

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying financial statements are the responsibility of management. The financial statements have been prepared by management in accordance with the accounting policies outlined in the notes to the financial statements. Financial statements include certain amounts based on estimates and judgments. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly, in all material respects. In the opinion of management, the financial statements have been prepared within acceptable limits of materiality and are in accordance with Canadian generally accepted accounting principles. The financial information contained in the annual report is consistent with that in the financial statements.

Management maintains appropriate systems of internal control. Policies and procedures are designed to give reasonable assurance that transactions are appropriately authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of financial statements.

KPMG LLP, an independent firm of chartered accountants, was appointed by a vote of shareholders at the Company's last annual meeting to audit the financial statements and provide an independent opinion.

The audit committee of the Board of Directors has reviewed the financial statements including notes thereto, with management and KPMG LLP. The financial statements have been approved by the Board of Directors on the recommendation of the audit committee.

(signed) "*Brad Turner*"

Brad Turner
President and Chief Executive Officer
April 7, 2009

(signed) "*Lonn Bate*"

Lonn Bate
Chief Financial Officer

AUDITORS' REPORT

To the Shareholders of Richards Oil & Gas Limited

We have audited the balance sheets of Richards Oil & Gas Limited as at December 31, 2008 and 2007 and the statements of operations, comprehensive loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(signed) "*KPMG LLP*"

KPMG LLP
Chartered Accountants
April 7, 2009

RICHARDS OIL & GAS LIMITED
BALANCE SHEETS

As at December 31,	2008	2007
ASSETS		
CURRENT		
Cash and cash equivalents	\$ 1,816,333	\$ 6,225,567
Accounts receivable	1,553,765	2,571,115
Prepaid expenses	109,380	103,546
	<u>3,479,478</u>	<u>8,900,228</u>
PROPERTY AND EQUIPMENT (note 5)	<u>21,682,114</u>	<u>16,064,757</u>
	<u>\$ 25,161,592</u>	<u>\$ 24,964,985</u>
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities	\$ 4,648,160	\$ 4,794,023
Credit facility (note 6)	2,000,000	-
	<u>6,648,160</u>	<u>4,794,023</u>
CONVERTIBLE DEBENTURES (note 7)	5,456,242	5,050,722
ASSET RETIREMENT OBLIGATION (note 8)	995,516	736,956
	<u>13,099,918</u>	<u>10,581,701</u>
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (note 9)	28,804,906	28,804,906
WARRANTS (note 9)	1,588,081	1,588,081
EQUITY COMPONENT OF CONVERTIBLE DEBENTURES (note 7)	1,435,822	1,435,822
CONTRIBUTED SURPLUS (note 11)	3,733,753	3,502,156
DEFICIT	(23,500,888)	(20,947,681)
	<u>12,061,674</u>	<u>14,383,284</u>
	<u>\$ 25,161,592</u>	<u>\$ 24,964,985</u>

GOING CONCERN (note 2)

COMMITMENTS (note 15)

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

APPROVED BY THE BOARD OF DIRECTORS

(signed) "Brian Moss"

Brian Moss, Chairman of the Board of Directors

(signed) "Lyell Farquharson"

Lyell Farquharson, Director

RICHARDS OIL & GAS LIMITED
STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT

For the years ended December 31,	2008	2007
REVENUE		
Production	\$ 3,653,752	\$ 2,102,333
Royalties	(500,147)	(392,611)
Interest and other	137,755	293,646
	<u>3,291,360</u>	<u>2,003,368</u>
EXPENSES		
Operating	1,472,958	1,000,946
General and administrative	1,467,295	1,924,035
Stock-based compensation	220,054	453,683
Interest and financing charges (note 13)	941,310	1,074,483
Depletion, amortization and accretion	1,742,950	1,463,245
Impairment of oil and gas properties (note 5)	-	14,100,000
	<u>5,844,567</u>	<u>20,016,392</u>
NET LOSS, before income taxes	(2,553,207)	(18,013,024)
Future income tax reduction (note 12)	-	2,456,383
NET LOSS AND COMPREHENSIVE LOSS	(2,553,207)	(15,556,641)
DEFICIT, beginning of year	<u>(20,947,681)</u>	<u>(5,391,040)</u>
DEFICIT, end of year	<u>\$ (23,500,888)</u>	<u>\$ (20,947,681)</u>
Loss per share (note 10)	<u>\$ (0.035)</u>	<u>\$ (0.29)</u>

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

RICHARDS OIL & GAS LIMITED
STATEMENTS OF CASH FLOWS

For the years ended December 31,	2008	2007
CASH FLOW FROM OPERATING ACTIVITIES		
Net loss and comprehensive loss for the year	\$ (2,553,207)	\$ (15,556,641)
Items not affecting cash		
Stock-based compensation	220,054	453,683
Depletion, amortization and accretion	1,742,950	1,463,245
Impairment of oil and gas properties	-	14,100,000
Accretion of discount on convertible debentures	405,520	404,412
Future income tax reduction	-	(2,456,383)
Asset retirement expenditures	-	(195,454)
Net change in non-cash working capital (note 14)	72,909	(39,841)
	(111,774)	(1,826,979)
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions of property and equipment	(7,090,204)	(9,761,919)
Change in non-cash working capital (note 14)	792,744	50,490
	(6,297,460)	(9,711,429)
CASH FLOWS FROM FINANCING ACTIVITIES		
Issuance of share capital (net of costs)	-	9,646,297
Increase in credit facility	2,000,000	-
	2,000,000	9,646,297
DECREASE IN CASH and CASH EQUIVALENTS	(4,409,234)	(1,892,111)
CASH and CASH EQUIVALENTS, BEGINNING of YEAR	6,225,567	8,117,678
CASH and CASH EQUIVALENTS, END of YEAR	\$ 1,816,333	\$ 6,225,567

The accompanying notes form an integral part of these financial statements

RICHARDS OIL & GAS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

1. DESCRIPTION OF BUSINESS

Richards Oil & Gas Limited (the "Company") was incorporated under the Business Corporations Act (Alberta) on May 18, 2004. Richards Oil & Gas Limited is an oil and gas exploration company that specializes in the exploration, development and exploitation of coalbed methane properties. The Company has conventional oil and gas production in the provinces of Alberta and Saskatchewan and is actively exploring for, developing and producing from coalbed methane properties in Alberta.

2. GOING CONCERN

These financial statements have been prepared on the basis that the Company will be able to discharge its obligations and realize its assets in the normal course of business at the values at which they are carried in these financial statements, and that the Company will be able to continue its business activities.

For the year ended December 31, 2008, the Company reported a net loss of \$2,553,207 and incurred negative cash flow from operating activities of \$111,774. The Company also has a net working capital deficit of \$3,168,682 in relation to currently its credit facilities of \$4,000,000 at December 31, 2008. The Company has also outlined its commitments in note 15. These conditions raise doubt about the Company's ability to continue as a going concern.

The future operation of the Company is dependent on its ability to successfully explore, develop and produce economically viable reserves and market natural gas products from its properties, raise capital and receive the continued financial support from its lenders (see note 6). Recent market events, including disruptions in credit markets and other financial systems and the deterioration of global economic conditions have resulted in significant declines in commodity prices. As a result of the current commodity price and credit environment management has restricted capital and administrative spending and continues to monitor financing opportunities to fund its future prospects and commitments. Management is also considering farming out interests in its oil and gas properties, other asset dispositions and strategic alternatives to continue operations. As at the date of these financial statements, no financing or other agreements have been signed nor can it be assured that such agreements will be reached, however, management believes the courses of action being taken will mitigate the conditions and events which could raise doubt about the validity of the going concern assumption used in preparing these financial statements.

Management of the Company believes that the going concern assumption is appropriate for these financial statements. If this assumption is not appropriate, adjustments to the carrying amounts of the assets and liabilities, revenues and expenses and the balance sheet classifications used may be necessary.

3. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The financial statements of the Company have been prepared by management 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 regarding certain assets, liabilities, revenues and expenses. Such estimates must often be made based on unsettled transactions and other events and a precise determination of many assets and liabilities is dependent upon future events. Actual results may differ from estimated amounts.

Joint Operations

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

Cash and Cash Equivalents

Cash includes cash and short-term money market instruments with a maturity of less than three months.

Property and Equipment

The Company follows the full cost method of accounting for its oil and gas properties, whereby all costs associated with the exploration for and development of oil and gas reserves, whether productive or unproductive, are capitalized. Costs include land acquisitions, drilling, well equipment, geological and geophysical, administrative and stock-based compensation expenses

RICHARDS OIL & GAS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

related to exploration and development activities. Gains or losses are not recognized upon disposition of oil and gas properties unless crediting the proceeds against accumulated costs would result in a change in the rate of depletion of 20% or more.

The accumulated costs, less the costs of unproved properties, are depleted and depreciated using the unit-of-production method based on total proved reserves before royalties as determined by independent reserves evaluators. For purposes of the depletion and depreciation calculations, oil and gas reserves are converted to a common unit of measure on the basis of their relative energy content.

The costs of acquiring and evaluating unproved properties are initially excluded from depletion calculations. These properties are assessed periodically to ascertain whether impairment has occurred. When proved reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of impairment is added to the costs subject to depletion.

Net capitalized costs of the Company's oil and gas properties are subject to a ceiling test to ensure that capitalized costs do not exceed an estimate of future net revenues. This latter amount is the aggregate of expected undiscounted future net cash flows from proved reserves and costs of unproven properties. Future cash flows are estimated using expected future prices and costs. If the carrying amount is assessed to be not fully recoverable, the cost centre is written down to its fair value estimated as the present value (discounted at a risk free interest rate) of expected future cash flows, using forecast prices from proved and probable reserves and the value of unproved properties. The impairment in the carrying amount would be recognized and charged to current operations as additional depletion.

Asset Retirement Obligation

The fair value of the estimated asset retirement obligation is recognized in the balance sheet when incurred and a reasonable estimate of fair value can be made. Asset retirement obligations include those legal obligations where the Company will be required to retire long-lived assets such as producing well sites and processing 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 for crude oil and natural gas assets are amortized using the unit-of-production method. Amortization of asset retirement costs is included in depletion, amortization and accretion expense. Increases in the asset retirement obligation resulting from the passage of time are recorded as accretion expense.

Convertible Debentures

Convertible debentures have been classified as debt, net of the fair value of the conversion feature at the date of issue, which is recorded as equity component of convertible debentures and classified as a part of shareholders' equity. Issue costs associated with the placement of the convertible debentures reduce the liability component of the convertible debenture balance. The debt portion of the convertible debentures, net of the conversion feature and the issue costs, is accreted up to its face value over its term using the effective interest rate method. The accretion to the convertible debentures and the interest paid are included in interest and financing charges. When convertible debentures are converted into common shares of the Company, that portion of the value of the conversion feature within shareholders' equity will be reclassified to common shares along with the principal amount converted.

Future Income Taxes

The Company follows the liability method of accounting for income taxes. Under this method, income tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the amounts reported in the financial statements and their respective tax basis, using enacted or substantially enacted tax rates. The effect of changes in income tax rates on future income tax liabilities and assets is recognized in income for the period in which the change occurs.

Revenue Recognition

Revenue is recognized when goods have been delivered, when services have been performed, or when hydrocarbons have been produced and delivered and payment is reasonably assured.

RICHARDS OIL & GAS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

Stock-Based Compensation

The Company follows the fair value method of valuing stock options. Under this method, compensation cost, attributable to stock options granted and issued to employees, contractors, officers and directors of the Company are measured at fair value at the date of grant and either capitalized or expensed over the vesting period with a corresponding increase to contributed surplus. Capitalized amounts are charged to earnings as depletion over the life of estimated reserves. When stock options are exercised for common shares, consideration paid by the stock option holders and contributed surplus associated with the stock options are recorded as share capital.

Financial Instruments

A financial instrument is any contract that gives rise to a financial asset to one entity and a financial liability or equity instrument to another entity. Upon initial recognition, all financial instruments, are recognized on the balance sheet at fair value. Subsequent measurement is then based on the financial instruments being classified into one of five categories: held for trading, held to maturity, loans and receivables, available for sale and other liabilities. The Company has designated its cash and cash equivalents as held for trading which is measured at fair value. Accounts receivable are classified as loans and receivables which are measured at amortized cost. Accounts payable and accrued liabilities, amounts outstanding under the credit facility and convertible debentures are classified as other liabilities which are measured at amortized cost determined using the effective interest rate.

The Company nets all transaction costs incurred, in relation to the acquisition of a financial asset or liability, against the related financial asset or liability. Amounts outstanding under the credit facility are presented net of deferred interest payments, with interest recognized in earnings on an effective interest basis.

Share Purchase Warrants

The Company estimates the fair value of share purchase warrants when the share purchase warrants are issued. Fair value is estimated using the Black-Scholes option-pricing model. When exercised, the fair value is added to share capital to represent the cost to the Company of issuing the warrants.

Flow-Through Shares

The Company has financed a portion of its exploration activities through the issuance of flow-through shares. Under the terms of the flow-through share issues, the tax attributes of the related expenditures are renounced to subscribers when the flow-through shares are issued. To recognize the foregone tax benefits to the Company, share capital is reduced and future income taxes are increased in the period when the Company files the renouncement with the appropriate tax authorities.

Per Share Amounts

Basic per share amounts are calculated by dividing earnings by the weighted average number of common shares outstanding during the period. Diluted per share amounts reflect the potential dilution that could occur if stock options, warrants and convertible debentures were converted or exercised. The treasury stock method is used to determine the dilutive effect of these dilutive securities. Under the treasury stock method, only proceeds received from the exercise of "in the money" stock options, warrants and convertible debentures are used to determine the impact on the diluted per share calculations.

Use of Estimates

The amounts recorded for depletion and amortization of property and equipment, stock-based compensation, share purchase warrants, income taxes and the asset retirement obligation, are based on estimates. The ceiling test is based on estimates of oil and natural gas reserves, production rates, oil and gas prices, future costs and other relevant assumptions. By their nature, these estimates and those related to future cash flows used to assess impairment are subject to change and the impact on future financial statements resulting from changes in such estimates could be significant.

RICHARDS OIL & GAS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

4. CHANGES IN ACCOUNTING POLICIES AND PRACTICES

As of January 1, 2008, The Company adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1400, "General Standards of Financial Statement Presentation"; Section 1535 "Capital Disclosures"; Section 3031 "Inventories"; Section 3862 "Financial Instruments – Disclosures", and Section 3863 "Financial Instruments – Presentation". These standards have been applied prospectively and accordingly the prior period financial statements have not been restated.

CICA Section 1400, General Standards of Financial Statement Presentation, was amended to include requirements to assess and disclose an entity's ability to continue as a going concern. The new requirements are effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008.

CICA Section 1535 establishes standards for disclosing information regarding an entities capital and how it is managed. The section specifies the disclosure of i) an entities objectives, policies, and processes for managing capital; ii) quantitative data about what 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 noncompliance.

CICA Sections 3862 and 3863 replace section 3861 "Financial Instruments – Disclosure and Presentation" which revises and enhances financial instruments disclosure requirements and leaves unchanged its presentation requirements. The objective of section 3862 is to provide financial statement disclosure to enable users to evaluate the significance of financial instruments for the Company's financial position and performance. The section also requires increased disclosure on the nature and extent of risks arising from financial instruments that the Company is exposed to during the reporting period and the balance sheet date and how the Company is managing those risks. The purpose of section 3863 is to enhance the financial statement users' understanding of the significance of financial instruments to the Company's financial position, performance and cash flows.

Future Accounting Policies

As of January 1, 2009, the Company will be required to adopt CICA Handbook Section 3064 Goodwill and Intangible Assets which replaces CICA Handbook Sections 3062 Goodwill and Other Intangible Assets and Section 3450 Research and Development Costs. The Company is assessing the impact of this new standard on its financial statements; however, the adoption is not expected to have a material impact on its financial statements.

In December 2008, the CICA issued Section 1582 Business Combinations, replacing Section 1581. Section 1582 includes significant changes to the measurement of purchase consideration in a business combination. Under Section 1582, the fair value ascribed to shares issued as consideration in a business combination will be based on their market value at the date of exchange, as compared to the current standard which prescribes market price for a reasonable period of time before and after the date of acquisition. In addition, the majority of acquisition costs will likely have to be expensed. Current standards allow for the capitalization of these costs as part of the purchase price. Section 1582 also addresses contingent liabilities, which will be required to be recognized at fair value on acquisition, and subsequently remeasured at each reporting date until settled. Currently, standards require only contingent liabilities that are payable to be recognized. Section 1582 also requires negative goodwill to be recognized in earnings rather than the current standard of deducting from non-currents assets in the purchase price allocation. Section 1582 will be effective for the Company on January 1, 2011, with prospective application.

The Accounting Standards Board of the Canadian Institute of Chartered Accountants has recently confirmed that in the year 2011 International Financial Reporting Standards ("IFRS") will replace current GAAP for publically accountable profit-oriented enterprises in Canada. The official changeover date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. Companies will be required to provide comparative IFRS information for the previous fiscal year. At present the Company is actively monitoring and assessing the impact of convergence of Canadian GAAP and IFRS.

RICHARDS OIL & GAS LIMITED
NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

5. PROPERTY AND EQUIPMENT

\$ Amount	As at December 31, 2008	As at December 31, 2007
Capitalized costs – oil and natural gas properties	41,473,380	34,187,334
Capitalized costs – other assets	115,746	105,095
Accumulated depletion and amortization	(19,907,012)	(18,227,672)
Net book value	21,682,114	16,064,757

As at December 31, 2008, unproved property costs of \$nil (December 31, 2007 – \$4,883,891) were excluded from costs subject to depletion. At December 31, 2008, \$12,621,900 (December 31, 2007 - \$12,281,500) of future development costs were included in the costs subject to depletion. The Company capitalizes the salaries of those employees directly involved in exploration activities. For the year ended December 31, 2008, the Company capitalized \$64,478 of salaries and \$11,544 of stock-based compensation related to exploration staff.

No impairment was required to be recognized for the year ended December 31, 2008 (December 31, 2007 - \$14,100,000). The prices used in the ceiling test evaluation of the Company's oil and natural gas reserves at December 31, 2008 were:

Forecast Year	WTI Crude Oil (\$US/Barrel)	Edmonton par Price 40° API (\$CAD/Barrel)	Alberta AECO-C Spot (\$CAD/MMBtu)	Inflation Rate (%)	Exchange Rate (\$US/\$CAD)
2009	53.73	65.35	6.82	2.0	.800
2010	63.41	72.78	7.56	2.0	.850
2011	69.53	79.95	7.84	2.0	.850
2012	79.59	86.57	8.38	2.0	.900
2013	92.01	94.97	9.20	2.0	.950

Various Escalation Rates Thereafter

6. CREDIT FACILITIES

The Company maintains two fully secured, demand credit facilities with a Canadian chartered bank. At December 31, 2008 the credit facilities in place for Richards Oil & Gas Limited consist of a \$2,000,000 revolving operating demand loan ("Facility A") and a \$2,000,000 non-revolving acquisition / development demand loan ("Facility B"). The per annum interest rate for Facility A is the bank's prime lending rate plus 1.0 percent and for Facility B is the bank's prime lending rate plus 1.5 percent. Monthly principal repayments of Facility B commence one month after draw down and the repayment amount is calculated using the estimated half-life of the reserves being financed.

Both Facility A and Facility B are secured by a single \$10,000,000 fixed and floating charge demand debenture with a floating charge over the assets of the Company. The facilities are subject to a financial-based covenant requiring the Company to maintain a working capital ratio (adjusted for the undrawn portion of Facility A) of no less than 1:1. At December 31, 2008 the Company had drawn \$2,000,000 on its Facility B and was in compliance with the working capital covenant described above.

Pursuant to an interim review conducted in January 2009, the bank re-confirmed the borrowing bases at \$2,000,000 for Facility A and \$2,000,000 for Facility B and amended the per annum interest rate payable under the current credit facilities. The per annum interest rate for Facility A increased to the bank's prime lending rate plus 1.5 percent and for Facility B the per annum interest rate increased to the bank's prime lending rate plus 2.0 percent. At April 7, 2009 the Company had drawn \$1,675,000 on its Facility A and \$1,700,000 on its Facility B.

The next scheduled review is to be completed on or before April 30, 2009. As the available borrowing bases of both facilities are based on the bank's interpretation of the Company's reserves, development prospects and future commodity prices, there can be no assurance that the amount of available facilities will not decrease at the next scheduled review on or before April 30, 2009.

RICHARDS OIL & GAS LIMITED
NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

7. CONVERTIBLE DEBENTURES

On June 26, 2006 the Company issued \$6.5 million of 8.0% convertible unsecured subordinated debentures (the "Convertible Debentures") for net proceeds of \$5.9 million. The Convertible Debentures have an initial maturity date of June 26, 2011. The Convertible Debentures bear interest at 8.0% per annum which is paid semi-annually on June 30 and December 31 of each year and are subordinated to all other liabilities of the Company.

The Convertible Debentures were convertible at the option of the holder into common shares of the Company at any time after October 26, 2006 and prior to June 26, 2008 at a conversion price of \$1.65 per share. From June 26, 2008 until maturity, the conversion price increases by 10% per year. The Convertible Debentures are not redeemable by the Company before June 28, 2008 but may be redeemed in whole or in part at the option of the Company providing the Company's common shares are trading at not less than \$3.50 per share for 20 consecutive trading days ending five days prior to conversion. Redemptions and conversions entitle the holder to accrued and unpaid interest to and including the effective date.

At the option of the Company, the payment of interest and the repayment of the principal amount of the Convertible Debentures may be settled in common shares. The number of common shares to be issued upon redemption by the Company will be calculated by dividing the interest or principal by 95% of the weighted average trading price for 20 consecutive trading days ending five days prior to the date the obligation is due.

The following summarizes the Company's accounting for its Convertible Debentures:

\$ Amount	Equity Component	Liability Component
Balance as at December 31, 2007	1,435,822	5,050,722
Accretion of non-cash interest expense	-	405,520
Balance as at December 31, 2008	1,435,822	5,456,242

8. ASSET RETIREMENT OBLIGATION

As at December 31, 2008 the Company has estimated undiscounted future costs related to the abandonment and restoration of its oil and gas properties to be \$1,568,295 (December 31, 2007 - \$1,155,194). These obligations are to be settled over an average of 6.3 years and have been discounted using a credit-adjusted risk free interest rate of 6.0% to 10.0% and inflation rate of 2.0%.

Changes to the asset retirement obligation were as follows:

\$ Amount	2008	2007
Balance, beginning of year	736,956	564,548
Liabilities incurred during the year	194,951	318,487
Liabilities settled during the year	-	(195,454)
Accretion of asset retirement obligation during the year	63,609	49,375
Balance, end of year	995,516	736,956

RICHARDS OIL & GAS LIMITED
NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

9. SHARE CAPITAL

Authorized:

-Unlimited number of common voting shares

i) Changes in Common Share Capital

	Number	\$ Amount
Balance as at December 31, 2006	40,991,964	21,712,192
Shares issued	31,250,000	8,411,919
Share issuance costs (net of future tax of \$178,490)	-	(402,532)
Warrants exercised for cash	419,638	227,319
Transfer from warrants account on exercise	-	80,008
Tax effect of flow-through share renouncements	-	(1,224,000)
Balance as at December 31, 2007 and 2008	72,661,602	28,804,906

ii) Stock Options

On October 2, 2004 the Company adopted a stock option plan whereby options may be granted from time to time to directors, officers, employees, and consultants to the Company. Under the terms of the original stock option plan common shares to be reserved for issuance as stock options are not to exceed 10% of the common shares outstanding and no one individual is allowed to hold stock options that if exercised would entitle the holder to acquire more than 5% of the outstanding common shares of the Company in any one year period. One third of the stock options issued under the original stock option plan vested immediately and one third on each of the first and second anniversary dates of the grant. On June 29, 2006 the vesting provisions of the original stock option plan were amended. Under the amended stock option plan all grants, except those issued to consultants to the Company, will vest one half of the stock options issued immediately and the remaining half on the first anniversary date of the grant. All stock options granted by the Company have a five year term.

The fair value of the stock options granted during the year ended December 31, 2008 have been determined using the Black-Scholes option-pricing model using the following assumptions; dividend yield (nil), expected volatility (91-92%), market risk-free interest rate (2.88-3.45%), and expected life of 5 years. The fair value of the stock options is recorded as stock-based compensation with an offsetting credit to contributed surplus over the vesting period. For the year ended December 31, 2008 the fair value of the options granted was \$140,118 (2007 - \$470,892).

The number of stock options granted and their exercise prices are as follows:

	Year ended December 31, 2008		Year ended December 31, 2007	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding at beginning of year	5,203,333	\$ 0.91	3,706,970	\$ 1.32
Options granted	1,215,000	\$ 0.16	2,155,000	\$ 0.34
Options expired	(1,628,333)	\$ 1.07	(658,637)	\$ 1.33
Outstanding at end of year	4,790,000	\$ 0.67	5,203,333	\$ 0.91
Exercisable at end of year	4,771,664	\$ 0.67	4,179,998	\$ 1.05

RICHARDS OIL & GAS LIMITED
NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

The following summarizes details about the Company's stock option granted as at December 31, 2008:

Range of exercise price	Options outstanding				Options vested	
	Outstanding options	Remaining contract life	Weighted average exercise price	Vested options	Remaining contract life	Weighted average exercise price
\$0.16 to \$0.49	2,970,000	2.8	\$0.22	2,951,664	2.8	\$0.22
\$0.50 to \$0.99	610,000	1.7	\$0.75	610,000	1.8	\$0.75
\$1.00 to \$1.49	400,000	0.9	\$1.41	400,000	0.9	\$1.41
\$1.50 to \$1.99	460,000	1.1	\$1.68	460,000	1.1	\$1.68
\$2.00 to \$2.49	350,000	1.3	\$2.16	350,000	1.3	\$2.16
	4,790,000	2.3	\$0.67	4,771,664	2.3	\$0.67

iii) Warrants

The Company issued 15,625,007 warrants to the subscribers of the private placement financing that was completed on July 10, 2007. Each warrant entitles the holder thereof to acquire one common share at a price of \$0.40 and will expire on July 10, 2009. This warrant grant represents the only warrants the Company has outstanding as at December 31, 2008.

When share purchase warrants are exercised the consideration received by the Company is recorded in the share capital account along with the fair value of the warrants previously recognized in the warrants account. The following table summarizes the changes in the warrants account:

\$ Amount	Year ended December 31, 2008	Year ended December 31, 2007
Balance, beginning of year	1,588,081	783,005
Fair value of warrants issued	-	1,588,081
Warrants exercised into common voting shares	-	(80,008)
Transfer of expired warrants to contributed surplus account	-	(702,997)
Balance, end of year	1,588,081	1,588,081

10. LOSS PER SHARE AMOUNTS

Per share amounts have been calculated based on the weighted average number of shares outstanding. Basic and diluted loss per share for both is calculated as follows:

		Net loss and comprehensive loss	Weighted average number of shares	Loss per share
Year ended:	December 31, 2008	\$ (2,553,207)	72,661,602	\$ (0.035)
	December 31, 2007	\$ (15,556,641)	53,540,137	\$ (0.29)

For the years ended December 31, 2008 and December 31, 2007 the conversion of stock options, convertible debentures and warrants is anti-dilutive.

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11. CONTRIBUTED SURPLUS

The following table summarizes the changes in the Company's contributed surplus account:

\$ Amount	Year ended December 31, 2008	Year ended December 31, 2007
Balance, beginning of year	3,502,156	2,192,993
Stock-based compensation	231,597	606,166
Transfer of expired warrants from warrants account	-	702,997
Balance, end of year	3,733,753	3,502,156

12. INCOME TAXES

The provision for current and future income taxes differs from the result which would be obtained by applying the combined federal and provincial statutory tax rates to net loss before income taxes. This difference results from the following:

\$ Amount	Year ended December 31, 2008	Year ended December 31, 2007
Net loss, before income taxes	(2,553,207)	(18,013,024)
Statutory rates	29.68%	32.60%
Expected income tax provision (recovery) computed at statutory rates	(757,792)	(5,872,246)
Effect on income tax of:		
Stock-based compensation	65,312	147,901
Valuation allowance	497,680	2,189,953
Change in income tax rate and other	194,800	1,078,009
Future income taxes	-	(2,456,383)

As at December 31, 2008 the Company has non-capital loss carry-forwards of approximately \$15,311,000 (2007 – \$10,827,000) which expire in the years 2014 to 2028.

Future income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts for income tax purposes. The components of the Company's future income tax assets and liabilities are as follows:

\$ Amount	Year ended December 31, 2008	Year ended December 31, 2007
Future income tax liabilities:		
Property and equipment	(1,593,916)	(1,730,306)
Future income tax assets:		
Asset retirement obligation	259,676	195,285
Share issue costs	221,928	407,415
Non-capital losses	3,799,944	3,317,559
Valuation allowance	(2,687,632)	(2,189,953)
Future income tax (liability) asset	-	-

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13. INTEREST AND FINANCING CHARGES

The following table summarizes the components of interest and financing charges:

\$ Amount	Year ended December 31, 2008	Year ended December 31, 2007
Interest on convertible debenture	520,000	520,000
Accretion of discount on convertible debentures	405,520	404,412
Interest on credit facility	15,790	-
Interest expense – Part XII.6 tax	-	150,071
Total	941,310	1,074,483

14. SUPPLEMENTAL CASH FLOW INFORMATION

Changes in non-cash working capital comprised the following:

\$ Amount	Year ended December 31, 2008	Year ended December 31, 2007
Accounts receivable	1,017,350	(1,583,972)
Prepaid expenses	(5,834)	(52,571)
Accounts payable and accrued liabilities	(145,863)	1,647,192
Net change	<u>865,653</u>	<u>10,649</u>
Net change by activity:		
Operating	72,909	(39,841)
Investing	<u>792,744</u>	<u>50,490</u>
Net change	<u>865,653</u>	<u>10,649</u>
Cash interest paid on part XII.6 tax	-	121,607

15. COMMITMENTS

The Company is committed to payments under an operating lease for office space over the next four years. The operating lease commitment, before operating costs, for the next four years are as follows; 2009 - \$136,192, 2010 - \$140,415, 2011 - \$144,638 and 2012 - \$148,860.

16. RELATED PARTY TRANSACTIONS

During 2008, the Company paid \$35,675 for consulting services to a firm of which a director of the Company is the President. As at December 31, 2008, the Company owed \$98,368 to the same firm.

17. CAPITAL STRUCTURE POLICIES

The Company's policy is to maintain a strong capital base for the objectives of maintaining financial flexibility, creditor and market confidence and to sustain the future development of the business. 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 oil and natural gas properties. The Company considers its capital structure to include shareholders' equity, convertible debt, available capacity under its credit facility and working capital. In order to maintain or adjust the capital structure, the Company may from time to time issue shares, sell or farm-out interests on its oil and gas properties and adjust its capital spending to manage its current and projected debt levels. Aside from the financial-based covenant requiring the Company to maintain a working capital ratio of no less than 1:1 associated with the Company's credit facility, the Company has no other externally imposed capital requirements.

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18. RISK MANAGEMENT AND FINANCIAL INSTRUMENTS

Commodity Price Risk Management

The Company's financial performance is closely linked to natural gas prices. While the Company may employ the use of financial instruments in the future to manage these price exposures, the Company has not used any such instruments to hedge its production, and its crude oil, natural gas liquids and natural gas production is sold into spot markets. A \$0.25 per mcf change in the price of natural gas received by the Company is expected to impact the annual net loss by approximately \$100,000.

Fair Value of Financial Instruments

The Company's exposure under its financial instruments is limited to financial assets and liabilities, all of which are included in these financial statements. The fair values of financial assets, liabilities, and convertible debentures that are included in the balance sheet approximate their carrying amounts.

Credit Risk

A substantial portion of the Company's accounts receivable are with customers and joint interest partners in the oil and gas industry and are subject to normal industry credit risks. Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from joint interest partners and petroleum and natural gas marketers.

Receivables from petroleum and natural gas marketers are normally collected on the 25th day of the month following production. The Company's policy to mitigate credit risk associated with these balances is to establish marketing relationships with large purchasers. The Company historically has not experienced any collection issues with its petroleum and natural gas marketers. Joint interest receivables are typically collected within one to two months of the joint interest bill being issued to the partner. The Company attempts to mitigate the risk from joint interest receivables by obtaining partner approval of significant capital expenditures and payment of cash advances prior to expenditure. However, the receivables are from participants in the petroleum and natural gas sector, and collection of the outstanding balances are dependent on industry factors such as commodity price fluctuations, escalating costs and the risk of unsuccessful drilling. The Company does not typically obtain collateral from petroleum and natural gas marketers or joint interest partners. However the Company does have the ability to withhold production from joint interest partners in the event of non-payment.

As at December 31, 2008 the Company had \$451,574 in accounts receivable that were past due. At December 31, 2008, Richards Oil & Gas Limited had no material accounts receivable that it deemed uncollectible.

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they are due. The Company manages liquidity by ensuring, as far as possible, that it will have sufficient liquidity under both normal and stressed commodity market and economic conditions.

The Company prepares annual capital expenditure budgets, which are regularly monitored and updated as necessary. The Company operates a high percentage of its oil and gas properties, which allows for significant control over future expenditures. To support the capital spending program, the Company maintains two fully secured credit facilities, as outlined in Note 6.

Foreign Currency Exchange Risk

The Company is exposed to foreign currency fluctuations as crude oil and natural gas prices received are referenced to U.S. dollar denominated prices. Price fluctuations can affect the fair value and future cash flows. However, given the indirect influence of currency fluctuations, the impact of currency rate changes cannot be accurately determined.

Interest Rate Risk

The Company is exposed to interest rate risk to the extent that its credit facility is at a floating rate of interest. With the drawings on the Company's credit facility at December 31, 2008, a one percent change in the prevailing interest rate for its credit facility would result in an estimated annual change to net income of \$20,000.