
Legend Power Systems Inc.
(formerly Texas Gas & Oil Inc.)
CONSOLIDATED FINANCIAL STATEMENTS
For the years ended September 30, 2009 and 2008

AUDITORS' REPORT

To the Shareholders of
Legend Power Systems Inc. (formerly Texas Gas & Oil Inc.)

We have audited the consolidated balance sheets of Legend Power Systems Inc. (formerly Texas Gas & Oil Inc.) as at September 30, 2009 and 2008 and the consolidated statements of loss and comprehensive loss and deficit and cash flow 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 audits.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at September 30, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Vancouver, B.C.
January 13, 2010

“D+H Group LLP”
Chartered Accountants

Legend Power Systems Inc.
(formerly Texas Gas & Oil Inc.)
CONSOLIDATED BALANCE SHEETS
AS AT SEPTEMBER 30

	<u>2009</u>	<u>2008</u>
ASSETS		
CURRENT ASSETS		
Cash	\$ 3,177,060	\$ 690,455
Accounts receivable	29,608	209,409
Inventory (Note 4)	318,459	340,299
Prepaid expenses and deposits	<u>111,179</u>	<u>89,183</u>
	3,636,306	1,329,346
PROPERTY AND EQUIPMENT (Note 5)	116,476	178,794
PATENTS (Note 6)	<u>1,269,539</u>	<u>1,433,339</u>
	\$ <u>5,022,321</u>	\$ <u>2,941,479</u>
LIABILITIES		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	\$ 301,714	\$ 454,056
DEFERRED BONUS PAYABLE (Note 7)	200,000	200,000
WARRANTY PROVISION (Note 8)	150,000	—
CONVERTIBLE DEBENTURE (Note 9)	<u>495,766</u>	<u>494,875</u>
	<u>1,147,480</u>	<u>1,148,931</u>
COMMITMENTS (Note 10)		
CREDIT FACILITY (Note 11)		
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (Note 12)	25,553,190	22,202,693
CONTRIBUTED SURPLUS (Note 15)	1,127,884	97,938
EQUITY COMPONENT OF CONVERTIBLE DEBENTURE (Note 9)	5,125	5,125
ACCUMULATED DEFICIT	<u>(22,811,358)</u>	<u>(20,513,208)</u>
	<u>3,774,841</u>	<u>1,792,548</u>
	\$ <u>5,022,321</u>	\$ <u>2,941,479</u>
NATURE OF OPERATIONS AND GOING CONCERN UNCERTAINTIES (Note 1)		
CONTINGENT LIABILITIES (Note 20)		
SUBSEQUENT EVENTS (Note 22)		

The accompanying notes are an integral part of these consolidated financial statements.

Approved by the Board "Gerry Gill" Director "Doug Blakeway" Director

Legend Power Systems Inc.
(formerly Texas Gas & Oil Inc.)
CONSOLIDATED STATEMENTS OF LOSS AND
COMPREHENSIVE LOSS AND DEFICIT
FOR THE YEARS ENDED SEPTEMBER 30

	<u>2009</u>	<u>2008</u>
REVENUE	\$ 24,079	\$ 690,212
COST OF SALES	<u>2,124</u>	<u>358,797</u>
	<u>21,955</u>	<u>331,415</u>
EXPENSES		
Advertising and promotion	24,647	90,627
Amortization of patents	163,800	163,808
Amortization of property and equipment	70,630	59,734
Consulting services	103,889	282,183
Corporate	61,669	71,362
Financing fees	—	136,899
Insurance	91,491	50,555
Interest and bank charges	27,151	35,591
Investor relations	57,073	15,677
Legal and professional fees	241,208	339,062
Office and general	66,635	103,089
Product development	169,596	55,726
Rent	182,067	177,528
Salaries	768,197	981,700
Stock-based compensation (Note 14)	158,904	97,938
Travel and entertainment	56,257	52,731
Warranty provision	<u>150,000</u>	<u>—</u>
	<u>2,393,214</u>	<u>2,714,210</u>
INCOME (LOSS) BEFORE OTHER ITEMS	<u>(2,371,259)</u>	<u>(2,382,795)</u>
OTHER ITEMS		
Flood damage expenses	—	(85,691)
Insurance claim proceeds	—	128,483
Foreign exchange	(390)	6,000
Other income	<u>73,499</u>	<u>39,250</u>
	<u>73,109</u>	<u>88,042</u>
NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS) FOR THE YEAR	(2,298,150)	(2,294,753)
ACCUMULATED DEFICIT, beginning of year	<u>(20,513,208)</u>	<u>(9,444,166)</u>
	(22,811,358)	(11,738,919)
ADJUSTMENT ON RECAPITALIZATION (Note 3)	—	(70,728)
RECAPITALIZATION ON CORPORATE REORGANIZATION (Note 3)	<u>—</u>	<u>(8,703,561)</u>
ACCUMULATED DEFICIT, end of year	\$ <u>(22,811,358)</u>	\$ <u>(20,513,208)</u>
EARNINGS (LOSS) PER SHARE		
Basic and fully diluted	\$ (0.09)	\$ (0.15)
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING		
Basic and fully diluted	27,446,339	15,295,038

The accompanying notes are an integral part of these consolidated financial statements.

Legend Power Systems Inc.
(formerly Texas Gas & Oil Inc.)
CONSOLIDATED STATEMENTS OF CASH FLOW
FOR THE YEARS ENDED SEPTEMBER 30

	<u>2009</u>	<u>2008</u>
CASH FLOW FROM (USED IN) OPERATING ACTIVITIES		
Net income (loss) for the year	\$ (2,298,150)	\$ (2,294,753)
Adjustments to reconcile net cash provided by operating activities		
Amortization of deferred costs	—	16,065
Amortization of patents	163,800	163,808
Amortization of property and equipment	70,630	59,734
Stock-based compensation expense	158,905	97,938
Warranty provision	150,000	—
Accretion expense for debenture	890	—
Net change in non-cash working capital accounts	<u>27,303</u>	<u>338,002</u>
	<u>(1,726,622)</u>	<u>(1,619,206)</u>
CASH FLOW FROM (USED IN) FINANCING ACTIVITIES		
Issue of common shares	4,992,810	—
Exercise of stock options	—	52,200
Share issue costs	(771,271)	—
Share warrant subscription proceeds prior to recapitalization	—	1,757,520
Cash assumed on recapitalization	—	6,041
Advances from legal parent prior to recapitalization	—	304,943
Shareholder loans repaid	<u>—</u>	<u>(311,027)</u>
	<u>4,221,539</u>	<u>1,809,677</u>
CASH FLOW FROM (USED IN) INVESTING ACTIVITY		
Purchase of property and equipment	<u>(8,312)</u>	<u>(97,158)</u>
INCREASE IN CASH DURING THE YEAR	2,486,605	93,313
CASH, beginning of year	<u>690,455</u>	<u>597,142</u>
CASH, end of year	\$ <u><u>3,177,060</u></u>	\$ <u><u>690,455</u></u>

SUPPLEMENTAL CASH FLOW INFORMATION (Note 17)

The accompanying notes are an integral part of these consolidated financial statements.

Legend Power Systems Inc.
(formerly Texas Gas & Oil Inc.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED SEPTEMBER 30, 2009 AND 2008

1. NATURE OF BUSINESS AND GOING CONCERN UNCERTAINTIES

Legend Power Systems Inc. (the "Company") is an electrical energy conservation company that manufactures and markets a patented device designed to provide energy savings through voltage optimization to commercial and industrial customers. Many customers receive higher voltage levels than required at certain points of the grid from electrical utilities due to line loss across the feeder length. Higher than nominal voltage can affect the lifespan of electrical equipment and result in higher monthly utility bills. The Company's Electrical Harmonizer and Automatic Voltage Regulator (collectively "Electrical Harmonizer-AVR") eliminates inefficiencies by delivering the optimal level of voltage a user needs. By delivering the optimal voltage to the user, Legend Power's Electrical Harmonizer-AVR helps customers reduce their electricity bills and maintenance costs while increasing the life of electrical equipment.

The Company is continuing to transition from its research and development mode to a marketing and selling mode, with full emphasis on selling its product, the Electrical Harmonizer-AVR. However, the Company's continuing operations are dependent on the profitable commercialization of its products, obtaining its products from its suppliers and/or obtaining additional financing to fund on-going operations until profitability is achieved. There is no assurance that profitability will be achieved or that management will be successful in obtaining financing when and if required on terms acceptable to the Company.

On July 2, 2008, the TSX Venture Exchange approved the Reverse Takeover ("RTO") of Texas Gas & Oil Inc. ("TGO") by Legend Power Systems Inc. ("Legend Power"). In connection with the RTO, the following transactions were completed:

- Texas Gas & Oil Inc. changed its name to Legend Power Systems Inc. by Certificate of Name Change to the British Columbia Registrar of Companies
- Legend Power Systems Inc. changed its name to 0809882 B.C. Ltd. by Certificate of Name Change to the British Columbia Registrar of Companies

Since August 2001, TGO has had no business operations and its sole function has been focused on the acquisition of Legend Power and funding the operations and development of Legend Power by way of Special Warrant Financings on a non-recourse basis.

Prior to August 2001, TGO's principal business activity was the acquisition, exploration and development of oil and gas interests.

These consolidated financial statements have been prepared in accordance with generally accepted accounting principles on a going concern basis, which presumes that the Company will be able to realize assets and discharge liabilities in the normal course of business for the foreseeable future. The Company has an accumulated deficit of \$ 22,911,359, net losses of \$ 2,398,151 for the year ended September 30, 2009, (2008: \$ 2,294,753), and to date the Company has accumulated revenues of just over \$ 1,225,000.

These consolidated financial statements do not give effect to adjustments, if any, which would be necessary should the Company be unable to continue as a going concern and, therefore, be required to realize its assets and liquidate its liabilities in other than the normal course of business and at amounts which may differ from those shown in the financial statements.

Legend Power Systems Inc.
(formerly Texas Gas & Oil Inc.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED SEPTEMBER 30, 2009 AND 2008

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Principles of consolidation:

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and include the accounts of the Company and its wholly-owned subsidiaries 0809882 B.C. Ltd., Legend Power Systems Corp., (US) and LPSI (Barbados) Limited. Intercompany balances and transactions are eliminated on consolidation.

(b) Measurement uncertainty:

The preparation of consolidated financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the consolidated financial statements, and the recognized amounts of revenues and expenses during the reporting period. The areas where management is required to make significant estimates and assumptions in determining recorded amounts include stock based compensation, the carrying value of inventory and all noncurrent assets. Actual results could differ from those estimates. By their nature, these estimates are subject to measurement uncertainty and the impact on the consolidated financial statements of future periods could be material. The financial statements have, in management's opinion, been properly prepared within the framework of the significant accounting policies summarized in this note.

(c) Currency:

The functional currency of the Company is Canadian dollars and these consolidated financial statements are presented in Canadian dollars.

Transactions of the Company that are denominated in foreign currencies are recorded in Canadian dollars at exchange rates in effect at the related transaction date. Monetary assets and liabilities denominated in foreign currencies are adjusted to reflect exchange rates at the balance sheet date.

(d) Cash:

The Company is not exposed to significant credit or interest rate risk although cash and cash equivalents are held in excess of federally insured limits with major financial institutions.

(e) Allowance for doubtful accounts:

The Company establishes an allowance for doubtful accounts through review of open accounts, and historical collection and allowance amounts. The allowance for doubtful accounts is intended to reduce trade accounts receivable to the amount that reasonably approximates their fair value due to their short term nature. The amount ultimately realized from trade accounts receivable may differ from the amount estimated in the financial statements based on collection experience and actual returns and allowances.

Legend Power Systems Inc.
(formerly Texas Gas & Oil Inc.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED SEPTEMBER 30, 2009 AND 2008

2. **SIGNIFICANT ACCOUNTING POLICIES** - continued

(f) **Inventory:**

The Company's inventory consists primarily of component parts required to manufacture its energy conservation devices and finished goods. Finished goods are comprised of the component parts and contract manufacturing charges. Inventory is recorded at the lower of cost and net realizable value. Cost is determined using the weighted average cost method. Net realizable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses. Inventory that is identified as obsolete is removed from the inventory asset account and charged to cost of sales.

(g) **Property and equipment:**

Property and equipment is recorded at cost less accumulated depreciation. Depreciation is calculated using the straight-line method at rates ranging from three to five years based on the useful life of the asset, commencing upon the utilization of the asset.

(h) **Impairment of long-lived assets:**

Long-lived assets are assessed for impairment when events and circumstances warrant. If the undiscounted value of the future cash flows is less than the carrying amount and fair value of the asset, impairment is recognized and the asset is written down to fair value.

(i) **Research and development:**

The Company is engaged in research and development. Research costs including design fees, materials and salaries of employees directly involved in research efforts are expensed as incurred. Development costs are expensed in the period incurred, unless they meet specific criteria related to technical, market and financial feasibility, in which case they are deferred and amortized over the estimated life of the related products. Management reviews the applicable criteria on a regular basis and if the criteria are no longer met, any remaining unamortized balance is written off as a charge to income.

(j) **Patents:**

Patents are recorded at cost less accumulated depreciation. Depreciation is calculated using straight-line over ten years based on the useful life of the asset at the time of purchase. Also see Note 6.

(k) **Revenue recognition:**

The Company generally recognizes revenue when product is installed assuming there is persuasive evidence of an arrangement, the fee is fixed or determinable, and collectability is reasonably assured. In limited circumstances, the Company retains ownership until product is received and inspected by the customer; revenue is recognized upon satisfaction of these conditions. The Company documents its arrangements with customers with purchase orders and sales agreements. When the proceeds of sales are received in advance of earning those revenues, the revenues are deferred and brought into income as delivery occurs or service is rendered, assuming all other revenue recognition criteria have been met.

Legend Power Systems Inc.
(formerly Texas Gas & Oil Inc.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED SEPTEMBER 30, 2009 AND 2008

2. **SIGNIFICANT ACCOUNTING POLICIES** - continued

(l) **Stock-based compensation:**

Stock-based compensation is accounted for at fair value as determined by the Black-Scholes option pricing model using amounts that are believed to approximate the volatility of the trading price of the Company's stock, the expected lives of awards of stock-based compensation, the fair value of the Company's stock and the risk-free interest rate. The estimated fair value of awards of stock-based compensation are charged to expense as awards vest, with offsetting amounts recognized as contributed surplus. If and when the stock options are exercised the applicable amounts of contributed surplus are transferred to share capital.

(m) **Income taxes:**

Future income tax assets and liabilities are recognized for the estimated future income tax consequences attributable to differences between the amounts reported in the consolidated financial statements and their respective tax bases, using substantially enacted income tax rates. The effect of a change in income tax rates on future tax liabilities and assets is recognized in income in the period that the change occurs. Future income tax assets are recognized to the extent that they are considered more likely than not to be realized.

(n) **Loss per share:**

Basic loss per share amounts are calculated using the weighted average number of common shares outstanding during the period. Diluted loss per share is calculated using the treasury stock method. This method assumes that common shares are issued for the exercise of options, warrants and convertible debentures and that the assumed proceeds from the exercise of options, warrants and convertible debentures are used to purchase common shares at the average market price during the period. The difference between the number of shares assumed issued and the number of shares assumed purchased is then added to the basic weighted average number of shares outstanding to determine the fully diluted number of common shares outstanding. No exercise or conversion is assumed during the periods in which a net loss is incurred as the effect is anti-dilutive. Shares held in escrow subject to performance conditions for release are considered contingently issuable shares and are excluded from the weighted average number of shares used in calculating loss per share.

(o) **Foreign currency translation:**

The Company's wholly owned subsidiaries are integrated foreign operations and are translated into Canadian dollars using the temporal method. Monetary assets and liabilities are translated into Canadian dollars at the rate of exchange prevailing at the balance sheet date. Non-monetary assets are translated at historical rates. Long-term debt is translated at the rate of exchange prevailing at the balance sheet date with any resulting gain or loss being deferred and amortized over the remaining term of the debt. Revenues and expenses, other than amortization of capital assets, are translated to Canadian dollars at the average rate for the period.

Legend Power Systems Inc.
(formerly Texas Gas & Oil Inc.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED SEPTEMBER 30, 2009 AND 2008

2. **SIGNIFICANT ACCOUNTING POLICIES** - continued

(p) **Financial Instruments:**

Handbook Section 3855, Financial Instruments – Recognition and Measurement, establishes standards for recognizing and measuring financial instruments, namely financial assets, financial liabilities and derivatives. It requires that financial instruments be classified into one of the following five categories: held for trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. Subsequent measurement and recognition of changes in fair value of financial instruments depend on their initial classification.

The Company has implemented the following classifications:

(i) Cash is classified as held for trading and is measured at fair value.

(ii) Accounts receivable are classified as loans and receivables and are initially recognized at fair value and then subsequently measured at amortized cost.

(iii) Accounts payable and accrued liabilities are classified as other financial liabilities and are initially recognized at fair value and then subsequently measured at amortized cost.

(iv) The component of the convertible debenture that exhibits characteristics of a liability is recognized as a liability on the balance sheet and classifies as other financial liabilities and recorded in accordance with Canadian Institute of Chartered Accountants Handbook Section 3840 – Related party transactions. On the issue of the convertible debenture, the liability component is determined using a rate for an equivalent nonconvertible bond and this amount is carried as a long term liability on the amortized cost basis until extinguished on conversion or redemption. The remainder of the proceeds is allocated to the conversion option that is recognized and included in shareholders' equity.

(q) **Adoption of New Accounting Standards:**

Effective October 1, 2008 the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants ("CICA") under Section 3862, *Financial Instruments Disclosures*, Section 3863, *Financial Instrument-Presentation* and Section 3064, *Goodwill and Intangible Assets*.

Financial Instruments

Section 3862 requires entities to provide disclosures in their financial statements that enable users to evaluate (a) the significance of financial instruments for the entity's financial position and performance; and (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks. The principles in this section complement the principles for recognizing, measuring and presenting financial assets and financial liabilities in Section 3855, *Financial Instruments - Recognition and Measurement*, Section 3863 and Section 3865, *Hedges*.

Section 3863 is to enhance financial statement users' understanding of the significance of financial instruments to an entity's financial position, performance and cash flows. This section establishes standards for presentation of financial instruments and non-financial derivatives. It deals with the classification of financial instruments, from the perspective of the issuer, between liabilities and equity, the classification of related interest, dividends, losses and gains, and the circumstances in which financial assets and financial liabilities are offset.

Legend Power Systems Inc.
(formerly Texas Gas & Oil Inc.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED SEPTEMBER 30, 2009 AND 2008

2. **SIGNIFICANT ACCOUNTING POLICIES** - continued

The Company has included the required disclosures recommended by Sections 3862 and 3863 in Note 16 of these financial statements.

Goodwill and Intangible Assets

Section 3064, Goodwill and Intangible Assets, replaces section 3062, Goodwill and Other Intangible Assets, and Section 3450, Research and Development Costs. This new section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of other intangible assets. The adoption of Section 3064 had no impact on the financial statements for the year ended September 30, 2009.

Future Accounting Policies

Business Combinations, Consolidated Financial Statements and Non-Controlling Interests

The CICA issued three new accounting standards in January 2009: Section 1582, *Business Combinations*, Section 1601, *Consolidated Financial Statements*, and Section 1602, *Non-Controlling Interests*. These new standards will be effective for fiscal years beginning on or after January 1, 2011. The Company is in the process of evaluating the requirements of the new standards.

Section 1582 replaces Section 1581, *Business Combinations*, and establishes standards for the accounting for a business combination. It provides the Canadian equivalent to IFRS 3, *Business Combinations*. The section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. Sections 1601 and 1602 together replace Section 1600, *Consolidated Financial Statements*. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1601 applies to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. It is equivalent to the corresponding provisions of IFRS IAS 27, *Consolidated and Separate Financial Statements*, and applies to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011.

International Financial Reporting Standards

In 2006 the AcSB published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period. In February 2008, the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada's own GAAP. The 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. While the Company has begun assessing the adoption of IFRS for 2011, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

Legend Power Systems Inc.
(formerly Texas Gas & Oil Inc.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED SEPTEMBER 30, 2009 AND 2008

3. RECAPITALIZATION

On July 2, 2008 (the "Effective Date"), Legend Power Systems Inc. (formerly Texas Gas & Oil Inc.) ("TGO") issued 16,498,442 shares to 0809882 B.C. Ltd. (formerly Legend Power Systems Inc.) ("LPSI"), completing the reverse takeover of the Company, which resulted in LPSI acquiring control of the Company. The acquisition has been treated for accounting purposes as a recapitalization. In accounting for this transaction:

- i. LPSI is deemed to be the purchaser and parent company for accounting purposes. Accordingly, its net assets are included in the consolidated balance sheets at their historical book value.
- ii. Control of the net assets and business of the Company was acquired on the Effective Date. The transaction has been accounted as a purchase of the assets and liabilities of the Company, which have been recorded at their fair values.

Cash	\$	6,041
Accounts receivable and prepaids		5,194
Deferred transaction costs		6,041
Advances from LPSI		(159,505)
Accounts payable and accruals		<u>(125)</u>
Net working capital deficiency		(142,354)
Advances to LPSI		8,703,495
Convertible debenture		<u>(500,000)</u>
Net assets assumed		8,061,141
Cost of purchase		<u>8,131,869</u>
Net adjustment to retained earnings on purchase	\$	<u><u>(70,728)</u></u>

- iii. The cost of purchase represents the value of the shares at \$ 8,125,828, based on 3,611,479 shares of the Company at a per share cost of \$ 2.25, being the fair market value based on the latest shares warrant subscription price just before the acquisition and transaction costs of \$ 6,041.
- iv. As a direct result of the reverse takeover, 6,005,085 special warrants, with warrant prices ranging from \$ 0.375 to \$ 2.25 and a total warrant value of \$ 8,365,387 were converted into common shares. Additionally, at the same time as the RTO the Company completed a private placement of 225,449 common shares at \$ 1.50 per share for total proceeds of \$ 338,174. Together these two transactions represent the \$ 8,703,561 recapitalization on corporate reorganization on the statement of deficit (see also Note 12 (ii) and (iii)).

4. INVENTORY

Inventory consists of Electrical Harmonizer-AVR units with cost of \$ 309,018 (2008: \$ 315,786) and sundry supplies with a cost of \$ 9,441 (2008: \$ 24,513).

Legend Power Systems Inc.
(formerly Texas Gas & Oil Inc.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED SEPTEMBER 30, 2009 AND 2008

5. PROPERTY AND EQUIPMENT

	2009		
	Cost	Accumulated amortization	Net
Computers	\$ 40,786	\$ 30,776	\$ 10,010
Equipment and furniture	209,778	149,740	60,038
Software	62,824	61,353	1,471
Leasehold improvements	<u>59,041</u>	<u>14,084</u>	<u>44,957</u>
	<u>\$ 372,429</u>	<u>\$ 255,953</u>	<u>\$ 116,476</u>

	2008		
	Cost	Accumulated amortization	Net
Computers	\$ 37,802	\$ 24,240	\$ 13,562
Equipment and furniture	206,897	94,977	111,920
Software	60,378	58,295	2,083
Leasehold improvements	<u>59,040</u>	<u>7,811</u>	<u>51,229</u>
	<u>\$ 364,117</u>	<u>\$ 185,323</u>	<u>\$ 178,794</u>

6. PATENTS

In 2007, the Company purchased the worldwide patents for the Electrical Harmonizer – AVR (excluding the Japanese patent). The purchase was from a related party and recorded at the exchange amount of \$ 1,638,099. Although it was not in the normal course of business, there was substantive change in the ownership interests and the exchange amount was supported by independent evidence. The patents are amortized over their remaining lives.

	2009		
	Cost	Accumulated amortization	Net
Patents	\$ <u>1,638,099</u>	\$ <u>368,560</u>	\$ <u>1,269,539</u>

	2008		
	Cost	Accumulated amortization	Net
Patents	\$ <u>1,638,099</u>	\$ <u>204,760</u>	\$ <u>1,433,339</u>

7. DEFERRED BONUS PAYABLE

By a consent resolution of the board of directors, the bonus previously approved as at August 25, 2008 for the Company's CEO, Mr. Gerry Gill, has been deferred at least until April 1, 2010 and until such time that the Company can demonstrate significant positive cash flow through the sales of its products to meet its budgetary requirements for another six months after that date. The bonus payable does not bear any interest.

Legend Power Systems Inc.
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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED SEPTEMBER 30, 2009 AND 2008

8. WARRANTY PROVISION

The warranty provision is based on management's best estimate of the Company's products returnable and/or replaceable based on non-performance in accordance with customer quotes or sales agreements and to provide for any liability for damages resulting from malfunctions of the Company's products or other costs incurred to remedy the problem. The estimate as at September 30, 2009 is \$ 150,000 (2008 - \$ Nil).

9. CONVERTIBLE DEBENTURE

The Company negotiated credit financing with a related party for a \$ 500,000 five year floating rate convertible debenture. The proceeds from the convertible debenture were used to fund working capital requirements.

The convertible debenture matures on May 22, 2013. Interest accrues on the convertible debenture at a variable annual rate equal to the prime lending rate plus 2 percent per annum, calculated daily. The convertible debenture is convertible at the holder's option into common shares of the Company at the earlier of any time prior to the maturity date and the business day immediately preceding the date fixed by the Company for redemption at a conversion price of \$ 2.25 per common share and is secured with a general charge against the Company's assets.

The Company may redeem the principal amount (or any portion thereof) of the convertible debenture at any time before the maturity date, providing that all accrued interest has been paid.

As the debenture is convertible into common shares, it is considered to represent both debt and equity to the Company under Canadian generally accepted accounting principles. The debt component of the debenture of \$ 495,766 (2008: \$ 494,875) is recorded at the fair value of the obligation without the conversion feature. This fair value is calculated based on the present value of all future payments of principal and interest using a discount rate applicable to similar debt instruments absent the conversion feature. The balance of the proceeds, \$ 5,125, represents the fair value of the conversion feature and is recorded as the equity component of the debentures. The debt component will accrete up to the principal balance at maturity and the accretion for the year of \$ 890 (2008: \$ Nil), is included in interest expense.

See also Note 18 (ii) and Note 22.

10. COMMITMENTS

The Company leases office premises under an operating lease that expires on September 30, 2015. The Company is obligated to make the following minimum annual lease payments under its operating lease:

September 30, 2010	\$	195,994
September 30, 2011		195,994
September 30, 2012		198,323
September 30, 2013		198,323
September 30, 2014		200,652
September 30, 2015		<u>200,652</u>
	\$	<u>1,189,938</u>

The lease annual payments are subject to changes or increases in additional rent, generally described as the Company's portion of the landlord's common area charges and property taxes.

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11. CREDIT FACILITY

On August 7, 2008, the Company finalized with a bank a \$ 2.0 million conditional operating line of credit as well as a \$ 300,000 revolving lease line of credit that allowed the Company to lease capital assets. In addition, the Company finalized a financing agreement for the bank to provide lease financing to qualified customers purchasing the Electrical Harmonizer-AVR. Under the terms of the lease agreement, the bank has agreed to provide qualified customers with capital leases for up to 100 per cent of the cost of Electrical Harmonizer-AVRs net of rebates and grants for lease terms ranging from 24 to 60 months.

The lines of credit and the financing agreement expired on January 31, 2009 and, as of their expiration, the lines of credit had not been utilized. After reviewing the Company's financial statements and conducting standard due diligence, the bank has offered to renew the lines of credit for \$ 1.0 million and the \$ 300,000 revolving lease line of credit. As at September 30, 2009, the Company has not yet executed the acceptance thereof.

12. SHARE CAPITAL

Authorized
100,000,000 common shares without par value

Issued and outstanding	<u># shares</u>	<u>Amount \$</u>
Balances at September 30, 2007	3,611,478	\$ 5,321,104
Purchase cost of TGO shares	16,498,442	8,125,828
Special warrants converted	6,005,086	8,365,387
Private placement	<u>225,449</u>	<u>338,174</u>
	26,340,456	22,150,493
Stock options exercised during the year	<u>34,800</u>	<u>52,200</u>
Balances at September 30, 2008	26,375,255	22,202,693
Returned to treasury	(15)	-
Short Form Offering issue, June 2009 (a) (i)	770,291	423,661
Non-brokered Private Placement, June 2009 (a) (ii)	63,907	35,149
Non-brokered Private Placement of shares, September 2009 (a) (iii)	100,000	45,000
Non-brokered Private Placement of units, September 2009 (a) (iii)	200,000	100,000
Brokered Private Placement of units, September 2009 (a) (iii)	8,778,000	4,389,000
Broker shares issued, September 2009 (a) (iv)	438,400	219,200
Less: Share issue costs for private placement	-	(771,271)
Less: Share issue costs for broker shares issued (a) (v)	-	(219,200)
Less: Fair value of warrants issued for private placement (a) (vi)	-	(687,132)
Less: Fair value of broker warrants issued (a) (vii)	<u>-</u>	<u>(183,910)</u>
Balances at September 30, 2009	<u>36,725,838</u>	\$ <u>25,553,190</u>

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12. **SHARE CAPITAL** - continued

a) During the year ended September 31, 2009, the following share transactions occurred:

- (i) In June 2009, the Company completed financing by way of short form offering document in which it issued a total of 770,291 common shares at \$ 0.55 per common share for aggregate gross proceeds of \$ 423,661.

Total share issue costs on the short form offering were \$66,588.

- (ii) In June 2009, the Company completed a non-brokered private placement in which it issued a total of 63,907 common shares at \$ 0.55 per common share for aggregate gross proceeds of \$ 35,149.

Total share issue costs on the non-brokered private placement were \$ 799.

- (iii) In September 2009, the Company completed a non-brokered private placement in which it issued a total of 100,000 common shares at \$ 0.45 per common share for aggregate gross proceeds of \$ 45,000.

In September 2009, the Company completed a non-brokered private placement in which it issued a total of 200,000 units at \$ 0.50 per unit for aggregate gross proceeds of \$ 100,000. Each whole unit consists of one common share and one-half of one common share purchase warrant. Each warrant will entitle the holder to purchase one share at a price of \$ 0.60 per share until March 10, 2011.

In September 2009, Company completed a brokered private-placement in which it issued a total of 8,778,000 units at \$ 0.50 per unit for aggregate gross proceeds of \$ 4,389,000. Each whole unit consists of one common share and one-half of one common share purchase warrant. Each warrant will entitle the holder to purchase one share at a price of \$ 0.60 per share until March 10, 2011.

Total number of whole warrants issued in the September 2009 non-brokered and brokered private placements was equal to 4,489,000. See also Note 13.

In connection with the September 2009, non-brokered and brokered private placements, D&D Securities Company (the "Agent") acted as the lead agent, with Phoenix Alliance Corporation participating in the selling group. The Agents cash commissions of \$ 256,350 were deducted from the fees paid to Phoenix Alliance. In connection with the above non-brokered private placements and brokered private placement Phoenix Alliance received a management finder's fee of \$ 219,450 and a consulting fee of \$ 365,874. Total other share issue costs on the brokered private placement were \$ 118,560.

- (iv) In connection with the non-brokered and brokered private placements in September 2009, Phoenix Consulting Corporation was issued 438,400 broker shares.

- (v) The fair value assigned to the 438,400 shares was \$ 219,200 or \$ 0.50 per share.

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12. **SHARE CAPITAL** - continued

- (vi) 4,489,000 warrants were attached to units sold in September 2009. The fair value of the warrants using pro-rata allocation between share and warrant was \$ 687,132.

The warrants were valued based on the following assumptions: dividend yield 0%, risk-free rate 1.24%, expected volatility 90% and expected life of 1.5 years.

- (vii) In connection with the non-brokered and brokered private placements in September 2009, D&D Securities Company (the "Agent") was issued broker warrants to acquire 867,800 shares. Each warrant entitles the holder to purchase one share at a price of \$ 0.50 per share until March 10, 2011. The fair value assigned to the 867,800 warrants was \$ 183,910. See also Note 13.

The warrants were valued based on the following assumptions: dividend yield 0%, risk-free rate 1.24%, expected volatility 90% and expected life of 1.5 years.

- b) During the year ended September 31, 2008, the following share transactions occurred:
- (i) The Company completed a reverse takeover with Texas Gas & Oil Inc. as explained in Note 3, as a result of which 16,498,442 common shares worth \$ 8,125,828 were issued.
- (ii) 6,005,085 special warrants were converted to common shares worth \$ 8,365,387.
- (iii) The Company completed a private placement of 225,449 common shares at \$ 1.50 per share for total proceeds of \$ 338,174.
- c) On each of January 2, 2009 and July 2, 2009, 397,930 common shares were released from escrow, totaling 795,860 common shares released. As at September 30, 2009, 11,827,781 common shares are still held in escrow, of which 4,665,040 common shares will be released based on performance and the remaining 7,162,741 will be released in stages before September 30, 2014.

13. **WARRANTS**

A summary of the number of common shares reserved pursuant to the Company's outstanding warrants at September 30, 2009 is as follows:

	September 30, 2009	
	Number	Weighted Average Exercise Price
Balance, beginning of period	—	\$ —
Issued	5,356,800	0.58
Expired	—	—
Balance, end of period	5,356,800	\$ 0.58

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13. **WARRANTS** - continued

The following table summarizes information of the number of common shares reserved pursuant to the warrants outstanding and exercisable at September 30, 2009:

<u>Number</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
4,489,000	\$ 0.60	March 10, 2011
<u>867,800</u>	0.50	March 10, 2011
<u>5,356,800</u>		

14. **STOCK OPTIONS**

The Company has adopted a stock option plan (the "Plan") in accordance with the policies of the TSX Venture Exchange for the benefit of directors, officers, employees and consultants of the Company whereby the maximum of 10% of the issued and outstanding common shares of the Company are reserved for issuance pursuant to the exercise of stock options to be granted under the Plan. Options granted under the Plan vest over various time periods from the grant date to five years at the discretion of the Board of Directors. Exercise prices on options granted under the Plan are determined by reference to the market value on the date of grant.

During the year, the Company cancelled 450,000 stock options on the expiration of unexercised options or on termination of employees or consultants.

The fair value of stock options granted to directors, employees and consultants is estimated on the date of the grant using the Black-Scholes option pricing model with the following assumptions used for the stock options vested during the Year:

Risk-free interest rate: 1.8% - 4.2%, Estimated volatility: 90%, Expected life: 2 - 5 years, Expected dividend yield: 0%

Option-pricing models require the use of estimates and assumptions including the expected volatility. Changes in the underlying assumptions can materially affect the fair value estimates and therefore existing models do not necessarily provide a reliable measure of the fair value of the Company's stock options.

A summary of the Company's stock options at September 30, 2009, and the changes during the year, is as follows:

	<u>Number</u>	<u>Weighted Average Exercise Price</u>
Balance, September 30, 2008	2,275,200	\$ 1.50
Granted	360,650	0.44
Expired/forfeited	<u>(450,000)</u>	1.50
Balance, September 30, 2009	<u>2,185,850</u>	1.39

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14. **STOCK OPTIONS** - continued

The following table summarizes stock options outstanding and exercisable at September 30, 2009:

<u>Number</u>	<u>Number Exercisable</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
100,000	100,000	\$ 1.50	December 24, 2009
1,550,200	1,480,200	1.50	October 30, 2012
300,000	125,000	1.50	August 10, 2013
<u>235,650</u>	<u>235,650</u>	0.44	June 8, 2012
<u>2,185,850</u>	<u>1,940,850</u>		

15. **CONTRIBUTED SURPLUS**

	<u>September 30, 2009</u>	<u>September 30, 2008</u>
Balance, September 30, 2008	\$ 97,938	\$ —
Stock-based compensation on options	158,904	97,938
Fair value of warrants issued for private placement (Note 12)	687,132	—
Fair value of broker warrants issued (Note 12)	<u>183,910</u>	<u>—</u>
Balance, September 30, 2009	\$ <u>1,127,884</u>	\$ <u>97,938</u>

16. **FINANCIAL INSTRUMENTS**

The Company's financial instruments consist of cash, accounts receivable, accounts payable and accrued liabilities and the convertible debenture.

Fair value

The fair value of cash, accounts receivable and accounts payable and accrued liabilities approximate their book values due to their short term nature.

The fair value of convertible debenture is approximated by the carrying amount as the debt bears interest at a rate close to the fair market rate of interest.

Credit risk

Cash and accounts receivable expose the Company to credit risk. The maximum credit risk exposure is equal to the carrying amount of these items.

Interest rate risk

The convertible debenture bears interest at a floating rate which exposes the Company to interest rate cash flow risk. If the market rate of interest increased by 1% the Company would be obligated to pay approximately \$ 5,000 in additional annual interest.

Liquidity risk

Liquidity risk is risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity is to evaluate current and expected liquidity requirements under both normal and stressed conditions to ensure that it maintain sufficient reserves of cash or have an available credit facility to meet its liquidity requirements in the short and long term. The Company prepares annual budgets, which are regularly monitored and updated as considered necessary.

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16. **FINANCIAL INSTRUMENTS** - continued

The Company's short-term financial liabilities are comprised of accounts payable and accrued liabilities which have expected maturities of less than one year. As at September 30, 2009, the Company had a cash balance of \$3,177,060 to settle current liabilities of \$301,714. Management believes that it has sufficient funds to meet its current liabilities as they become due.

Currency Risk

The Company incurs operating expenses and capital expenditures mostly in Canadian dollars. The Company's exposure to assets and liabilities denominated in foreign currencies is nominal. Accordingly, the Company does not have a significant exposure to losses arising from fluctuations in exchange rates.

17. **SUPPLEMENTAL CASH FLOW INFORMATION**

(i) Net changes in non-cash working capital accounts:

	<u>2009</u>	<u>2008</u>
Decrease (increase) in:		
Accounts receivable	\$ 179,801	\$ (134,930)
Inventory	21,840	50,406
Prepaid expenses	(21,996)	47,379
Increase (decrease) in:		
Deferred bonus payable	—	200,000
Accounts payable and accrued liabilities	<u>(152,342)</u>	<u>175,147</u>
	\$ <u>27,303</u>	\$ <u>338,002</u>

(ii) During the year, the Company paid interest of \$ 27,151 (2008: \$ 35,591) and received interest of \$ 1,448 (2008: \$ 30,441).

(iii) During the year, the Company paid taxes of \$Nil (2008: \$ Nil).

18. **RELATED PARTY TRANSACTIONS**

Unless otherwise stated, related party transactions are in the normal course of business and measured at the exchange amount, being the amount of consideration established and agreed to by the related parties.

(i) During the year the Company incurred \$ 60,000 (2008: \$ 138,818) in consulting fees and other charges with a shareholder of the Company, of which \$ Nil (2008: \$ Nil) remains unpaid.

(ii) In the prior year, the Company obtained financing from a shareholder by way of convertible debenture of \$ 500,000, of which \$ 500,000 (2008: \$ 500,000) remains unpaid. During the year the Company paid interest on the convertible debenture amounting to \$ 25,877 (2008: \$ 10,078) - see also Note 9 and Note 22.

(iii) During the year financing fees in the amount of \$ Nil were paid to a relative of an officer of the Company (2008: \$ 128,559).

(iv) see also note 6.

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19. INCOME TAXES

Future income tax assets and liabilities of the Company as at September 30, 2009 and 2008 are as follows:

	<u>2009</u>	<u>2008</u>
Future income tax assets		
Loss carryforwards	\$ 2,945,896	\$ 2,307,795
Other	<u>154,254</u>	<u>—</u>
	3,100,150	2,307,795
Valuation allowance	<u>(3,100,150)</u>	<u>(2,307,795)</u>
Net future income tax assets	\$ <u> —</u>	\$ <u> —</u>
Future income tax liabilities	\$ <u> —</u>	\$ <u> —</u>

The recovery of income taxes shown in the statements of loss and comprehensive loss and deficit differs from the amounts obtained by applying statutory rates to the loss before provision for income taxes as follows:

	<u>2009</u>	<u>2008</u>
Income tax rate reconciliation		
Combined federal and provincial income tax rate	<u>30.21%</u>	<u>32.15%</u>
Expected income tax recovery	\$ 724,481	\$ 737,763
Share issue costs	46,600	—
Effect of reduction in statutory rate	179,085	—
Unrecognized benefit of income tax losses	<u>(950,166)</u>	<u>(737,763)</u>
Actual income tax recovery	\$ <u> —</u>	\$ <u> —</u>

As at September 30, 2009 the Company has non-capital losses of approximately \$ 11,700,000 carried forward for Canadian income tax purposes and are available to reduce taxable income of future years. The non-capital losses expire commencing in 2027 through 2029.

20. CONTINGENT LIABILITIES

On December 10, 2002 the Company was informed of intent to file a claim in the United States for specific performance under proposed joint venture documents alleged to have been agreed to. The Company believes that this matter is without merit and therefore has made no provisions for loss in these consolidated financial statements. The Company will vigorously oppose any claim.

The Company has received a demand letter claiming a “finder’s fee” for the introduction to the Company of certain lenders and that this fee became due and payable within five days of the completion of the reverse takeover transaction. The Company has been in discussion with the claimant’s counsel and the deadline set out in the claimant’s demand letter has passed, but to date, no writ has been filed. The Company believes that it has a valid defence to this claim.

The contingent loss amounts, if any, resulting from the above claims are not determinable.

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21. CAPITAL MANAGEMENT

The Company's objective when managing capital, defined as equity, is to safeguard the entity's ability to continue as a going concern, so that it can continue to develop and sell its products for the benefit of its stakeholders. The Company funds all its programs from the issue of shares, generally through private placements. If the Company is unsuccessful in raising sufficient capital, its programs are extended, delayed or cancelled. In order to preserve cash, the Company may issue shares to compensate directors, employees, consultants and contractors through stock options. Any cash raised in surplus to immediate requirements is invested in low-risk liquid instruments.

22. SUBSEQUENT EVENTS

On October 26, 2009, the Company completed the second (and final) tranche of its previously announced brokered private placement of up to 15,000,000 units at a price of \$ 0.50 per unit for gross proceeds of up to \$ 7,500,000. Each unit consists of one common share of the Company and one half of one common share purchase warrant. Each whole warrant entitles the holder thereof to purchase one share at a price of \$ 0.60 per share for a period of 18 months until April 26, 2011. The second tranche resulted in the sale of 1,363,200 units for gross proceeds of \$ 681,600.

On October 26, 2009, the Company granted incentive stock options to certain directors, officers and employees of the Company to purchase up to 1,250,000 common shares in the capital of the Company pursuant to the Company's stock option plan. The stock options are subject to certain vesting provisions and, in particular, 800,000 stock options vest immediately and 450,000 stock options vest over a five-year period. Subject to the vesting provisions and the terms of the plan, the stock options are exercisable on or before October 25, 2014 at an exercise price of \$ 0.49 per share.

On November 12, 2009, the Company repaid in full, without penalty, the Convertible Debenture of \$500,000, together with accrued interest of \$1,630.14 as of that date. See also note 9 and note 18 (ii).