



GALILEO

Galileo Funds Annual Report 2009

Galileo High Income Plus Fund
Galileo Small/Mid Cap Fund

AUDITORS' REPORT

To the Unitholders of:

Galileo High Income Plus Fund
Galileo Small/Mid Cap Fund
(collectively the "Funds")

We have audited the statements of investment portfolio of each of the Funds as at December 31, 2009, the statements of net assets as at December 31, 2009 and 2008, and the statements of operations and changes in net assets for the years then ended. These financial statements are the responsibility of the Funds' manager. 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 investment portfolios of the Funds as at December 31, 2009, their net assets as at December 31, 2009 and 2008, and the results of each of their operations and changes in net assets for the years then ended, in accordance with Canadian generally accepted accounting principles.

Collins Barrow Toronto LLP

Licensed Public Accountants
Chartered Accountants

February 23, 2010
Toronto, Canada

Galileo High Income Plus Fund

STATEMENTS OF NET ASSETS (audited)

As at December 31

| | 2009 | 2008 |
|---|----------------------|---------------------|
| Assets | | |
| Investments, at fair value | \$ 12,430,734 | \$ 6,278,685 |
| Cash including foreign currency holdings, at fair value | 317,146 | 278,609 |
| Accrued investment income | 80,695 | 93,820 |
| Receivable for portfolio securities sold | 523,415 | 263,873 |
| Receivable for units issued | 2,147 | 19,662 |
| | 13,354,137 | 6,934,649 |
| Liabilities | | |
| Payable for portfolio securities purchased | 185,350 | 308,109 |
| Payable for units redeemed | 777 | 16,112 |
| Management fees payable (note 5) | 20,976 | - |
| Accrued expenses | 5,260 | 21,141 |
| Distributions payable to unitholders | 22,998 | 11,434 |
| | 235,361 | 356,796 |
| Net Assets Representing Unitholders' Equity | \$ 13,118,776 | \$ 6,577,853 |
| Total Net Assets per Class | | |
| Class A | \$ 12,871,101 | \$ 6,451,394 |
| Class F | \$ 247,675 | \$ 126,459 |
| Net Assets per Unit (note 4 and 8) | | |
| Class A | \$ 13.18 | \$ 9.03 |
| Class F | \$ 13.63 | \$ 9.25 |

See accompanying notes

Galileo High Income Plus Fund

STATEMENTS OF OPERATIONS (audited)

For the years ended December 31

| | 2009 | 2008 |
|--|---------------------|-----------------------|
| Income | | |
| Interest | \$ 526,998 | \$ 471,044 |
| Dividend | 87,997 | 116,441 |
| Gain (loss) on derivatives | - | (695) |
| | 614,995 | 586,790 |
| Expenses (note 5) | | |
| Management fees | 169,473 | 137,201 |
| Custodial fees | 47,107 | 44,871 |
| Audit fees | 27,387 | 13,794 |
| Legal and regulatory fees | 40,889 | 22,963 |
| | 284,856 | 218,829 |
| Expenses waived or absorbed by the Manager | (68,698) | (47,136) |
| | 216,158 | 171,693 |
| Net Investment Income | 398,837 | 415,097 |
| Realized and Unrealized Gain (Loss) on Investments | | |
| Net realized gain (loss) on sale of investments | 455,261 | (1,398,085) |
| Net realized gain (loss) on foreign currency | - | (6,386) |
| Transaction costs (note 7) | (132,285) | (105,986) |
| Change in unrealized appreciation (depreciation) of investments | 3,365,620 | (1,410,427) |
| Net Gain (Loss) on Investments | 3,688,596 | (2,920,884) |
| Increase (Decrease) in Net Assets from Operations | \$ 4,087,433 | \$ (2,505,787) |
| Increase (Decrease) in Net Assets from Operations per Class | | |
| Class A | \$ 4,013,774 | \$ (2,506,434) |
| Class F | \$ 73,659 | \$ 647 |
| Increase (Decrease) in Net Assets from Operations per Unit | | |
| Class A | \$ 5.12 | \$ (4.47) |
| Class F | \$ 5.30 | \$ 0.05 |

See accompanying notes

Galileo High Income Plus Fund

STATEMENTS OF CHANGES IN NET ASSETS (audited)

For the years ended December 31

| | 2009 | 2008 |
|--|---------------|--------------|
| CLASS A | | |
| Net Assets, Beginning of Year | \$ 6,451,394 | \$ 3,130,967 |
| Increase (Decrease) in Net Assets from Operations | 4,013,774 | (2,506,434) |
| Distributions Paid or Payable to Unitholders | | |
| From net investment income | (445,895) | (334,702) |
| From net realized capital gains | (59,042) | - |
| Return of capital | (189,829) | (226,857) |
| | (694,766) | (561,559) |
| Changes Due to Unitholder Transactions (note 4) | | |
| Amount received from the issuance of units | 3,754,709 | 7,207,927 |
| Amount received from reinvestment of distributions | 497,292 | 418,808 |
| Amount paid on redemptions of units | (1,151,302) | (1,238,315) |
| | 3,100,699 | 6,388,420 |
| Increase in Net Assets for the Year | 6,419,707 | 3,320,427 |
| Net Assets, End of Year | \$ 12,871,101 | \$ 6,451,394 |
| CLASS F | | |
| Net Assets, Beginning of Year | \$ 126,459 | \$ 192,919 |
| Increase in Net Assets from Operations | 73,659 | 647 |
| Distributions Paid or Payable to Unitholders | | |
| From net investment income | (7,890) | (7,710) |
| From net realized capital gains | (1,078) | - |
| Return of capital | (3,456) | (5,226) |
| | (12,424) | (12,936) |
| Changes Due to Unitholder Transactions (note 4) | | |
| Amount received from the issuance of units | 76,950 | 143,188 |
| Amount received from reinvestment of distributions | 10,771 | 11,232 |
| Amount paid on redemptions of units | (27,740) | (208,591) |
| | 59,981 | (54,171) |
| Increase (Decrease) in Net Assets for the Year | 121,216 | (66,460) |
| Net Assets, End of Year | \$ 247,675 | \$ 126,459 |

See accompanying notes

Galileo High Income Plus Fund

STATEMENT OF INVESTMENT PORTFOLIO (audited)

As at December 31, 2009

| Number of shares/units | | Average cost (\$) | Fair value (\$) |
|---|--|----------------------|--------------------|
| CANADIAN EQUITIES | | | |
| Consumer Discretionary- 5.72% | | | |
| 60,000 | Cervus Equipment Corp. | 528,574 | 750,000 |
| | | 528,574 | 750,000 |
| Consumer Staples- 4.78% | | | |
| 18,000 | AG Growth International Inc. | 465,722 | 626,400 |
| | | 465,722 | 626,400 |
| Energy - 29.04% | | | |
| 20,000 | ARC Energy Trust Units | 403,293 | 398,800 |
| 40,000 | Black Diamond Income Fund | 449,768 | 660,000 |
| 15,000 | Bonavista Energy Trust | 323,169 | 334,050 |
| 50,000 | Canadian Energy Services L.P., Class A units | 474,865 | 585,000 |
| 18,000 | Crescent Point Energy Corp. | 557,826 | 710,100 |
| 25,000 | Daylight Resources Trust | 218,147 | 254,250 |
| 24,000 | Pacific Northern Gas Ltd. | 420,733 | 449,040 |
| 30,000 | Peyto Energy Trust | 365,081 | 419,100 |
| | | 3,212,882 | 3,810,340 |
| Financial - 14.93% | | | |
| 40,000 | Allied Properties Real Estate Investment Trust | 625,961 | 770,000 |
| 55,000 | Crombie Real Estate Investment Trust | 484,331 | 594,000 |
| 30,000 | RioCan Real Estate Investment Trust | 457,406 | 595,200 |
| | | 1,567,698 | 1,959,200 |
| Industrials - 12.80% | | | |
| 165,000 | CanWel Building Materials Income Fund | 481,960 | 679,800 |
| 30,000 | IBI Income Fund | 456,240 | 501,000 |
| 35,000 | Westshore Terminal Income Fund | 492,184 | 498,400 |
| | | 1,430,384 | 1,679,200 |
| Information Technology - 3.62% | | | |
| 25,000 | MOSAID Technologies Inc. | 450,812 | 475,250 |
| | | 450,812 | 475,250 |
| Other - 8.45% | | | |
| 60,000 | Deans Knight Income Corp. | 623,826 | 684,000 |
| 40,000 | Marret High Yield Strategies Fund | 415,672 | 424,000 |
| | | 1,039,498 | 1,108,000 |
| Total Canadian equities - 79.34% | | 8,695,570 | 10,408,390 |

See accompanying notes

Galileo High Income Plus Fund

STATEMENT OF INVESTMENT PORTFOLIO (cont'd) (audited)

As at December 31, 2009

| Par value | | Average cost (\$) | Fair value (\$) |
|---|--|------------------------------|----------------------------|
| FIXED INCOME | | | |
| Corporate - 3.29% | | | |
| 393,750 | Algonquin Power & Utilities Corp., Callable, Convertible, 7.5%, 11/30/14 | 415,012 | 431,156 |
| | | 415,012 | 431,156 |
| Energy - 10.22% | | | |
| 300,000 | Daylight Resources Trust, Series 'C', Callable, 10.0%, 12/31/13 | 273,270 | 348,000 |
| 400,000 | NAL Oil & Gas Trust, Convertible, Callable, 6.25%, 12/31/14 | 400,000 | 411,000 |
| 575,000 | Trinidad Drilling Ltd., Convertible, Callable, 7.75%, 07/31/12 | 490,816 | 582,188 |
| | | 1,164,086 | 1,341,188 |
| Financial - 1.90% | | | |
| 250,000 | H&R Real Estate Investment Trust, Convertible, 6.0%, 06/30/17 | 250,000 | 250,000 |
| | | 250,000 | 250,000 |
| Total Fixed Income - 15.41% | | 1,829,098 | 2,022,344 |
| Transaction costs | | (28,458) | - |
| Total investments - 94.75% | | 10,496,210 | 12,430,734 |
| Other assets, net of liabilities - 5.25% | | | 688,042 |
| Total net assets - 100.00% | | | 13,118,776 |

See accompanying notes

Galileo Small/Mid Cap Fund

STATEMENTS OF NET ASSETS (audited)

As at December 31

| | 2009 | 2008 |
|---|----------------------|---------------------|
| Assets | | |
| Investments, at fair value | \$ 11,870,618 | \$ 5,285,909 |
| Cash including foreign currency holdings, at fair value | 165,425 | 32,406 |
| Accrued investment income | 1,014 | 7,280 |
| Receivable for units issued | - | 10,000 |
| Receivable for securities sold | 202,378 | - |
| | <u>12,239,435</u> | <u>5,335,595</u> |
| Liabilities | | |
| Management fees payable (note 5) | 12,617 | - |
| Accrued expenses | 4,831 | 11,336 |
| Payable for portfolio securities purchased | 35,647 | - |
| Payable for units redeemed | 581 | - |
| | <u>53,676</u> | <u>11,336</u> |
| Net Assets Representing Unitholders' Equity | \$ 12,185,759 | \$ 5,324,259 |
| Total Net Assets per Class | | |
| Class A | \$ 3,492,556 | \$ 41,343 |
| Class F | \$ 8,693,203 | \$ 5,282,916 |
| Net Assets per Unit (notes 4 and 8) | | |
| Class A | \$ 14.69 | \$ 10.54 |
| Class F | \$ 14.49 | \$ 10.28 |

See accompanying notes

Galileo Small/Mid Cap Fund

STATEMENTS OF OPERATIONS (audited)

For the years ended December 31

| | 2009 | 2008 |
|--|---------------------|-----------------------|
| Income | | |
| Interest | \$ 17,869 | \$ 57,973 |
| Dividend | 50,031 | 40,871 |
| Investment income | - | 36,898 |
| Gain (loss) on derivatives | (8,011) | 639 |
| | <u>59,889</u> | <u>136,381</u> |
| Expenses (note 5) | | |
| Management fees | 90,890 | 59,011 |
| Custodial fees | 57,900 | 36,531 |
| Audit fees | 27,387 | 13,794 |
| Legal and regulatory fees | 40,889 | 22,963 |
| | <u>217,066</u> | <u>132,299</u> |
| Expenses waived or absorbed by the Manager | (80,056) | (39,999) |
| | <u>137,010</u> | <u>92,300</u> |
| Net Investment Income (Loss) | <u>(77,121)</u> | <u>44,081</u> |
| Realized and Unrealized Gain (Loss) on Investments | | |
| Net realized gain (loss) on sale of investments | 1,122,860 | (725,038) |
| Net realized (loss) gain on foreign currency | (104,851) | 146,322 |
| Transaction costs (note 7) | (253,799) | (21,252) |
| Change in unrealized appreciation (depreciation) of investments | 2,501,068 | (1,556,839) |
| Net Gain (Loss) on Investments | <u>3,265,278</u> | <u>(2,156,807)</u> |
| Increase (Decrease) in Net Assets from Operations | <u>\$ 3,188,157</u> | <u>\$ (2,112,726)</u> |
| Increase (Decrease) in Net Assets from Operations per Class | | |
| Class A | \$ 761,612 | \$ (14,111) |
| Class F | \$ 2,426,545 | \$ (2,098,615) |
| Increase (Decrease) in Net Assets from Operations per Unit | | |
| Class A | \$ 6.32 | \$ (3.90) |
| Class F | \$ 4.31 | \$ (4.03) |

See accompanying notes

Galileo Small/Mid Cap Fund

STATEMENTS OF CHANGES IN NET ASSETS (audited)

For the years ended December 31

| | 2009 | 2008 |
|--|--------------|--------------|
| CLASS A | | |
| Net Assets, Beginning of Year | \$ 41,343 | \$ 77,688 |
| Increase (Decrease) in Net Assets from Operations | 761,612 | (14,111) |
| Changes Due to Unitholder Transactions (note 4) | | |
| Amount received from the issuance of units | 1,214,468 | 14,000 |
| Amount received from the issuance of units due to merger (note 12) | 1,945,987 | - |
| Amount paid on redemptions of units | (470,854) | (36,234) |
| | 2,689,601 | (22,234) |
| Increase (Decrease) in Net Assets for the Year | 3,451,213 | (36,345) |
| Net Assets, End of Year | \$ 3,492,556 | \$ 41,343 |
| CLASS F | | |
| Net Assets, Beginning of Year | \$ 5,282,916 | \$ 7,936,959 |
| Increase (Decrease) in Net Assets from Operations | 2,426,545 | (2,098,616) |
| Distributions Paid or Payable to Unitholders | | |
| From net investment income | - | (49,475) |
| Changes Due to Unitholder Transactions (note 4) | | |
| Amount received from the issuance of units | - | 20,002 |
| Amount received from the issuance of units due to merger (note 12) | 2,498,162 | - |
| Amount received from reinvestment of distributions | - | 49,474 |
| Amount paid on redemptions of units | (1,514,420) | (575,428) |
| | 983,742 | (505,952) |
| Increase (Decrease) in Net Assets for the Year | 3,410,287 | (2,654,043) |
| Net Assets, End of Year | \$ 8,693,203 | \$ 5,282,916 |

See accompanying notes

Galileo Small/Mid Cap Fund

STATEMENT OF INVESTMENT PORTFOLIO (audited)

As at December 31, 2009

| Number of shares/units | | Average cost (\$) | Fair value (\$) |
|---|---|----------------------|--------------------|
| CANADIAN EQUITIES | | | |
| Energy - 23.97% | | | |
| 900,000 | Alange Energy Corp. | 360,305 | 567,000 |
| 80,000 | Bankers Petroleum Ltd. | 342,319 | 496,000 |
| 23,333 | Legacy Oil + Gas Inc. | 175,000 | 224,230 |
| 400,000 | Longford Energy Inc. | 209,846 | 144,000 |
| 250,000 | NaiKun Wind Energy Group Inc. | 218,448 | 142,500 |
| 30,000 | North American Energy Partners Inc. | 204,815 | 217,500 |
| 7,500 | Pacific Rubiales Energy Corp. | 119,905 | 115,500 |
| 40,000 | Pacific Rubiales Energy, Warrants, 07/12/12 | 192,593 | 356,800 |
| 22,600 | Petrominerales Ltd. | 295,430 | 423,750 |
| 325,000 | Vast Exploration Inc. | 196,625 | 234,000 |
| | | 2,315,286 | 2,921,280 |
| Industrials - 7.32% | | | |
| 50,000 | ATS Automation Tooling Systems Inc. | 243,083 | 373,500 |
| 190,800 | Yalian Steel Corp. | 346,031 | 314,820 |
| 150,000 | Zongshen Pem Power Systems Inc. | 158,707 | 204,000 |
| | | 747,821 | 892,320 |
| Information Technology - 0.00% | | | |
| 2 | Nortel Networks Corp. | - | - |
| | | - | - |
| Materials - 38.66% | | | |
| 78,200 | Consolidated Thompson Iron Mines Ltd. | 345,782 | 526,286 |
| 120,000 | East Asia Minerals Corp. | 243,265 | 544,800 |
| 100,000 | Energold Drilling Corp. | 192,538 | 247,000 |
| 50,000 | Grande Cache Coal Corp. | 219,265 | 268,000 |
| 60,000 | Lake Shore Gold Corp. | 207,566 | 244,800 |
| 50,000 | Mantra Resources Ltd. | 200,000 | 220,000 |
| 1,000,000 | Medoro Resources Ltd. | 605,904 | 530,000 |
| 200,000 | Medoro Resources Ltd., Warrants, 07/22/11 | - | 6,000 |
| 80,000 | Paladin Energy Ltd. | 389,878 | 312,800 |
| 35,000 | Sino-Forest Corp. | 654,090 | 676,200 |
| 15,000 | Thompson Creek Mining Inc. | 190,980 | 184,500 |
| 50,000 | TimberWest Forest Corp. | 234,302 | 216,500 |
| 200,000 | UXE Corp. | 277,649 | 210,000 |
| 50,000 | Western Areas NL | 258,094 | 240,000 |
| 200,000 | Western Lithium Canada Corp. | 213,496 | 284,000 |
| | | 4,232,809 | 4,710,886 |
| Total Canadian equities - 69.95% | | 7,295,916 | 8,524,486 |

See accompanying notes

Galileo Small/Mid Cap Fund

STATEMENT OF INVESTMENT PORTFOLIO (cont'd) (audited)

As at December 31, 2009

| Number of shares/units | | Average cost (\$) | Fair value (\$) |
|---|--|----------------------|--------------------|
| FOREIGN EQUITIES | | | |
| Consumer Discretionary - 2.51% | | | |
| 250,000 | Belle International Holdings Ltd. | 311,785 | 305,553 |
| | | 311,785 | 305,553 |
| Energy - 4.70% | | | |
| 1,000,000 | China Gas Holdings Ltd. | 345,953 | 573,249 |
| | | 345,953 | 573,249 |
| Financials - 3.08% | | | |
| 1,100,000 | Shanghai Forte Land Co. Ltd., Class 'H' | 381,095 | 374,775 |
| | | 381,095 | 374,775 |
| Industrials - 9.70% | | | |
| 150,000 | China High Speed Transmission Equipment Group Co. Ltd. | 347,736 | 383,293 |
| 550,000 | Neo-Neon Holdings Ltd. | 295,494 | 415,673 |
| 400,000 | Shenji Kunming Machine Tool Co. Ltd., Class 'H' | 346,643 | 383,428 |
| | | 989,873 | 1,182,394 |
| Information Technology - 2.58% | | | |
| 300,000 | Travelsky Technology Ltd., Class 'H' | 308,314 | 314,341 |
| | | 308,314 | 314,341 |
| Materials - 4.89% | | | |
| 320,000 | Uranium Star Corp. | 106,508 | 132,512 |
| 840,000 | Western Desert Resources Ltd. | 257,266 | 463,308 |
| | | 363,774 | 595,820 |
| Total Foreign equities - 27.46% | | 2,700,794 | 3,346,132 |
| Transaction costs | | (40,049) | - |
| Total investments - 97.41% | | 9,956,661 | 11,870,618 |
| Other assets, net of liabilities - 2.59% | | | 315,141 |
| Total net assets - 100.00% | | | 12,185,759 |

See accompanying notes

Galileo Mutual Funds

Notes to the Financial Statements

For the years ended December 31, 2009 and 2008 (audited)

1. THE FUNDS

The following Funds are open-ended mutual fund trusts formed under the laws of Ontario by Declarations of Trust, as amended and restated from time to time, on the dates as noted below:

| | |
|-------------------------------|--------------------|
| Galileo High Income Plus Fund | September 14, 2006 |
| Galileo Small/Mid Cap Fund | June 15, 2000 |
| [the "Funds"] | |

On November 7, 2006, Galileo Funds Inc. filed a simplified prospectus for an initial public offering to sell an unlimited number of class A and F units of the Funds.

The Funds are referred to individually as a "Fund" and collectively as the "Funds". Galileo Funds Inc. acts as the Trustee and the Manager of the Funds (the "Funds' Manager"). As such, the Funds are dependent on the Funds' Manager for the administration and management of all matters relating to their operation. Galileo Global Equity Advisors Inc. is the portfolio advisor for the Funds.

On July 30, 2009, Northland Bancorp Inc. acquired a controlling interest in Galileo Global Equity Advisors Inc., the parent corporation of Galileo Funds Inc. and the portfolio advisor of the Fund.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") within the framework of the significant accounting policies summarized below:

Valuation of investments

Equities and warrants are recorded at fair value, established by the closing bid price for a security on the recognized exchange on which it is principally traded. Bonds, money market securities and asset-backed securities are recorded at fair value, established using the closing bid price obtained from recognized securities dealers. Investment funds are valued based on the net asset value per unit at the end of each valuation day. Unlisted securities are valued at the last ascertainable bid price of such securities. If the closing bid price for a security is not readily available, the last transacted price is used or the Funds' Manager may estimate fair value based on available market information. Warrants that are not listed on a recognized exchange are priced using the Black-Scholes model.

Foreign currency contracts are valued at the gain or loss that would be realized if, on the valuation date, the positions were closed out. They are reflected in the Statements of Operations as part of "change in unrealized appreciation (depreciation) of investments" and in the Statements of Net Assets in "unrealized gain (loss) on derivatives". When foreign currency contracts are closed out, gains and losses are realized and are included in "net realized gain (loss) on foreign currency" in the Statements of Operations.

Galileo Mutual Funds

Notes to the Financial Statements

For the years ended December 31, 2009 and 2008 (audited)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Use of estimates

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Significant estimates include the valuation of investments. Actual results could differ from those estimates.

Transaction costs

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of an investment, which include fees and commissions paid to agents, advisors, brokers, and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Such costs are expensed and are included in "Transaction costs" in the Statements of Operations.

Translation of foreign currencies

Purchases and sales of investments and investment income denominated in foreign currencies are translated into Canadian dollars at the rate of exchange prevailing on the respective dates of the transactions.

Realized and unrealized foreign currency gains or losses on investments are included in the Statements of Operations in "net realized gain (loss) on sale of investments" and "change in unrealized appreciation (depreciation) of investments."

Realized foreign currency gains or losses on assets, liabilities and income other than investments denominated in foreign currency are included in the Statements of Operations in "net realized gain (loss) on foreign currency".

The fair values of investments, short-term notes and other assets and liabilities are translated into Canadian dollars at the rates of exchange prevailing at the end of the period.

Investment transactions and income recognition

Investment transactions are accounted for on the trade date. Gains and losses arising from the sale of investments are determined using the average cost basis. Income and expenses are recorded on an accrual basis with dividend income being recorded on the ex-dividend date. Distributions from income trusts, mutual funds and REITs are recognized on the ex-distribution date and are recorded as income, capital gains or a return of capital, based on the best information available to the Funds' Manager. Distributions from investment trusts that are treated as a return of capital for income tax purposes reduce the average cost of the underlying investment. Dividends are recorded net of any related withholding tax.

Galileo Mutual Funds

Notes to the Financial Statements

For the years ended December 31, 2009 and 2008 (audited)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Fund unit transactions and valuation

The units of each class of the Funds are issued and redeemed at their net asset value per unit. The units of the Funds are valued on each "Valuation Date". The Funds are valued on each day the markets trade. The net asset value per unit is calculated by dividing the excess of the Fund's assets over its liabilities by the number of units outstanding for that class on that day.

In addition, at the reporting date for financial statement purposes only, net assets are determined in accordance with CICA Section 3855 ("net assets"). A reconciliation of net asset value and net assets is described in note 8.

The net assets of each class is computed by calculating the value of that class' proportionate share of the Fund's assets less that class' proportionate share of the Fund's common liabilities, and less any class specific liabilities.

Expenses directly attributable to a class are charged to that class while common fund expenses are allocated to each class in a reasonable manner as determined by the Funds' Manager.

Income and realized and unrealized gains and losses are allocated to each class based on their relative average net asset value.

Increase (decrease) in net assets from operations per unit

Increase (decrease) in net assets from operations per unit in the Statements of Operations represents the net increase (decrease) in net assets from operations for the year, by class, divided by the weighted average units outstanding per class during the year.

Adoption of new accounting standards

During the year, the Funds adopted an amendment to CICA Section 3862, which applies to fiscal years ending after September 30, 2009. The amendment introduces a fair value hierarchy for disclosures, which intends to provide information to financial statement users about the relative observability of inputs to fair value measurements. This amendment has no impact on the net assets or net asset value of the Funds. Refer to note 10(f) for these additional disclosures.

Galileo Mutual Funds

Notes to the Financial Statements

For the years ended December 31, 2009 and 2008 (audited)

3. DISTRIBUTION OF INCOME AND CAPITAL GAINS

Net investment income and net realized capital gains are distributed by the issuance of an equivalent amount of units in the Funds, such that the Funds are not subject to tax. Distributions are recorded on the business day immediately following the record date.

For the Galileo High Income Plus Fund, the net investment income is distributed to unitholders monthly and net realized capital gains on the sale of investments are distributed to unitholders annually at the end of the calendar year.

For the Small/Mid Cap Fund, the net investment income and net realized capital gains on the sale of investments are distributed to unitholders annually at the end of the calendar year.

4. UNITS OF THE FUNDS

Units issued and outstanding represent the capital of each Fund. Units of the Funds are redeemable at the option of the unitholder, in accordance with the provisions of the applicable Declaration of Trust, at their net asset value per unit. Investors of each class of units of the Funds are entitled to participate in the distribution of net investment income and net realized capital gains on a proportionate basis. The Funds have no restrictions or specific capital requirements on the subscription and redemption of units. The Statements of Changes in Net Assets identify changes in each Fund's capital during the year. The Funds' Manager manages the capital of the Funds in accordance with the Funds' investment objectives. Unit transactions during the years ended December were as follows:

January 1 to December 31, 2009

| Fund | Units Outstanding Beginning of Year | Issued | Issued from Merger (note 12) | Redeemed | Reinvested from Distributions | Units Outstanding End of Year |
|---------------------------------|--|---------|------------------------------------|----------|-------------------------------------|-------------------------------------|
| Galileo High Income Plus | | | | | | |
| Class A | 714,094 | 326,061 | - | 109,605 | 45,688 | 976,238 |
| Class F | 13,678 | 5,977 | - | 2,452 | 965 | 18,168 |
| Galileo Small/Mid Cap | | | | | | |
| Class A | 3,923 | 90,852 | 180,803 | 37,813 | - | 237,765 |
| Class F | 513,804 | - | 236,748 | 150,573 | - | 599,979 |

January 1 to December 31, 2008

| Fund | Units Outstanding Beginning of Year | Issued | Redeemed | Reinvested from Distributions | Units Outstanding End of Year |
|---------------------------------|--|---------|----------|----------------------------------|----------------------------------|
| Galileo High Income Plus | | | | | |
| Class A | 249,963 | 538,573 | 108,764 | 34,322 | 714,094 |
| Class F | 15,206 | 14,157 | 16,554 | 869 | 13,678 |
| Galileo Small/Mid Cap | | | | | |
| Class A | 5,260 | 1,234 | 2,571 | - | 3,923 |
| Class F | 551,264 | 1,380 | 43,640 | 4,800 | 513,804 |

Galileo Mutual Funds

Notes to the Financial Statements

For the years ended December 31, 2009 and 2008 (audited)

5. EXPENSES

Reasonable expenses incurred in the operation of the Funds, such as audit, legal, custodian and other professional fees are charged in the Statements of Operations. The Funds' Manager has, at its discretion, agreed to absorb certain expenses. The absorbed amounts are shown in the Statements of Operations. Such absorbed amounts can be terminated at any time, but can be expected to continue until such time as the Funds are of sufficient size to reasonably absorb all management and operating expenses incurred.

The management fees before GST for the Class A and Class F units are based on a percentage of average net asset value per annum as follows:

| <u>Fund</u> | <u>Class A</u> | <u>Class F</u> |
|-------------------------------|----------------|----------------|
| Galileo High Income Plus Fund | 1.90% | 0.90% |
| Galileo Small/Mid Cap Fund | 1.95% | 0.95% |

During the year certain funds held units of other Galileo mutual funds. Adjustments to the management fees were made to ensure no duplication of management fees applied to a Fund holding units of another Galileo mutual fund.

6. INCOME TAXES

The High Income Plus Fund is a mutual fund trust, and the Small/Mid Cap Fund is a unit trust under the provisions of the Income Tax Act (Canada) and accordingly, are subject to taxes on their net investment income, including net realized capital gains for the period which are not paid or payable to their unitholders as at the end of the year. The Funds pay out sufficient net investment income and net realized capital gains to unitholders so that no provision for income taxes is required in the financial statements. Occasionally, distributions by a fund will exceed the net investment income and taxable capital gains realized by the fund. To the extent that the excess is not designated by the fund to be income for Canadian tax purposes and taxable to the unitholders, this excess distribution is a return on capital and is not immediately taxable to unitholders.

As at December 31, 2009, the Funds had the following net capital and non-capital losses to be carried forward.

| <u>Fund</u> | <u>Total Net Capital Loss (\$)</u> | <u>Total Non Capital Loss (\$)</u> |
|-------------------------------|--|--|
| Galileo High Income Plus Fund | 735,504 | - |
| Galileo Small/Mid Cap Fund | 1,009,759 | - |

7. TRANSACTION COSTS

The total fees paid to brokers in connection with investment portfolio transactions for the years ended December 31, 2009 and 2008 are as follows:

| <u>Fund</u> | <u>2009 (\$)</u> | <u>2008 (\$)</u> |
|-------------------------------|------------------|------------------|
| Galileo High Income Plus Fund | 132,285 | 105,986 |
| Galileo Small/Mid Cap Fund | 253,799 | 21,252 |

Galileo Mutual Funds

Notes to the Financial Statements

For the years ended December 31, 2009 and 2008 (audited)

8. RECONCILIATION OF NET ASSET VALUE

In accordance with the decision made by the Canadian securities regulatory authorities, reconciliation between the net asset value and the net assets of an investment fund is required for financial reporting periods. For investments that are traded in an active market, bid prices (for investments held) and ask prices (for investments sold short) are used in the fair valuation of investments, rather than the use of closing sale prices currently used for the purpose of determining net asset value. For investments that are not traded in an active market, Section 3855 requires the use of specific valuation techniques, rather than the use of valuation techniques by virtue of general practice in the investment fund industry. These changes account for the difference between net asset value and net assets.

The impact on the net asset value per unit and the net assets per unit of the Funds are as follows:

As at December 31, 2009:

| Fund | Net Asset Value per Unit (\$) | Section 3855 Adjustments (\$) | Net Assets per Unit (\$) |
|--------------------------------------|--|--|-------------------------------------|
| Galileo High Income Plus Fund | | | |
| Class A | 13.25 | (0.07) | 13.18 |
| Class F | 13.70 | (0.07) | 13.63 |
| Galileo Small/Mid Cap Fund | | | |
| Class A | 14.85 | (0.16) | 14.69 |
| Class F | 14.64 | (0.15) | 14.49 |

As at December 31, 2008:

| Fund | Net Asset Value per Unit (\$) | Section 3855 Adjustments (\$) | Net Assets per Unit (\$) |
|--------------------------------------|--|--|-------------------------------------|
| Galileo High Income Plus Fund | | | |
| Class A | 9.10 | (0.07) | 9.03 |
| Class F | 9.31 | (0.06) | 9.25 |
| Galileo Small/Mid Cap Fund | | | |
| Class A | 10.56 | (0.02) | 10.54 |
| Class F | 10.31 | (0.03) | 10.28 |

9. SOFT DOLLARS

No soft dollar expenses were incurred by the Funds during 2009 (2008 - Nil).

Galileo Mutual Funds

Notes to the Financial Statements

For the years ended December 31, 2009 and 2008 (audited)

10. FINANCIAL INSTRUMENTS AND RISK DISCLOSURES

Fair Value

Financial instruments of the Funds consist of cash, accrued investment income, receivable for portfolio securities sold, receivables for units issued, payable for portfolio securities purchased, distributions payable to unitholders, payables for units redeemed, management fees payable and accrued expenses. There are no significant differences between the carrying values of these financial instruments and their fair value. Investments are carried at their fair value as described in note 2.

Risk Management

The Funds are exposed to various types of risks that are associated with their investment strategies, financial instruments and markets in which they invest. The most important risks include credit risk, liquidity risk, and market risk, which includes interest rate risk, currency risk and equity and other price risk. These risks and related risk management practices employed by the Funds are discussed below. The sensitivity analysis shown in the notes to the statements may differ from actual trading and the difference could be material.

The Funds' Manager seeks to minimize potential adverse effects of these risks on the Funds' performance by employing professional, experienced portfolio advisers, daily monitoring of the Funds' positions and market events, and by diversifying the investment portfolio within the constraints of the investment. To assist in managing risks, the Funds' Manager also uses internal guidelines that identify the target exposure for each type of risk, maintains a governance structure that oversees the Funds' investment activities and monitors compliance with the Funds' stated investment strategy and securities regulations.

Market Risk

a) Interest Rate Risk

Interest rate risk arises on interest-bearing financial instruments.

The High Income Plus Fund and the Galileo Small/Mid Cap Fund invest in fixed income securities which bear interest at fixed rates and, as such, they are subject to interest rate price risk resulting from changes in fair value from market fluctuations in interest rates.

The table below summarizes this Fund's exposure to interest rate risk by remaining term to maturity. It includes the Fund's assets and trading liabilities at fair values, categorized by the earlier of contractual re-pricing or maturity dates.

Galileo High Income Plus Fund

As at December 31, 2009

| Investment | Less than 1 year | 1 – 3 years | 3 – 5 years | More than 5 years | Total |
|--------------|---------------------|-------------|--------------|----------------------|--------------|
| Fixed Income | \$ - | \$ 582,188 | \$ 1,190,156 | \$ 250,000 | \$ 2,022,344 |

Galileo Mutual Funds

Notes to the Financial Statements

For the years ended December 31, 2009 and 2008 (audited)

10. FINANCIAL INSTRUMENTS AND RISK DISCLOSURES (cont'd)

Market Risk (cont'd)

Interest Rate Risk (cont'd)

As at December 31, 2008

| Investment | Less than 1 year | 1 – 3 years | 3 – 5 years | More than 5 years | Total |
|--------------|---------------------|-------------|-------------|----------------------|------------|
| Fixed Income | \$ - | \$ 82,140 | \$ 300,390 | \$ 141,000 | \$ 523,530 |

At December 31, 2009, should interest rates have increased or decreased by 100 basis points with all other variables remaining constant, the Galileo High Income Plus Fund would have increased or decreased by \$77,522 (2008 - \$21,009). The Galileo Small/Mid Cap Fund has been excluded as it is not subject to interest rate risk.

b) Currency Risk

Currency risk is the risk that financial instruments which are denominated or exchanged in a currency other than the Canadian dollar, which is each of the Funds' reporting currency, will fluctuate due to changes in exchange rates.

The table below indicates the foreign currencies to which each Fund has exposure at year end in Canadian dollar terms, including the underlying principal amount of forward currency contracts, if any. The table also illustrates the potential impact to the Funds' net assets, all other variables held constant. The result of a 5% change in these currencies relative to the Canadian dollar would have increased by \$167,352 (2008 - \$27,862). In practice, the actual trading results may differ from this sensitivity analysis and the difference could be material. The Galileo High Income Plus Fund has been excluded as it is not subject to currency risk.

Galileo Small/Mid Cap Fund

As at December 31, 2009

| Currency | Investments (\$) | Impact on Net Assets (\$) |
|-------------------|------------------|------------------------------|
| Hong Kong Dollar | 2,750,312 | 137,516 |
| Australian Dollar | 463,308 | 23,165 |
| U.S. Dollar | 133,420 | 6,671 |

As at December 31, 2008

| Currency | Investments (\$) | Impact on Net Assets (\$) |
|-------------------|------------------|------------------------------|
| Hong Kong Dollar | - | - |
| Australian Dollar | - | - |
| U.S. Dollar | 557,231 | 27,862 |

Galileo Mutual Funds

Notes to the Financial Statements

For the years ended December 31, 2009 and 2008 (audited)

10. FINANCIAL INSTRUMENTS AND RISK DISCLOSURES (cont'd)

Market Risk (cont'd)

c) Equity and Other Price Risk

Equity and other price risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate or currency risk). The investments of the Funds are subject to normal market fluctuations and the risks inherent in investment in financial markets. The maximum risk resulting from financial instruments held by the Funds is equivalent to the fair value of the financial instruments. The portfolio advisor moderates this risk through a careful selection of securities within specified limits and the Funds' market price risk is managed through diversification of the investment portfolio. The most significant exposure to other price risk arises from its investments in equity securities.

Had the prices on the respective stock exchanges for these securities raised or lowered by 5%, with all other variables held constant, the following chart shows the amount which the net assets of the respective funds would have increased or decreased:

As at December 31, 2009

| <u>Fund</u> | <u>Change in Net Assets</u> <u>(\$)</u> |
|-------------------------------|--|
| Galileo High Income Plus Fund | 520,420 |
| Galileo Small/Mid Cap Fund | 593,531 |

As at December 31, 2008

| <u>Fund</u> | <u>Change in Net Assets</u> <u>(\$)</u> |
|-------------------------------|--|
| Galileo High Income Plus Fund | 287,785 |
| Galileo Small/Mid Cap Fund | 168,537 |

d) Credit Risk

Credit risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment that it has entered into with each respective Fund.

The Galileo High Income Plus Fund has significant credit risk. The Fund's greatest concentration of credit risk is in bonds. This Fund limits its exposure to credit loss by placing its cash investments with high credit quality borrowers. The fair value of debt securities includes consideration of the credit worthiness of the debt issues. The carrying amount of these investments represents the maximum credit risk exposure as at December 31, 2009. This Fund invests in financial assets, which have an investment grade as rated by Standard & Poor's. Ratings for securities that subject this Fund to credit risk are noted below:

Galileo Mutual Funds

Notes to the Financial Statements

For the years ended December 31, 2009 and 2008 (audited)

10. FINANCIAL INSTRUMENTS AND RISK DISCLOSURES (cont'd)

Market Risk (cont'd)

d) Credit Risk (cont'd)

As at December 31, 2009

| <u>Fund</u> | Debt Rating as a Percentage of Net Assets | | |
|-------------------------------|--|------------|--------------|
| | Unrated | BBB | Total |
| Galileo High Income Plus Fund | 10.2% | 5.2% | 15.4% |

As at December 31, 2008

| <u>Fund</u> | Debt Rating as a Percentage of Net Assets | | |
|-------------------------------|--|------------|--------------|
| | Unrated | BBB | Total |
| Galileo High Income Plus Fund | 8.0% | 0.0% | 8.0% |

All transactions in listed securities are settled/paid for upon delivery using approved brokers. The risk of default is considered minimal, as delivery of securities sold is only made once the broker has received payment. Payment is made on a purchase once the securities have been received by the broker.

The Funds do not perform securities lending transactions.

e) Liquidity Risk

The Funds are exposed to daily cash redemptions of redeemable units. In accordance with securities regulations, the Funds must maintain at least 90% of their assets in liquid investments (i.e. investments that are traded in an active market and can be readily disposed). In addition, the Funds must retain sufficient cash and cash equivalent positions to maintain adequate liquidity. The Funds also have the ability to borrow up to 5% of their net assets for the purposes of funding redemptions. Liquidity risk for all funds is considered minimal.

In addition, the Funds have financial liabilities outstanding including payables for portfolio securities purchased, payables for units redeemed, payables for management fees, distributions payable and accrued liabilities. These financial liabilities are all current and are due within 30 days.

Galileo Mutual Funds

Notes to the Financial Statements

For the years ended December 31, 2009 and 2008 (audited)

10. FINANCIAL INSTRUMENTS AND RISK DISCLOSURES (cont'd)

Market Risk (cont'd)

f) Fair Value Hierarchy

The Funds adopted the amendments to the accounting standards associated with financial instruments resulting in a three-tier categorization as a framework for disclosing fair value based upon inputs used to value the Funds' investments. The hierarchy is summarized as:

Level 1 - quoted prices (unadjusted) in active markets for identical assets and liabilities

Level 2 - inputs that are observable for the asset or liability, either directly (prices) or indirectly (derived from prices) from observable market data

Level 3 - inputs for assets and liabilities not based upon observable market data

The table below summarizes the categories for each Fund:

| | Level 1 (\$) | Level 2 (\$) | Level 3 (\$) | Total (\$) |
|-------------------------------|--------------|--------------|--------------|------------|
| Galileo High Income Plus Fund | | | | |
| Equities | 10,408,390 | - | - | |
| Fixed Income | - | 2,022,344 | - | |
| | | | | 12,430,734 |
| Galileo Small Mid Cap Fund | | | | |
| Equities | 11,864,618 | 6,000 | - | |
| Fixed Income | - | - | - | |
| | | | | 11,870,618 |

For the year ended December 31, 2009 no investments were transferred from Level 1 to Level 2 or vice versa.

11. RELATED PARTY TRANSACTIONS

The Funds' Manager, its officers and directors may invest in units of the Funds from time to time in the normal course of business.

All transactions with related parties are measured at the exchange amounts, and occur within the normal course of operations.

Galileo Mutual Funds

Notes to the Financial Statements

For the years ended December 31, 2009 and 2008 (audited)

12. MERGERS AND TERMINATIONS

At the close of business on May 31, 2009, the following Funds merger took place:

| Terminating Funds | \$ NAV/unit | Outstanding Units to be Fully Redeemed | Total Dollar Amount (\$) | Merge in Shares |
|---|--------------------|---|-------------------------------------|------------------------|
| Galileo Canadian Active/Passive Fund - Series A | 9.374 | 34,288.11 | 321,417 | 29,863.12 |
| Galileo Canadian Active/Passive Fund - Series F | 9.456 | 2,887.64 | 27,305 | 2,587.71 |
| Galileo Global Active/Passive Fund - Series A | 7.629 | 60,248.50 | 459,636 | 42,705.18 |
| Galileo Global Active/Passive Fund - Series F | 7.853 | 86,106.45 | 676,194 | 64,082.07 |
| Galileo Fund - Series A | 8.214 | 138,152.90 | 1,134,788 | 105,434.17 |
| Galileo Fund - Series F | 8.875 | 95,036.28 | 843,447 | 79,932.43 |
| Galileo Absolute Return Fund - Series A | 10.457 | 2,882.87 | 30,146 | 2,800.91 |
| Galileo Absolute Return Fund - Series F | 10.184 | 93,403.04 | 951,217 | 90,145.62 |

| Continuing Fund | \$ NAV/unit | Units Outstanding as of May 29, 2009 | Subscription from Closed Funds | |
|---------------------------------------|--------------------|---|---------------------------------------|--------------------|
| | | | Total Dollar Amount (\$) | Total Units |
| Galileo Small/Mid Cap Fund - Series A | 10.7630 | 3,063.28 | 1,945,987 | 180,803.38 |
| Galileo Small/Mid Cap Fund - Series F | 10.5517 | 426,595.90 | 2,498,163 | 236,747.83 |

The merger was carried out on a taxable basis under the Income Tax Act (Canada). The Terminating Funds had a deemed year end for tax purposes on May 31, 2009, after which the funds were wound up. All unrealized losses of the Terminating Funds were deemed to be realized. Any unutilized capital and non-capital loss carry forwards of the Terminating Funds expired upon the merger. None of the costs related to the mergers have been charged to the Funds.

The Continuing Fund assumed all the liabilities applicable of the Terminating Funds, in return for the issuance by the Continuing Fund of units equal in value to the net assets acquired from the Terminating Funds. As a result, the unit holders of each Terminating Fund became unit holders of the Continuing Fund.

Galileo Mutual Funds

Notes to the Financial Statements

For the years ended December 31, 2009 and 2008 (audited)

13. TRANSITION TO INTERNATIONAL REPORTING STANDARDS

The Canadian Accounting Standards Board has confirmed January 1, 2011 as the date International Financial Reporting Standards (“IFRS”) will replace Canadian Generally Accepted Accounting Principles (“GAAP”) for publicly accountable enterprises, which include investment funds and other reporting issuers. Accordingly the Fund will adopt IFRS for their fiscal period starting January 1, 2011.

In preparing to meet the requirements, the Funds’ Manager has taken the following steps in managing the transition to IFRS:

1. identified key differences between Canadian GAAP and IFRS and coordinated an action plan
2. identified areas of required disclosures under IFRS standards
3. evaluated current information technology and reporting systems for readiness in IFRS implementation
4. assessed the likely impacts on business activity and operational areas such as internal controls, staffing and training requirements.

Based upon the current evaluation of the differences between Canadian GAAP and IFRS, the adoption of IFRS is expected to have no impact on the calculation of net assets or net asset value. IFRS is expected to affect the overall presentation of financial statements and result in additional disclosure in the notes. However, the Funds’ Manager’s assessment may change if new standards are issued or if the interpretations of current standards are revised.