(567,176)
Net loss and comprehensive loss	<u>(706,104)</u>	<u>(422,562)</u>	<u>(1,579,655)</u>	<u>(1,294,025)</u>
Deficit, beginning of period	<u>(6,906,954)</u>	<u>(4,470,140)</u>	<u>(6,033,403)</u>	<u>(3,598,677)</u>
Deficit, end of period	<u>\$ (7,613,058)</u>	<u>\$ (4,892,702)</u>	<u>\$ (7,613,058)</u>	<u>\$ (4,892,702)</u>
Net loss per share				
Basic and diluted	\$ (0.03)	\$ (0.03)	\$ (0.06)	\$ (0.09)
Weighted average common shares outstanding				
Basic and diluted	27,233,727	14,304,019	27,233,727	14,162,686

See accompanying notes to the financial statements.

Consolidated Statements Cash Flows

For the periods ended September 30

(Unaudited)	3 months 2008	3 months 2007	9 months 2008	9 months 2007
CASH FLOWS RELATED TO THE FOLLOWING ACTIVITIES				
OPERATING:				
Net loss	\$ (706,104)	\$ (422,562)	\$ (1,579,655)	\$ (1,294,025)
Items not involving cash:				
Depletion, depreciation and accretion	667,910	895,981	1,969,447	2,255,468
Stock compensation expense	180,986	195,949	384,978	235,529
Future income tax recovery	(176,487)	(173,896)	(454,427)	(567,176)
	(33,695)	495,473	320,343	629,796
Abandonment expenditures	(43,042)	–	(43,042)	–
Changes in non-cash working capital (Note 13)	238,748	(1,304,776)	61,760	(1,027,044)
	162,011	(809,303)	339,061	(397,248)
FINANCING:				
Increase in bank loan	(39,305)	566,131	3,226,239	2,298,156
Deferred subscriptions (Note 8)	650,000	–	650,000	–
Proceeds from issuance of share capital	–	80,000	–	80,000
Share issue costs	–	(160,000)	(11,978)	(160,000)
	610,695	486,131	3,864,261	2,218,156
INVESTING:				
Additions to capital assets	(372,707)	107,929	(833,225)	(1,307,823)
Acquisition of oil & gas assets	(107,830)	–	(3,364,788)	(893,762)
Acquisition of Subsidiaries (Note 4)	(485,907)	–	(485,907)	–
Cash from acquisition of Subsidiaries	–	381,745	–	381,745
Proceeds from asset disposition	497,890	–	924,296	120,000
Changes in non-cash working capital (Note 13)	(220,405)	202,316	(486,047)	263,023
	(688,959)	691,990	(4,245,671)	(1,436,817)
Net increase (decrease) in cash	83,747	368,818	(42,349)	384,091
Cash, beginning of period	29,596	15,273	155,692	–
Cash, end of period	\$ 113,343	\$ 384,091	\$ 113,343	\$ 384,091

See accompanying notes to the financial statements

Notes to Financial Statements

For the periods ended September 30, 2008 and 2007

Unaudited

1. Description of Business and Basis of Presentation

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.

The interim financial statements of the Company have been prepared by management, in accordance with Canadian generally accepted accounting principles and are unaudited. The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The interim financial statements have been prepared following the same accounting policies and methods of computation as the audited financial statements for the year ended December 31, 2007. These interim financial statements do not include all the note disclosures required for annual financial statements and therefore they should be read in conjunction with the Company's audited financial statements for the year ended December 31, 2007.

The Company's financial statements as at and for the interim period ended September 30, 2008 have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. The ability of the Company to continue as a going concern is dependent upon the Company's ability to generate future profitable operations and obtaining additional equity or debt financing.

2. Adoption of New Policies

Financial Instruments

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.

3. Financial Risk and Capital Management

All financial instruments are initially recognized at fair value on the balance sheet. The Company has classified each financial instrument into one of the following categories: held-for-trading (assets and liabilities), loans and receivables, financial assets available-for-sale, financial assets held-to-maturity, and other financial liabilities. Subsequent measurement of financial instruments is based on their classification.

Financial assets and liabilities "held-for-trading" are subsequently measured at fair value with changes in those fair values recognized in net earnings. Financial assets "available-for-sale" are subsequently measured at fair value with changes in fair value recognized in other comprehensive income, net of tax.

Financial assets "held-to-maturity", "loans and receivables", and "other financial liabilities" are subsequently measured at amortized cost using the effective interest method.

Cash is classified as "held-for-trading". Accounts receivable is classified as "loans and receivables". Accounts payable and accrued liabilities and bank revolving credit facility and convertible debenture are designated as "other financial liabilities". The carrying values of these financial instruments approximate their fair values due to their relatively short periods to maturity.

The Company is exposed to financial risk in a range of financial instruments including accounts receivable, accounts payable, and a bank revolving credit facility. The Company manages its exposure to financial risks by operating in a manner that minimizes its exposure to the extent practical. The main financial risks affecting the Company are discussed below:

Credit Risk

Credit risk arises when a failure by counter parties to discharge their obligation could reduce the amount of future cash inflows from financial assets on hand at the balance sheet date. A majority of the Company's financial assets at the balance sheet date arise from crude oil, natural gas liquids, and natural gas sales. Industry standard dictates that commodity sales are settled on the 25th day of the month following the month of production. The Company markets its oil and natural gas to several marketers so that the exposure to any one entity is minimized. In addition, when joint operations are conducted on behalf of a joint venture partner relating to capital expenditures, costs of such operations are paid for in advance to the Company by way of a cash call by the partner of the operation being conducted.

The Company assesses quarterly if there has been any impairment of the financial assets of the Company. During the three month period ended September 30, 2008 the company has provided a write off for a shareholder's loan in the amount of \$100,000. The Company does not have any significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics.

The carrying value of accounts receivable approximates their fair value due to the relatively short periods to maturity on this instrument. The maximum exposure to credit risk is represented by the carrying amount on the balance sheet. There are no material financial assets that the Company considers past due.

Market Risk

Interest Rate Risk

Interest rate risk refers to the risk that the value of a financial instrument or cash flows associated with the instrument will fluctuate due to changes in market interest rates. The Company is exposed to interest rate risk as it borrows funds at floating interest rates as disclosed in Note 9. The Company currently does not use interest rate hedges or fixed interest rate contracts to manage the Company's exposure to interest rate fluctuations.

Assuming all other variables remain constant, a 1% increase or decrease in interest rates would have impacted the cash flows of the Company during the nine month period ended September 30, 2008 by approximately \$47,100. The Company considers this risk to be limited and therefore does not hedge its interest rate risk.

Liquidity Risk

Liquidity risk includes the risk that, as a result of the Company's operational liquidity requirements:

- The Company will not have sufficient funds to settle a transaction on the due date;
- The Company will be forced to sell financial assets at a value which is less than what they are worth; or
- The Company may be unable to settle or recover a financial asset at all.

The Company's operating cash requirements, including amounts projected to complete the Company's existing capital expenditure program, are continuously monitored and adjusted as input variables change. These variables include, but are not limited to, available bank lines, oil and natural gas production from existing wells, results from new wells drilled, commodity prices, cost overruns on capital projects, and regulations relating to prices, taxes, royalties, land tenure, allowable production, and availability of markets. As these variables change, liquidity risks may require the Company to conduct equity issues or obtain project debt financing. The Company also mitigates liquidity risk by maintaining an insurance program to minimize exposure to insurable losses. Currently, the Company's maturities of financial liabilities as at September 30, 2008 are within one year for accounts payable, accrued liabilities, the credit facility, and two years for the convertible debenture. Given the balances, with the exception of the convertible debenture, are due in the next twelve months there is a risk, as discussed in Note 1, that the Company may not be able to meet its obligations as they come due.

Capital Risk Management

The Company's objective when managing capital is to safeguard its ability to continue as a going concern, so that it can continue to provide returns to shareholders and benefits for other stakeholders. The Company manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. The Company's objective is met by retaining adequate equity to guard against the possibility that cash flows from assets will not be sufficient to meet future cash flow requirements. The Board of Directors does not establish quantitative return on capital criteria for management; but rather promotes year over year sustainable and growth in net income and cash flow from operating activities. The Company defines capital as total equity (\$14,357,125) plus cash (\$113,343) plus debt (\$6,264,077), and convertible debenture (\$150,827).

The Company is not subject to any externally imposed cash flow requirements other than covenants on its operating credit facility with its lender to maintain its working capital ratio at a 1 to 1 level, as defined in the credit agreement. At September 30, 2008, the Company's working capital ratio was 1.19:1.

Working Capital Ratio of 1.19:1, is calculated as follows:

Current Assets	\$ 1,460,772
+ undrawn availability under Facilities	\$ 235,923
	<u>\$ 1,696,695</u>
divided by Current Liabilities, excluding any amount drawn under Facilities:	<u>\$ 1,422,813</u>

Commodity Price Risk

The Company is exposed to fluctuations in commodity prices for crude oil, natural gas and natural gas liquids. Commodity prices are affected by many factors including supply and demand. The Company monitors these risks and when appropriate, utilizes financial instruments to manage its exposure to these risks. The Company currently does not use financial hedges to manage the Company's exposure to commodity price fluctuations and therefore has no related financial instruments.

4. Business Acquisition

Arrow Energy Ltd. and Discovery Drilling Funds 2005 Oil and Gas Limited Partnership (Dublin Resources Inc.) entered into a purchase agreement dated June 15, 2008, whereas the partnership transferred 67.84% of its common shares to Arrow Energy Ltd. for cash consideration of \$398,906. This acquisition closed on September 12, 2008.

Arrow Energy Ltd. and Discovery Drilling Funds V Development Limited Partnership (1078287 Alberta Ltd.) entered into a purchase agreement dated June 15, 2008, whereas the partnership transferred all of its common shares to Arrow Energy Ltd. for cash consideration of \$82,029. This acquisition closed on September 12, 2008.

Arrow Energy Ltd. and Discovery Drilling Funds VI Limited Partnership (1125048 Alberta Ltd.) entered into a purchase agreement dated June 15, 2008, whereas the partnership transferred all of its common shares to Arrow Energy Ltd. for cash consideration of \$109,336. This acquisition closed on September 12, 2008.

The acquisitions have been accounted for using the purchase price method. Management has estimated the fair market values of the net assets acquired based on current available information as follows:

Consideration:	
Cash	\$ 590,271
Net assets received at estimated fair value	
Cash	\$ 104,364
Accounts receivable	46,195
Prepaid	37,697
Property, plant, & equipment	538,312
Accounts payable	(2,402)
Asset retirement obligation	(5,606)
Non-controlling interest	(128,289)
	\$ 590,271

The company has made its best estimate as to the net assets acquired. The final purchase price adjustments have not been finalized, therefore, the above amounts may be subject to adjustments.

5. Capital Assets

	September 30, 2008		
	Cost	Accumulated Depletion and Depreciation	Net Book Value
Petroleum and natural gas properties	\$ 27,039,048	\$ 8,448,497	\$ 18,590,551
Pipeline	3,740,797	224,448	3,516,349
Office equipment and furniture	155,481	61,112	94,369
	\$ 30,935,326	\$ 8,734,057	\$ 22,201,269
	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

(Capital Assets – continued)

Petroleum and natural gas properties as at September 30, 2008 include costs of \$2,356,113 (December 31, 2007 - \$2,353,420) relating to undeveloped land, which has been excluded from the amounts subject to depletion.

The pipeline, which is not included in the full-cost pool, is amortized on a straight-line basis over 25 years.

Unproved properties are assessed for impairment on an annual basis and those deemed impaired are written off.

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 \$1,321,345 as at September 30, 2008 (December 31, 2007 - \$1,081,877) based on a total future liability of \$5,915,966 (December 31, 2007 - \$4,855,639).

These payments are expected over the next 20 years with the majority of costs incurred between 2010 and 2026. An inflation factor of 2% has been applied to the estimated asset retirement cost at September 30, 2008 and December 31, 2007. A credit-adjusted risk-free rate of 8% was used to calculate the fair value of the asset retirement obligations at September 30, 2008 and December 31, 2007.

A reconciliation of the asset retirement obligation is provided below:

	September 30, 2008	December 31, 2007
Carrying amount, beginning of period	\$ 1,081,877	\$ 234,050
Increase in obligations	191,233	223,615
Pipeline	-	563,666
Liabilities settled	(15,000)	-
Accretion expense	63,235	60,546
Carrying amount, end of period	\$ 1,321,345	\$ 1,081,877

7. Share Capital

	Number of Shares	Amount
Balance, December 31, 2007	27,233,727	14,126,407
Share issue costs		(11,978)
Future income taxes on renunciation of flow through shares issued		(147,500)
Write off of shareholder's loan		100,000
Balance, September 30, 2008	27,233,727	14,066,929

	Number of Warrants	Amount
Balance, December 31, 2007	5,142,958	612,276
Expiry of warrants, June 30, 2008	(2,000,000)	(102,259)
Balance, September 30, 2008	3,142,958	510,017

(a) *Warrants*

During the second quarter of 2008, 2,000,000 warrants expired, which were issued in connection with a P&NG acquisition in 2007. The fair value of these warrants, equal to \$102,259, was moved to contributed surplus on the date of expiration.

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 (1/2) 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, subject to certain accelerated expiration conditions.

In connection with the private placement issued in 2007, Arrow 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 Broker Unit issued is comprised of one (1) Common Share and one-half (1/2) Common Share purchase warrant. As at June 30, 2008, there are 571,428 Broker Options outstanding that if exercised, will result in the issue of 571,428 Common Shares and the 285,714 Broker Warrants become exercisable at a price of \$0.50.

(b) *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.

On April 24, 2008 the Board approved the granting of 1,730,000 Options to certain directors, employees and consultants of the company. On May 30, 2008 the Board approved the granting of 600,000 stock options to new Directors of the Corporation. On August 1, 2008 an employee was granted 100,000 options pursuant to his employment agreement. On September 12, 2008 the Board approved the granting of 2,000,000 stock options to the new President and Executive Vice-President of Arrow. The fair value of each option granted within the current period was \$0.09, using the Black-Scholes option pricing model with the following assumptions:

	Sept 30, 2008	Dec 31, 2007
Risk-free interest rate	3.3%	4.5%
Estimated hold period prior to exercise (years)	3	5
Volatility in the price of the company's common shares	60%	90%

The Company incurred stock-based compensation expense of \$180,986 for Q3, 2008, versus \$195,949 for Q3, 2007. For the nine months ended September 30, 2008, the expense amounted to \$384,979, compared to \$235,529 for the nine-month period ended September 30, 2007.

	Number of Options	Weighted average exercise price
Balance at December 31, 2007	2,190,178	\$ 0.40
Granted during the period	4,430,000	\$ 0.21
Cancellation of options / Sept 30, 2008	(150,000)	—
Balance at Sept 30, 2008	6,470,178	\$ 0.27

(Stock Options – continued)

The following table summarizes information about stock options outstanding as at Sept 30, 2008:

Exercise Price	Options Outstanding	Exercisable	Weighted Average Years to Expiry
\$0.45	893,750	801,182	3.35
\$0.38	725,000	725,000	3.76
\$0.35	571,428	571,428	1.00
\$0.22	1,730,000	1,343,333	4.63
\$0.20	450,000	450,000	4.67
\$0.17	100,000	100,000	4.83
\$0.20	2,000,000	666,666	4.92
Total	6,470,178	4,657,609	3.88

The total stock options exercisable at September 30, 2008 was 4,657,609 (2007 – 1,902,678) at a weighted average exercise price of \$0.26 (2007 - \$0.39).

On September 30, 2008, 150,000 options granted to a Director on May 30, 2008, were cancelled.

(c) Contributed Surplus

A summary of the change in the Company's contributed surplus balance for the nine months ended September 30, 2008 is as follows:

	September 30, 2008	December 31, 2007
Balance, beginning of period	\$ 6,306,827	\$ 482,368
Acquisition of oil and gas assets		5,389,125
Expiry of warrants	102,259	–
Cancellation of shares		34,500
Stock-based compensation expense	284,978	288,833
Fair value of common shares included in broker units		112,001
Balance, end of period	\$ 6,694,064	\$ 6,306,827

The Company accounts for its stock-based compensation program using the fair-value method. Under this method, compensation expense is recorded in the statement of operations over the vesting term of the options granted. During the third quarter of 2008, \$180,986 of stock-based compensation expense was recorded as compared to \$195,949 as stock compensation expense during the third quarter of 2007. In the third quarter of 2008, the Company granted 2,100,000 options, of which 766,666 were immediately vested, and the remaining 1,333,334 will vest over two years. For the nine months period ending September 30, 2008, stock-based compensation expense amounted to \$384,978, and for the nine months period ended September 30, 2007, the amount for stock-based compensation expense amounted to \$235,529. Included in the stock-based compensation expense for the current quarter and the year-to-date period ending September 30, 2008 is an amount of \$100,000 relating to the write off of a shareholder's loan.

8. Deferred Subscriptions

On September 12, 2008 the Company announced, subject to regulatory approval, its intention to complete a private placement of \$650,000 through the sale of 3,250,000 units at a price of \$0.20 per unit. Each unit is comprised of one (1) flow-through common share and one (1) common share warrant. Each warrant entitles the holder to purchase one (1) additional common share of Arrow at a price of \$0.30 per common share for a period of two (2) years following the date of closing. The closing was completed on November 10, 2008.

9. Bank Loan

At September 30, 2008, Arrow was in compliance with its debt covenants relating to working capital.

On April 2, 2008, the facility was increased from \$3,500,000 to \$6,000,000. On May 29, 2008, the Facility was again renegotiated and increased from \$6,000,000 to \$6,500,000, due to additional reserves as evaluated by the external reserve engineers. Interest on this facility is charged monthly at the bank's prime rate plus 50 basis points. At September 30, 2008 the effective rate charged on the loan facility was 5.25%.

The Company is not subject to any externally imposed cash flow requirements other than covenants on its operating credit facility with its lender to maintain its working capital ratio at a 1 to 1 level, as defined in the credit agreement.

10. Convertible Debentures

During the quarter, Arrow issued \$200,000 principal amount of 8.0% Convertible Unsecured Debenture. The debenture may be converted to share capital at any time at \$0.25 per common share. The debenture, which matures on June 25, 2010, had \$49,173 reclassified to equity, due to the fair value under the Black-Scholes model using the following assumption:

Risk free rate	3.31
Estimated life	2 years
Volatility	60%

11. Income Taxes

The major components of the future income tax liability at September 30, 2008 and December 31, 2007 using the combined federal and provincial income tax rates of 25.00% based on reversal of the future income tax liability (2007 – 25.00%) are as follows:

	September 30, 2008	December 31, 2007
Property and equipment	\$ (688,037)	\$ (953,054)
Share issue costs deductible for tax purposes	42,823	65,580
Asset retirement obligation	335,135	270,469
Non-capital losses carried forward	292,514	292,515
	\$ (17,565)	\$ (324,490)

12. Commitments and Contingencies

(a) The Company has remaining lease commitments for office space of \$28,198 and \$811,395 which expire on February 28, 2010 and July 1, 2012. On September 12, 2008, the Company entered into a sub-lease agreement effective October 1, 2008 and expiring July 1, 2012. The premises to be subleased comprise 1,696 square feet on an annual rate of thirty dollars per square foot.

(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 Company will be subject to a Part XII.6 tax based on the prescribed rate and the balance of exploration expenditures not yet incurred. As at September 30, 2008, the Company expended \$148,698 relating to these commitments.

On September 12, 2008 the Company announced, subject to regulatory approval, its intention to complete a private placement of \$650,000 through the sale of 3,250,000 units at a price of \$0.20 per unit. Each unit is comprised of one (1) flow-through common share and one (1) common share warrant. Each warrant entitles the holder to purchase one (1) additional common share of Arrow at a price of \$0.30 per common share for a period of two (2) years following the date of closing. The closing was completed on November 10, 2008. Arrow has until December 31, 2009 to incur these exploration expenditures.

13. Supplementary Cash Flow Information

The following table details the components of non-cash working capital for the nine-month period ended:

	September 30, 2008	September 30, 2007
Accounts receivable	\$ 628,996	\$ (1,006,436)
Deposits and prepaid expenses	26,097	(20,608)
Accounts payable and accrued liabilities	(1,079,380)	263,023
	(424,287)	(764,021)
Operating	61,760	(1,027,044)
Investing	\$ (486,047)	\$ 263,023

14. Related-Party Transactions

For the period ended September 30, 2008, Arrow incurred \$148,405 (December 31, 2007: \$13,574) in legal fees with a balance of \$23,672 still payable to Parlee McLaws LLP. Parlee McLaws is legal counsel to Arrow Energy Ltd, and a partner of that firm is also a Director of this company (Arrow Energy Ltd.)

At September 30, 2008 the Company has a payable to the Peavine Métis Settlement in the amount of \$40,567, to the Métis Settlement General Council in Trust for Peavine for \$27,723, and \$11,593 to the Métis Settlement General Council. These payables relate to revenues earned on land from participation in joint ventures. Tirmoil Energy Ltd, a shareholder of Arrow Energy Ltd, is controlled by the Peavine Métis Settlement.

(Related-Party Transactions – continued)

At December 31, 2007, the Company entered into a loan agreement with the former 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 stipulates that the promissory note is payable on demand, and interest is paid at the rate of 8% per annum calculated and compounded semi-annually. The Company has determined that this loan is uncollectable as at September 30, 2008, and therefore has been expensed in the current period. The company has an outstanding balance due from the former President in the amount of \$56,008.

During the quarter, the company issued a convertible debenture. The companies 383699 Alberta Ltd., which is controlled by the current President of Arrow Energy Ltd, and Agropyron Enterprises Ltd., were the initial holders of the convertible debenture. This convertible debenture was subsequently assigned to a related party. The debenture agreement replaced a \$200,000 liability due to the companies 383699 Alberta Ltd. and Agropyron Enterprises Ltd. from a previous sale of Petroleum Natural Gas Properties to Arrow in the fourth quarter of 2007.