



**Gale Force Petroleum Inc.**

**Annual Financial Statements**

*As at December 31, 2009*

**SUMMARY**

Management's Report	1
Auditor's Report	2
Balance Sheet	3
Statement of Operations	4
Cash Flow Statement	6
Notes to the Financial Statements	7 to 20

## Management's report

Management is responsible for the preparation of the financial statements. Management believes that these financial statements fairly reflect the form and substance of transactions, and that they reasonably present the Company's financial position and the results of its operations.

The financial statements have been prepared in accordance with accounting principles generally accepted in Canada. Management has included in the Company's financial statements amounts based on best estimates and careful judgements that it believes are reasonable under the circumstances, and designed to ensure that the financial statements are presented fairly, in all material respects

To fulfil its responsibility, management developed and continues to maintain systems of internal accounting controls and establishes policies and procedures to ensure the reliability of financial information and to safeguard assets. The internal control systems and financial records are subject to reviews by external auditors during the examination of the yearly financial statements.

The Board of Directors is responsible for reviewing and approving the financial statements and overseeing management's performances of its financial reporting responsibilities.

A handwritten signature in black ink, appearing to read "Michael McLellan". The signature is written in a cursive, flowing style.

Michael McLellan, CFA  
Chairman & CEO

January 13, 2010

# GALE FORCE PETROLEUM INC. (Consolidated)

## BALANCE SHEETS

	December 31	June 30
	2009	2009
<b>ASSETS</b>		
<i>Current assets</i>		
Cash	\$ 911,361	\$ 21,998
Receivables (note 3)	10,000	700,000
	<b>921,361</b>	721,998
Deposits	-	-
Capital assets (note 4)	957,870	960,829
	<b>\$ 1,879,231</b>	<b>\$ 1,682,827</b>
<b>LIABILITIES</b>		
<i>Current liabilities</i>		
Creditors (note 5)	\$ 429,762	\$ 2,568,449
Private Placement Funds Held in Trust (note 5)	910,000	-
Short term debt from a related party (note 6)	1,830,281	2,197,434
	<b>3,170,043</b>	4,765,883
Convertible debentures (note 7)	-	244,707
Asset retirement obligations (note 8)	43,630	46,295
	<b>3,213,673</b>	5,056,885
<b>SHAREHOLDER'S EQUITY (DEFICIENCY)</b>		
Share capital (note 9)	13,135,027	10,789,747
Contributed surplus	1,556,775	1,556,775
Cumulative Deficit	(16,286,259)	(15,704,925)
Other comprehensive income (loss)	260,015	(15,655)
	<b>(1,334,442)</b>	<b>(3,374,058)</b>
	<b>\$ 1,879,231</b>	<b>\$ 1,682,827</b>

The accompanying notes form an integral part of these financial statements.

Signed for the Board,



Director



Director

## GALE FORCE PETROLEUM INC. (Consolidated)

### STATEMENTS OF OPERATIONS

For the quarter ended December 31, 2009

	Three months		Six months	
	2009	2008	2009	2008
<b>Income</b>				
Oil and natural gas revenues	\$ 396	\$ 52,802	\$ 396	\$ 508,562
Royalties and production taxes	-	(5,352)	-	(90,796)
	\$ 396	\$ 47,450	\$ 396	\$ 417,766
<b>Operating expenses</b>				
Production, transportation and selling expenses	\$ -	\$ 22,700	\$ -	\$ 285,368
Administrative expenses	182,840	272,298	286,696	503,992
Depletion, depreciation and amortization (note 14)	-	21,517	-	177,481
Stock-based compensation expense (note 11)	-	-	-	15,823
	\$ 182,840	316,515	\$ 286,696	982,664
<b>Income (loss) before financial expenses</b>	<b>(182,444)</b>	<b>(269,065)</b>	<b>(286,300)</b>	<b>(564,898)</b>
Financial expenses (note 14)	937	278,244	1,181	448,975
<b>Loss from operations</b>	<b>(183,381)</b>	<b>(547,309)</b>	<b>(287,481)</b>	<b>(1,013,873)</b>
Sale of Manitoba Assets (note 19)	-	146,519	-	2,434
Other (income) and expenses (note 20)	40,106	(180,847)	107,318	(148,021)
<b>Loss before income taxes</b>	<b>(223,487)</b>	<b>(512,981)</b>	<b>(394,799)</b>	<b>(868,286)</b>
Income taxes (note 17)	-	-	-	-
<b>Net loss (note 16)</b>	<b>\$ (223,487)</b>	<b>\$ (512,981)</b>	<b>\$ (394,799)</b>	<b>\$ (868,286)</b>
<b>Deficit, beginning of period</b>	<b>-</b>	<b>(13,276,996)</b>	<b>(15,930,500)</b>	<b>(12,921,691)</b>
<b>Deficit, end of period</b>	<b>\$ (223,487)</b>	<b>\$ (13,789,977)</b>	<b>\$ (16,325,299)</b>	<b>\$ (13,789,977)</b>
<b>Loss per share (note 16)</b>				
Basic	\$ (0.004)	\$ (0.027)	\$ (0.008)	\$ (0.047)
Diluted	\$ (0.004)	\$ (0.027)	\$ (0.008)	\$ (0.047)

The accompanying notes form an integral part of these financial statements.

## GALE FORCE PETROLEUM INC. (Consolidated)

### CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) AND ACCUMULATED OTHER COMPREHENSIVE INCOME

For the quarter ended December 31, 2009

	Three months		Six months	
	2009	2008	2009	2008
Net loss (note 16)	\$ (223,487)	\$ (512,981)	\$ (394,799)	\$ (868,286)
Foreign currency translation adjustment	39,026	-	110,430	-
<b>Comprehensive income (loss)</b>	<b>\$ (184,461)</b>	<b>\$ (512,981)</b>	<b>\$ (284,369)</b>	<b>\$ (868,286)</b>
Accumulated other Comprehensive Income (loss)	\$ (184,461)	\$ (512,981)	\$ (284,369)	\$ (868,286)
Other comprehensive income (loss)	-	-	-	-
<b>Accumulated other Comprehensive Income (loss) end of year</b>	<b>\$ (184,461)</b>	<b>\$ (512,981)</b>	<b>\$ (284,369)</b>	<b>\$ (868,286)</b>

The accompanying notes form an integral part of these financial statements.

# GALE FORCE PETROLEUM INC. (Consolidated)

## CASH FLOW STATEMENTS

For the quarter ended December 31, 2009

(unaudited)	Three Months		Six months	
	2009	2008	2009	2008
<b>OPERATING ACTIVITIES</b>				
Net loss	\$ (223,487)	\$ (512,981)	\$ (394,799)	\$ (868,286)
Items not affecting cash flows	-	-	-	-
Depreciation, amortization and depletion	-	21,517	-	177,481
Write-down of exploration and development costs	-	146,518	-	2,434
Stock-based compensation	-	-	-	15,823
Revision of capitalized assets retirement obligation	-	2,574	-	2,574
Comprehensive (income) loss	(79,218)	(45,066)	32,987	(45,066)
	<b>(302,705)</b>	<b>(387,437)</b>	<b>(361,812)</b>	<b>(715,040)</b>
Net change in non-cash working capital items (note 12)	<b>(538,687)</b>	1,015,994	<b>(538,687)</b>	417,124
<b>Cash used in operating activities</b>	<b>(841,392)</b>	628,557	<b>(900,499)</b>	(297,916)
<b>FINANCING ACTIVITIES</b>				
Issuance of common shares and warrants	2,345,280	53,232	2,345,280	658,254
Redemption of convertible debentures	-	-	-	-
Short-term loan	(367,153)	-	(367,153)	(1,000,000)
Long-term borrowing	-	(1,481)	-	(3,671)
<b>Cash used in financing activities</b>	<b>1,978,127</b>	51,751	<b>1,978,127</b>	(345,417)
<b>INVESTING ACTIVITIES</b>				
Acquisition of capital assets	-	(762,165)	59,106	(491,674)
Disposition of capital assets	-	-	-	-
Redemption of Convertible debentures	(244,707)	-	(244,707)	(290,000)
Capitalized Asset Retirement Obligations	(2,665)	47,341	(2,665)	(442,709)
Deposits	-	4,457	-	75,868
<b>Cash used in investing activities</b>	<b>(247,372)</b>	(710,367)	<b>(188,266)</b>	<b>(1,148,515)</b>
Increase (decrease) in cash and cash equivalents	889,363	(30,059)	889,363	(1,791,848)
Opening cash and cash equivalents	21,998	103,818	21,998	1,865,607
<b>Ending cash and cash equivalents</b>	<b>\$ 911,361</b>	<b>\$ 73,759</b>	<b>\$ 911,361</b>	<b>\$ 73,759</b>

# GALE FORCE PETROLEUM INC. (Consolidated)

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2009

---

### NOTE 1 INCORPORATION AND NATURE OF BUSINESS

The Corporation was incorporated under the *Canada Business Corporations Act* in 2001. As at May 27th, 2008, the Corporation changed its name from Rolland Energy Inc to Gale Force Petroleum Inc. The Corporation exploits oil and gas properties in North America.

### NOTE 2 ACCOUNTING POLICIES

#### *Basis of consolidation*

The consolidated financial statement include the accounts of the Company and its wholly owned subsidiary, Gale Force Petroleum (USA) inc.

The subsidiary is an entity controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of the subsidiary is included in the consolidated financial statements from the date that control commences until the date that control ceases.

Investments in the Corporation's subsidiary are carried at their cost of acquisition less any impairment in the Company's financial statements.

Intra-group balances and any unrealized gains and losses or income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

Unrealized losses are eliminated in the same was as unrealized gains, but only to the extent that there is no evidence of impairment. Gains and losses are recognised as the contributed assets are consumed or sold by the associates and jointly controlled entities or, if not consumed or sold by the associate or jointly controlled entity, when the consolidated entity's interest in such entities is disposed of.

#### *Financial Instruments and Comprehensive Income*

##### i) Comprehensive income, Section 1530

Comprehensive income is defined as the change in equity from transactions and other events from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income but that are excluded from net income calculated in accordance with generally accepted accounting principles.

##### ii) Financial instruments - Recognition and Measurement, Section 3855

All financial instruments are classified into one of the following five categories: held-to-trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. Initial and subsequent measurement and recognition of changes in the value of financial instruments depends on their initial classification.

Held on maturity investments, loans and receivables, and other financial liabilities are initially measured at fair value and subsequently measured at amortized cost. Amortization of premiums or discounts and transaction costs are amortized into net earnings (loss), using the effective interest method.

Available for sale financial assets are measured at fair value, with unrealized gains and losses recorded in other comprehensive income until the asset is realized, at which time they will be recorded in net earnings.

Held for trading financial instruments are measured at fair value. All gains and losses resulting from changes in their fair value are included in the statement of operations in the period in which they arise.

# GALE FORCE PETROLEUM INC. (Consolidated)

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2009

---

### NOTE 2 ACCOUNTING POLICIES (CONTINUED)

All derivate financial instruments are classified as held for trading financial instruments and are measured at fair value, even when they are part of a hedging relationship. All gains and losses resulting from changes in their fair value are include in the statement of operations in the period in which they arise.

The Company's financial instruments are classified as follows:

- Cash and cash equivalents are classified as held for trading.
- Accounts receivable is classified as loans and receivables.
- Term loan to a particular is classified as loans and receivables.

liabilities.

- Short-term debt is classified as other financial liability
- Long-term debt is classified as other financial liability
- Convertible debenture is classified as other financial liability

Transaction costs for financial instruments classified as other than held for trading and held to maturity are expensed in the period incurred.

#### *Changes in Accounting Policy*

Effective July 1, 2008, the Company adopted new accounting standards set out by the Canadian Institute of Chartered Accountants (CICA) Handbook section 1530 "Comprehensive income", 1535 "Capital Disclosures", section 3863 "Financial Instruments - Presentation" and section 3862 "Financial Instruments - Disclosures".

#### i) Capital Disclosures :

Section 1535 - "Capital Disclosures", specifies the disclosure of (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about with the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such non-compliance. The Company has included disclosures recommend by this section in Note 25 to these financial statements.

#### ii) Financial Instruments - Disclosures :

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 extend of risks arising from financial instruments to which the entity is exposed and how the entity manages those risks. The Company has included disclosures recommended by this section in Note 16 to these financial statements.

#### iii) Financial Instruments - Presentation :

Section 3863 - "Financial Instruments - Presentation", establishes standards for presentation of financial instruments and non-financial derivates. The adoption of the Section has had no significant impact on the Company's financial statements.

# GALE FORCE PETROLEUM INC. (Consolidated)

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2009

---

### NOTE 2 ACCOUNTING POLICIES (CONTINUED)

#### *Future change in accounting policies*

##### i) Goodwill and intangible assets (Section 3064)

In February 2008, the CICA issued Section 3064, "Goodwill and Intangible Assets", which replaces Section 3062, "Goodwill and Other Intangible Assets". This new standard provides guidance on the recognition, measurement, presentation and disclosure of goodwill and intangible assets. Concurrent with the adoption of this standard, EIC 27, "Revenue and Expenditures in the Pre-operating Period", will be withdrawn. The Company does not expect the adoption of this section to have a significant effect on its financial statements. This section will be adopted effective July 1, 2009.

##### ii) Business combinations (Section 1582)

In January 2009, the CICA issued Section 1582, "Business Combinations" to replace Section 1581. Prospective application of the standards is effective January 1, 2011, with early adoption permitted. This new standard effectively harmonizes the business combinations standard under Canadian GAAP with International Financial Reporting Standards. The new standard revises guidance on the determination of the carrying amount of the assets acquired and liabilities assumed, goodwill and accounting for non-controlling interest at the time of a business combination. The Company does not expect the adoption of this section to have a significant effect on its financial statements.

##### interest (Section 1602)

The CICA concurrently issued Section 1601 "Consolidated Financial Statements" and Section 1602 "Non-Controlling Interests" which replace Section 1600, "Consolidated Financial Statements". Section 1601 provided revised guidance on the preparation of consolidated financial statement and Section 1602 addresses accounting for non-controlling interests in consolidated financial statements subsequent to a business combination. These standards are effective January 1, 2011, unless they are early adopted at the same time as Section 1582 "Business Combinations". The Company does not expect the adoption of this section to have a significant effect on its financial statements.

##### iv) International Financial Reporting Standards (IFRS)

On February 13, 2008 the CICA Accounting Standards Board (AcSB) announced that accounting standards in Canada are to converge with IFRS for Canadian public companies. The AcSB has indicated that Canadian entities will need to begin reporting under IFRS for fiscal years beginning on or after January 1, 2011 with appropriate comparative data from the prior year. The transition date of July 1, 2011 will require restatement for comparative purpose of amounts reported by the Company for the year ended June 30, 2011. Under IFRS, the primary audience is capital markets and as a result, there is significantly more disclosure required, specifically for quarterly reporting. Further, while IFRS uses a conceptual framework similar to Canadian GAAP, there are significant differences in accounting policy which must be addressed.

In February 2008, the Accounting Standards Board confirmed that all Canadian publicly accountable enterprises will be required to adopt IFRS for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011. Gale Force Petroleum is continually assessing the impact of the convergence of Canadian GAAP with IFRS on the Company's results of operations, financial position and disclosures. Under the direction and oversight of the Board of Directors and audit Committee, the Company has assembled a project team to manage the transition and to ensure successful implementation within the required time frame.

The Company recognizes that the changeover to IFRS has complex implications on a combination of accounting, financial reporting, IT and business systems. The company has not engaged any external consultants at this point to conduct a Business Impact Study, or to assist in the development of a project plan, or to provide assistance in considering various accounting policy decisions which will be required throughout the transition period. Not all of the company personnel involved with the transition project have received all the appropriate training and education.

# GALE FORCE PETROLEUM INC. (Consolidated)

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2009

---

### NOTE 2 ACCOUNTING POLICIES (CONTINUED)

#### iv) International Financial Reporting Standards (IFRS) (Continued)

The overall IFRS transition project will consist of 5 phases: (i) Scope; (ii) Plan; (iii) Design and Build; (iv) Implement; (v) Review. The Scope phase consists of identifying the significant differences between Canadian GAAP and IFRS. The Company will conclude that the following key issues are expected to have the most significant impact on Gale Force Petroleum results of operations, financial position and disclosures:

- IFRS 1 - First-time adoption of International Financial Reporting Standards;
- IFRS 6 - Exploration and evaluation of mineral resources;
- IFRS 16 – Property, Plant and Equipment;
- IAS 36 – Impairment of assets;

The Company will soon be commencing the Scope and Planning phase. During this phase, the Company will be gathering information and financial data to assess the potential impacts of the differences that will be identified during the Scoping phase. The Company will also be developing recommendation for IFRS policy decisions which are based on appropriately documented consideration of the following factors;

- Impact of financial and key performance indicators;
- Impact on information technology systems;
- Impact on the internal control and disclosure control frameworks;
- Transition and maintenance costs;
- Impact on communications with key stakeholders;
- Other general business impacts.

The Company anticipated completion of the Planning phase by mid-2010 and will provide additional disclosures of the key elements of its plan and progress of the project as the information becomes available.

#### *Going Concern*

These financial statements have been prepared on a going concern basis, which assumes the realization of assets and discharge of liabilities in the normal course of business. The Corporation has sustained substantial losses in the past, and is presently unable to continue as a going concern. On February 4, 2009, the Corporation filed a Proposal to Creditors under the Bankruptcy and Insolvency Act (Canada), and the Corporation remains under bankruptcy protection. The Proposal to Creditors addressed all classes of creditors and observed standard practice, regulatory and financial requirements. The Proposal to Creditors was approved by the Creditors, was approved by the Superior Court of Quebec, and the Trustee has issued a Certificate of Full Performance of the Proposal since the end of the year ended June 30, 2009. However, the ability of the Corporation to continue as a going concern thereafter is dependent on its ability to obtain additional new financing in the near-term, to generate future profitable operations and to begin to generate sufficient cash flows to meet its obligations on a timely basis. The outcome of these matters cannot be predicted at this time.

These financial statements do not give effect to any adjustments that would be necessary should the Corporation be unable to continue as a going concern and, therefore, be required to realize its assets and discharge its liabilities in other than the normal course of business and at amounts different from those reflected in these financial statements.

#### *Use of estimates*

The preparation of financial statements in accordance with Canadian generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities and the reported amounts of revenues and expenses. Actual results could differ from these estimates.

Examples of significant estimates include the key economic assumptions used in determining the allowance for doubtful accounts; the recovery of research and development tax credits, the recovery of future income tax assets, the useful lives of capital assets, the assumptions used for capital assets and impairment tests, asset retirement obligations, the assumptions used for the calculation of stock-based compensation costs and the fair value of financial instruments.

# GALE FORCE PETROLEUM INC. (Consolidated)

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2009

---

### NOTE 2 ACCOUNTING POLICIES (CONTINUED)

#### *Revenue recognition*

The sale of oil is recorded when the title passes from the Corporation to external parties.

#### *Inventories*

Inventories are valued at the lower of cost and replacement cost, the cost being determined using the first in, first out method.

#### *Capital assets*

Depreciation of non oil & gas capital assets is calculated using the diminishing balance method at a rate of 30% for vehicles and 20% for office equipment and tools.

#### *Oil and gas assets*

##### i) Capitalized costs

The Corporation follows the full cost method of accounting for its petroleum and natural gas operations as determined by the Canadian Institute of Chartered Accounts, Accounting Guideline 16 ("AcG-16"). Under this method all costs related to the exploration for and development of petroleum and natural gas reserves are capitalized. Costs include lease acquisition costs, geological and geophysical expenses, costs of drilling both producing and non-producing wells, production facilities, asset retirement costs and certain general and administrative expenses directly related to exploration and development activities.

Proceeds from the sale of properties are applied against capitalized costs, without any gain or loss being realized, unless such sale would significantly alter the rate of depletion and depreciation.

Expenditures related to renewals or betterments that improve the productive capacity or extend the life of an asset are capitalized. Maintenance and repairs are expensed as incurred.

##### ii) Depletion and depreciation

Depletion and depreciation of property and equipment is provided using the unit-of-production method based upon estimated proved petroleum and natural gas reserves. The costs of undeveloped properties are excluded from costs subject to depletion until it is determined whether or not proved reserves are attributable to the properties or impairment has occurred. Estimated future costs to be incurred in developing proved reserves are included in costs subject to depletion. For depletion and depreciation purposes, relative volumes of natural gas production and reserves are converted at the energy equivalent conversion rate of six thousand cubic feet of natural gas to one barrel of crude oil.

##### iii) Impairment test

Each year end the Corporation performs an impairment test to determine the recoverability of capitalized costs associated with reserves. An impairment loss is recognized when the carrying amount of a cost centre exceeds its fair value. The carrying amount of the cost centre is not recoverable if the carrying amount exceeds the sum of the undiscounted cash flows from proved reserves plus the costs of unproved properties. If the sum of the cash flows is less than the carrying amount, the impairment loss is limited to the amount by which the carrying amount exceeds the sum of the fair value of proved and probable reserves and the costs of unproved properties that have been subject to a separate impairment test and contain no probable reserves.

# GALE FORCE PETROLEUM INC. (Consolidated)

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2009

---

### NOTE 2 ACCOUNTING POLICIES (CONTINUED)

#### *Oil and gas assets (Continued)*

##### iv) Asset retirement obligations

The Corporation recognizes the fair value of estimated asset retirement obligations on the balance sheet when a reasonable estimate of fair value can be made. Asset retirement obligations include those legal obligations where the Corporation will be required to retire tangible long-lived assets such as well sites, pipelines and facilities. The asset retirement cost, equal to the initially estimated fair value of the asset retirement obligation, is capitalized as part of the cost of the related long lived asset. Changes in the estimated obligation resulting from revisions to estimated timing or amount of undiscounted cash flows are recognized as a change in the asset retirement obligation and the related asset retirement cost.

Asset retirement costs are amortized using the unit-of-production method and are included in depletion and depreciation in the statement of operations. Increases in the asset retirement obligations resulting from the passage of time are recorded as accretion of asset retirement obligations in the consolidated statement of operations.

#### *Convertible debentures*

Convertible Debentures are accounted for based on their estimated components. The debt component, representing the obligation to make interest payments, is accounted for as long-term debt, and the equity component, representing the option of conversion of the holder, are accounted for as shareholders equity under the heading "Equity component of convertible debentures".

The value of the debt component of the convertible debentures is determined by updating the future payments of interest and principal at a discount rate representing the rate of borrowing of the Corporation for similar debentures without the right of conversion. Management estimated that this rate corresponds to 15 %. The accounting value of the equity component is determined by reducing the accounting value of the debt component from the value of the amounts received for the convertible debentures.

The interest expense for the equity component is accounted for and results in the difference between this expense and the disbursement, representing the increase of the value of the debt component due to the passage of time.

#### *Capital stock*

The resource expenditure deductions for income tax purposes related to exploration and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. Under the liability method of accounting of income taxes, the future income taxes related to temporary differences arising at the renunciation are recorded at that time together with a corresponding charge to results from operation.

#### *Research and development tax credits*

Research and development tax credits are recognized when the qualifying expenditures are incurred. The amounts recognized are applied to reduce research and development expenses. Research and development tax credits are subject to the acceptance of the tax authorities.

#### *Income taxes*

The Corporation follows the liability method of accounting for income taxes. According to this method, future income taxes are determined using the difference between the accounting and tax basis of assets and liabilities using the substantively enacted tax rates and fiscal laws expected to apply in the periods in which those differences are expected to be recovered. Future income tax assets are recognized when it is more likely than not that the assets will be realized. The Corporation has adopted a policy whereby this determination is made when the Corporation demonstrates profitability.

# GALE FORCE PETROLEUM INC. (Consolidated)

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2009

### NOTE 2 ACCOUNTING POLICIES (CONTINUED)

#### *Earnings per share*

Earnings per share are reported on the basis of the treasury stock method. This method recognizes the use of proceeds that could be obtained upon exercise of options and warrants in computing diluted earnings per share. It assumes that any proceeds would be used to purchase common shares at the average market price during the period. The exercise of options and warrants that would result in an increase in earnings per share amounts or a decrease in loss per share amounts are excluded from the calculations as they become anti-dilutive.

#### *Stock-based compensation*

The Corporation has established a stock-based compensation plan which includes stock options. The Corporation records compensation expense in the statement of operations for stock options granted to Directors, Officers, employees and consultants using the fair-value method. Compensation costs are recognized over the vesting period. Fair value is determined using the Black-Scholes option pricing model.

#### *Foreign exchange translation*

The accounts of foreign subsidiaries, which are financially or operationally dependent on the parent company, are accounted for using the temporal method. Under this method the monetary assets and liabilities of the Corporation that are denominated in foreign currencies are translated into Canadian dollars at the year-end exchanges rates. Non-monetary assets and liabilities denominated in foreign currencies are translated at their historical exchange rates. Revenue and expenses are translated at rates of exchange prevailing on the transaction dates. All of the exchange gains or losses resulting from these transactions are included in the statement of operations.

### NOTE 3 RECEIVABLES

	Dec 31 2009	June 30 2009
Accounts receivable - Canadian dollars	\$ -	\$ 0
Accounts receivable - US dollars	-	-
Other accruals (note 24)	10,000	700,000
Term loan to a particular, bearing interest at an annual rate of 5 % interest rate, and secured by personal collateral	-	0
	<b>10,000</b>	700,000
Allowance for doubtful accounts	-	-
	<b>\$ 10,000</b>	<b>\$ 700,000</b>

### NOTE 4 CAPITAL ASSETS

	Dec 31 2009		
	Cost	Accumulated depreciation	Net book value
<i>Oil and gas</i>			
Exploration and development costs (i)	\$ 957,870	\$ -	\$ 957,870
	<b>\$ 957,870</b>	<b>\$ -</b>	<b>\$ 957,870</b>
			June 30 2009
	Cost	Accumulated depreciation	Net book value
<i>Oil and gas</i>			
Exploration and development costs	\$ 960,829	\$ -	\$ 960,829
	<b>\$ 960,829</b>	<b>\$ -</b>	<b>\$ 960,829</b>

Gale Force Petroleum USA, Derby Resources, WHL Energy joint venture where Gale Force had a 50% interest in the Kentucky gas shale project.

# GALE FORCE PETROLEUM INC. (Consolidated)

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2009

### NOTE 5 CREDITORS

	Dec 31 2009	June 30 2009
Accounts payable - Canadian dollars	\$ 282,347	\$ 1,600,361
Accrued liabilities	183,324	271,656
Taxes Payable	(51,533)	(15,256)
Interest on convertible debentures	-	16,471
Investor Tax Indemnity	-	679,540
Interest and Penalty	15,625	15,677
<b>Creditors</b>	<b>\$ 429,762</b>	<b>\$ 2,568,449</b>
Private placement funds held in trust	910,000	-
<b>Creditors and Funds Held in Trust</b>	<b>\$ 1,339,762</b>	<b>\$ 2,568,449</b>

Private placement funds were received from investors for a proposed equity private placement. Since the financing is not closed at this reporting period, the funds are held in trust.

The Investor Tax Indemnity was indemnity owing to 2007 flow-through investors because the Corporation did not meet its Canadian Exploration Expense and Canadian Development expense obligations for the calendar year 2008. Therefore, the Corporation was required to withdraw its renunciation of part of the deduction made toward these investors in flow-through shares of the Corporation and assume the equivalent tax liability of these investors.

### NOTE 6 SHORT-TERM DEBT

	Dec 31 2009	June 30 2009
Facility A term loan (12% interest until February 2, 2009)	\$ 1,660,461	\$ 2,027,614
Loan inducement	169,820	169,820
	<b>\$ 1,830,281</b>	<b>\$ 2,197,434</b>

The Facility A is a maximum authorized loan of \$4 million. The loan is guaranteed by 1) General Security Agreement creating a security interest on all present and future personal property rights and other assets; 2) a fixed and floating charge demand debenture creating a security on a 25% working interest before payout in 3 wells in the Radway Area and a 20% working interest before payout in 1 well in the same Area; 3) a UCC financing statement creating a security interest on an undivided co-ownership interest in the Kentucky Properties, as defined in the Joint Operating Agreement (JOA) entered into by Gale Force Petroleum USA, WHL Energy and Derby Resources, on July 21, 2008, under which the Corporation is the operator, and under which the Corporation owns a 50% working interest.

The Facility A term loan agreement was amended simultaneous with the Proposal to Creditors filed by the Corporation on February 2, 2009. The amendments include an extension of the maturity date to December 31, 2010; the loan will not earn any interest or fees between February 2, 2009 to December 31, 2009; after December 31, 2009, the loan can be convertible at the election of the lender into common shares of the Corporation, and; the loan can be repaid at any time by the Corporation without penalty.

In the past, due to the short term nature of the bridge loans, renewal and management fees associated with the loans have increased the cost of the loans by approximately 8% per year.

#### *Loan inducement*

On February 4, 2009, the corporation signed an agreement to amend Facility A simultaneously with the filing of the Proposal to Creditors. Under the terms of the agreement, there would be no interest or fees payable on the loan until after December 31, 2009, which is evaluated at approximately \$216,990 in savings to the Corporation. The amount of the vacation of interests is depreciated according to the straight line method on the duration of the loan as a decrease of expenses of interests.

# GALE FORCE PETROLEUM INC. (Consolidated)

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2009

### NOTE 7 CONVERTIBLE DEBENTURES

There were convertible debentures outstanding with a total face value of \$270,000. The convertible debentures were repaid during the quarter under the terms of the Proposal to Creditors filed by the Corporation on February 4, 2009. The convertible debentures had a 12% coupon and were convertible at the election of the holder or the corporation, in full or in part, into common shares of the corporation according to the the terms of conversion as follows:

Conversion terms for the debenture holder: at a conversion price of \$1.9290 for a conversion taking place on or before February 16, 2009, and an additional 10% premium to the amount set out in each subsequent year after February 16, 2009.

Conversion terms for the Corporation: provided that the volume-weighted-average-trading-price of the common shares is at or above \$4.80 per common share for not less than 20 consecutive trading days on the TSX Venture Exchange until February 16, 2008; \$6.40 per common share for the period between February 17, 2008 to February 16, 2009 and \$8.00 per common share for the period between February 17, 2008 to February 16, 2012.

### NOTE 8 ASSET RETIREMENT OBLIGATIONS

The following table provides a reconciliation of the carrying amount of the obligation associated with the retirement of oil and gas properties:

	Dec 31 2009	June 30 2009
Asset retirement obligations, beginning of year	\$ 46,295	\$ 704,385
Liabilities incurred, net of liabilities disposed, year to date	-	(703,245)
Revisions to estimated liabilities	(2,665)	41,295
Accretion expense	-	3,860
Asset retirement obligations	\$ 43,630	\$ 46,295

The key assumptions on which the carrying amount of the asset retirement obligations are based include an 8.0% discount rate and an annual inflation rate of 3%. The total undiscounted amount of the estimated cash flows required to settle the obligations was \$252,091 (\$1,346,830 June 30, 2008). The expected timing of payment of the cash flows required to settle the obligations ranges from 1 year to 6 years for Canada and 1 year to 15 years for Kentucky. As for the revision of estimated liabilities, new information led us to re-evaluate our estimations and assumptions.

### NOTE 9 CAPITAL STOCK

The Corporation is authorized to issue an unlimited number of common shares without par value.

	Dec 31 2009	June 30 2009
Common Shares Issued and Outstanding		
62,667,213 common shares (19,468,355 common shares after consolidation as at June 30, 2009)	\$ 13,135,027	\$ 10,789,747

During the quarter the Company did not issue any common shares.

## GALE FORCE PETROLEUM INC. (Consolidated)

### NOTES TO THE FINANCIAL STATEMENTS

December 31, 2009

#### NOTE 9 CAPITAL STOCK (CONTINUED)

The following tables show the variation in outstanding convertible instruments:

##### Warrants

Issue Date	Expiry Date	Exercise Price	Balance at beginning of the year	Issued	Exercised	Cancelled	Expired	Balance at end of period
October 26, 2007	October 26, 2009	\$ 0.800	375,000	-	-	-	375,000	-
October 18, 2007	October 18, 2009	\$ 0.800	4,600,588	-	-	-	4,600,588	-
December 29, 2007	December 29, 2009	\$ 0.800	357,143	-	-	-	357,143	-
December 31, 2007	January 1, 2010	\$ 0.800	921,886	-	-	-	-	921,886
June 30, 2008	May 27, 2010	\$ 0.582	1,417,437	-	-	-	-	1,417,437
June 27, 2008	June 27, 2010	\$ 0.700	1,700,000	-	-	-	-	1,700,000
June 27, 2008	June 27, 2010	\$ 0.500	285,920	-	-	-	-	285,920
			9,657,974	-	-	-	5,332,731	4,325,243

Each purchase warrant gives the right to purchase one common share of the Company at its exercise price on or before its expiry date.

##### Convertible Debentures

Issue Date	Expiry Date	Conversion Price (During period)	Balance at beginning of the year	Adjusted	Converted	Redeemed	Reached Maturity	Balance at end of period
February 16, 2007	February 16, 2012	\$ 1.929	\$ 244,707	\$ -	\$ 244,707	\$ -	\$ -	\$ -

The convertible debentures were reimbursed under the terms of the Proposal to Creditors filed by the Corporation on February 4, 2009.

#### NOTE 10 STOCK-BASED COMPENSATION

Under the amended 2004 stock option plan, the Corporation may grant options in respect of a maximum of 1,770,000 common shares after the consolidation to directors, officers and employees of, and consultants to the Corporation.

The Corporation uses the fair-value method to record stock-based compensation expense with respect to stock options granted. The fair value of each option granted is estimated on the date of grant using the Black-Sholes options pricing model, using the following average assumptions for 2008-2009:

# GALE FORCE PETROLEUM INC. (Consolidated)

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2009

### NOTE 11 SUPPLEMENTAL CASH FLOW INFORMATION

	Dec 2009	Dec 2008
Changes in non-cash working capital:		
Accounts Receivable	\$ 690,000	\$ 137,951
Inventory	-	71,116
Prepaid expenses	-	58,876
Creditors, reduction due to payment or write-down of debts under Proposal to Creditors	(2,138,687)	149,181
Changes in non-cash working capital items	\$ (1,448,687)	\$ 417,124

During the year, the Corporation made the following cash outlays for interest expenses:

Interest expense	\$ -	\$ 150,118
------------------	------	------------

### NOTE 12 RELATED PARTY TRANSACTION

During the year \$0 (\$162,424 in 2008) was paid in interest expense and fees associated to the loans from Primatlantis Capital, where a former director of the Corporation was a principal. These transactions were concluded in the normal course of business.

### NOTE 13 STATEMENT OF OPERATIONS

	Dec 2009	Dec 2008
The statement of operations includes the following charges :		
<i>Depletion, depreciation and amortization</i>		
Tangible assets	\$ -	\$ 3,218
Oil and gas	-	174,263
	\$ -	\$ 177,481
<i>Financial expenses</i>		
Interest on long term debt	\$ -	\$ 19,975
Interest on short term debt	-	150,118
Other interest, financing expenses and bank charges	1,181	278,882
	\$ 1,181	\$ 448,975

### NOTE 14 FINANCIAL INSTRUMENTS

#### *Interest Rate Risk*

The Corporation has a working capital deficiency and significant outstanding short-term commitments. The Corporation is reliant on funds advanced by its secured creditor as well as on the goodwill of management to cover cash shortfalls from operations, until it can raise new funds or become cash-flow positive in its operations. The Corporation will have to raise funds from equity investors before to meet its obligations until then.

#### *Fair value*

Fair value is estimated on a specific date through the use of the information available about the financial instrument in question. Estimates of fair value are of a subjective nature and cannot, in many cases, be established with any degree of precision.

The Corporation has determined that the book value of its short-term assets and liabilities is close to their fair value because of their immediate and short-term expiry.

The fair value of long-term debt is close to its book value because of its short-term maturity.

# GALE FORCE PETROLEUM INC. (Consolidated)

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2009

### NOTE 15 FINANCIAL INSTRUMENTS CONTINUED

#### *Liquidity Risk*

The Corporation has a working capital deficiency and significant outstanding short-term commitments. The Corporation is reliant on funds raised from shareholders to cover cash shortfalls from operations, until it becomes cash-flow positive. The Corporation will have to raise funds from equity investors before to meet its obligations until then.

#### *Credit Risk*

Credit risk is the potential exposure of the Corporation to losses that would be recognized if counterparties failed to perform or failed to pay amounts due. The Corporation has no issues with respect to collection. In Canada, the oil and gas industry has a pre-arranged monthly clearing day for payment of revenues from all buyers of oil and natural gas, which occurs 25 days following the end of the month of sale. In Kentucky, USA, the Corporation received payment for delivered production 60 days following the end of the month of sale. As a result, the Corporation's production revenues are collected in an orderly fashion.

#### *Foreign Exchange Risk*

The Corporation is subject to risks associated with fluctuations in foreign currencies with regard to the operations in the USA. This includes foreign currency-denominated receivables, payables, debt, and other balance sheet positions as well as future cash flows resulting from anticipated transactions including intercompany transactions.

### NOTE 16 LOSS PER SHARE

The following table reconciles the numerators and denominators of the basic and diluted earnings per share:

	Dec 2009	Dec 2008
Net loss	\$ (394,799)	\$ (355,287)
Weighted average number of shares outstanding - basic	51,170,507	18,621,181
Weighted average number of shares outstanding - diluted (anti-dilutive)	51,170,507	18,621,181

### NOTE 17 INCOME TAXES AND DEFERRED LOSSES

	2009	2008
--	------	------

For income tax purposes, the Corporation can carry forward losses totalling \$5,856,584 at the Federal level and Manitoba and \$5,907,945 at the Québec level. The expiration dates for using these losses to reduce income taxes are as follows:

	Federal	Manitoba	Quebec
2009	\$ -	\$ -	\$ 150,260
2014	220,621	220,621	214,964
2015	1,876,873	1,876,873	1,780,874
2026	911,289	911,289	974,942
2027	811,966	811,966	751,070
2028	2,035,835	2,035,835	2,035,835
	<b>\$ 5,856,584</b>	<b>\$ 5,856,584</b>	<b>\$ 5,907,945</b>

## GALE FORCE PETROLEUM INC. (Consolidated)

### NOTES TO THE FINANCIAL STATEMENTS

December 31, 2009

#### NOTE 18 COMPARATIVE FIGURES FOR THE PRIOR YEAR

Certain figures for 2008 have been reclassified to make their presentation identical to that adopted in 2009.

#### NOTE 19 SALE OF MANITOBA ASSETS

	2009	2008
Write-down of exploration and development cost, depreciation and amortization	\$ -	\$ 300,218
Other gain on sale of Manitoba properties	-	(297,180)
Other selling expenses	-	(604)
	\$ -	\$ 2,434

#### NOTE 20 OTHER (INCOME) AND EXPENSES

	2009	2008
Loss (Gain) on settlement of debt	\$ (11,537)	\$ 2,996
Interest	-	(2,086)
Settlement of litigation (recovery)	8,425	13,332
Allowance for doubtful accounts	-	1,090
Exchange rate variation	110,430	(298,990)
Contigent Income tax liability	-	117,858
Loss (gain) on disposal of assets	-	17,779
	\$ 107,318	\$ (148,021)

#### *Litigation Settled*

During the quarter, an agreement to settle a litigation brought by the Corporation has been reached by the Corporation and the defendant on November 16, 2009, and the Corporation was paid gross \$700,000 or \$500,000 net of trial costs on December 16, 2009, under the terms of the agreement; of the \$500,000 in net proceeds, the Corporation disbursed \$200,000 to repay advances that had been made to it by its secured creditor over and above the secured loan amount, and a further \$200,000 was used to pay-down the Corporation's \$2,027,614 secured loan, reducing the balance of the loan to \$1,827,614. The remainder of the funds were dispersed immediately to discharge some of the Corporation's accumulated short-term liabilities, to pay for the administrative costs of bringing the Corporation into compliance with its reporting obligations, and to pay some of the costs of obtaining the necessary regulatory and shareholder approvals of the Financing and Acquisitions described below.

#### NOTE 21 CAPITAL DISCLOSURE

The Company manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust its capital structure, the Company may issue new shares, sell assets to settle liabilities or return capital to its shareholders. The Company is not exposed to externally imposed capital requirements. The Company considers the items included in shareholders' equity as capital.

The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the business.

# GALE FORCE PETROLEUM INC. (Consolidated)

## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2009

### NOTE 22 SEGMENT INFORMATION

	Canada		USA	
	2009	2008	2009	2008
<b>Income</b>	-	393,427	<b>396</b>	<b>24,339</b>
Operating expenses	<b>285,918</b>	969,286	<b>778</b>	<b>13,378</b>
Financial Expenses	<b>1,181</b>	448,975	-	-
Sale of Manitoba Assets	-	2,434	-	-
Other expenses	<b>107,318</b>	(148,021)	-	-
<b>Net loss</b>	<b>(394,417)</b>	<b>(879,247)</b>	<b>(382)</b>	<b>10,961</b>

The Corporation has operating segments in Canada and the USA. In the USA, the Corporation owns a 50% working interest in its Kentucky Shale Gas Property, consisting of 10,000 acres of oil and gas leases, 9 gas wells and 5 miles of gathering lines, including compressors.

	Canada		USA	
	2009	2009	2009	2009
<b>Balance Sheet</b>				
Assets				
Current Assets	<b>919,402</b>	721,998	<b>1,959</b>	-
Capital Assets	-	960,829	<b>957,870</b>	-
Others	<b>1,774,432</b>	-	<b>(1,774,432)</b>	-
<b>Total Assets</b>	<b>2,693,834</b>	1,682,827	<b>(814,603)</b>	-
Liabilities				
Current Liabilities	<b>2,933,738</b>	4,765,883	<b>236,305</b>	-
LTD and others	<b>5,000</b>	291,002	<b>38,630</b>	-
Total Liabilities	<b>2,938,738</b>	5,056,885	<b>274,935</b>	-
SHLD'S Equity (Deficiency)	<b>(250,943)</b>	(3,374,058)	<b>(1,083,499)</b>	-
<b>Total Liabilities and SHLD'S Equity (Deficiency)</b>	<b>2,687,795</b>	1,682,827	<b>(808,564)</b>	-

### NOTE 23 SUBSEQUENT EVENTS

#### *New Revised Conditional Amendment to Loan Agreement with Secured Creditor*

Subsequent to the end of the quarter, the Corporation reached a new conditional agreement with its secured lender to write down or reimburse the full amount of its \$1,830,231 secured loan: the Lender will write-down \$9,877,614 of the loan, convert \$400,000 into shares of the Corporation at a price of one-half cents (\$0.005) per share consolidation), and convert the balance of \$450,000 into preferred shares of the Corporation, subject to the Corporation concluding a consolidation of its shares on a basis of one (1) new share for fifty (50) old shares, subject to the Corporation creating a news class of Preferred Shares, and subject to the Corporation concluding an equity private placement of a minimum CA\$1 million concomitant with the purchase of new property assets.

#### *Property and Asset Acquisitions plus Financing Plans*

Subsequent to the end of the year, agreements have to purchase oil and gas properties in Texas, Oklahoma and Tennessee have been revised. As at the publication of these financial statements, the Corporation has completed its due diligence on these transactions. The transactions are subject to the Corporation obtaining shareholder and regulatory approval of the consolidation of its shares on a basis of one (1) new share for fifty (50) old shares and the approval to create a news class of Preferred Shares. The transactions are also subject to the approval of the TSX Venture Exchange prior to closing the transactions.

# Gale Force Petroleum Inc.

## BOARD OF DIRECTORS

Guillaume Dumas<sup>2,3</sup>

*Partner, Primatlantis Capital Inc.*

Mazen Haddad<sup>2,3</sup>

*Consultant, Township Capital Inc.*

Antoinette Lizzi

*Vice-President of Finance and CFO, Gale Force Petroleum Inc.*

Michael McLellan<sup>1,2,3</sup>

*Chairman & CEO, Gale Force Petroleum Inc.*

## OFFICERS

Michael McLellan<sup>1,2,3</sup>

*Chairman & CEO, Gale Force Petroleum Inc.*

Antoinette Lizzi

*Vice-President of Finance and CFO, Gale Force Petroleum Inc.*

1. Chairman

2. Member of Audit Committee

3. Member of the Reserves Committee

## AGENTS

Computershare Investor Services Inc.

Suite 700 - 1500 University

Montréal, Québec

Canada, H3A 3S8

## BANKERS

National Bank of Canada

600, de la Gauchetière West

Montréal, Québec

H3B 4L2

## AUDITORS

Bélanger Dalcourt CA

Suite 1600 - 2000 McGill College

Montreal, Quebec

H3A 3H3

## EVALUATION ENGINEERS

Trimble Engineering Associates Ltd.

2200, 801-6th Ave. S.W.

Calgary, Alberta

T2P 3W2

## STOCK EXCHANGE LISTINGS

TSX Venture Exchange

Ticker Symbol "GFP"

## ABBREVIATIONS

bbls *barrels*

mbbls *thousand barrels*

bbls/d *barrels per day*

CICA *Canadian Institute of Chartered Accountants*

## CONVERSION OF UNITS

Imperial *Metric*

1 acre *0.4 hectares*

2.5 acres *1 hectare*

1 bbl *0.159 cubic metre*

6.29 bbls *1 cubic metre*

1 foot *0.3048 metres*

3.281 feet *1 metre*

1 mcf *28.2 cubic metres*

1 mile *1.61 kilometres*

0.62 miles *1 kilometre*

## HEAD OFFICE

1200 McGill College Avenue

11th Floor

Montréal, Québec

H3B 4G7

Phone. : 514.333.9292

Fax: 514.333.9273

[www.galeforcepetroleum.com](http://www.galeforcepetroleum.com)