

Management's discussion and analysis

This Management's Discussion and Analysis ("MD & A") of the financial and operating results for WesternZagros Resources Ltd. ("WesternZagros" or the "Company") should be read in conjunction with the Company's audited consolidated financial statements (the "Annual Financial Statements") and related notes for the years ended December 31, 2009 and 2008.

Additional information relating to the Company, including its quarterly MD & A for the year is available on SEDAR at www.sedar.com

This MD & A is dated February 22, 2010.

Basis of presentation

The financial data presented below has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and is based on an assumption that the Company will continue as a going concern. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from December 31, 2009.

The reporting and functional currency of the Company is the United States ("U.S.") dollar. All references herein to US\$ or to \$ are to United States dollars and references herein to Cdn\$ are to Canadian dollars.

Forward-looking information

This discussion offers management's analysis of the financial and operating results of WesternZagros and contains certain forward-looking statements relating, but not limited, to operational information, future drilling plans and testing programs and the timing associated therewith, estimated Production Sharing Contract commitments ("PSC"), anticipated capital and operating budgets, anticipated working capital and estimated costs. Forward-looking information typically contains statements with words such as "anticipate", "estimate", "expect", "potential", "could", or similar words suggesting future outcomes. The Company cautions readers and prospective investors in the Company's securities to not place undue reliance on forward-looking information as, by its nature, it is based on current expectations regarding future events that involve a number of assumptions, inherent risks and uncertainties, which could cause actual results to differ materially from those anticipated by WesternZagros.

Forward-looking information is based on management's current expectations and assumptions regarding, among other things, plans for and results of drilling activity, future capital and other expenditures (including the amount, nature and sources of funding thereof), future economic conditions, future currency and exchange rates, continued political stability, timely receipt of any necessary government or regulatory approvals, the Company's continued ability to employ qualified staff and to obtain equipment in a timely and cost efficient manner, the continued participation of the Company's co-venture partners in exploration activities and the timely receipt of insurance proceeds. In addition, budgets are based upon WesternZagros' current exploration plans and anticipated costs both of which are subject to change based on, among other things, the actual results of drilling activity, unexpected delays and changes in market conditions. Although the Company believes the expectations and assumptions reflected in such forward-looking information are reasonable, they may prove to be incorrect. Forward-looking information involves significant known and unknown risks and uncertainties. A number of factors could cause actual results to differ materially from those anticipated by WesternZagros including, but not limited to, risks associated with the oil and gas industry (e.g. operational risks in exploration; inherent uncertainties in interpreting geological data; changes in plans

with respect to exploration or capital expenditures; interruptions in operations together with any associated insurance proceedings; the uncertainty of estimates and projections in relation to costs and expenses and health, safety and environmental risks), the risk of commodity price and foreign exchange rate fluctuations, the uncertainty associated with negotiating with foreign governments and risk associated with international activity.

In addition, statements relating to “resources” are deemed to be forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the resources described can be profitably produced in the future. Terms related to resource classifications referred to herein are based on the definitions and guidelines in the Canadian Oil and Gas Evaluation Handbook. Contingent resources are those quantities of petroleum estimated, as of a given date, to be potentially recoverable from known accumulations using established technology or technology under development, but which are not currently considered to be commercially recoverable due to one or more contingencies. Contingent resources have an associated chance of development (economic, regulatory, market and facility, corporate commitment or political risks). The estimates referred to herein have not been risked for the chance of development. There is no certainty that the contingent resources will be developed and, if developed, there is no certainty as to the timing of such development or that it will be commercially viable to produce any portion of the contingent resources. Prospective resources are those quantities of petroleum estimated, as of a given date, to be potentially recoverable from undiscovered accumulations by application of future development projects. Prospective resources have both an associated chance of discovery (geological chance of success) and a chance of development (economic, regulatory, market and facility, corporate commitment or political risks). The chance of commerciality is the product of these two risk components. The estimates referred to herein have not been risked for either the chance of discovery or the chance of development. There is no certainty that any portion of the prospective resources will be discovered. If a discovery is made, there is no certainty that it will be developed or, if it is developed, there is no certainty as to the timing of such development or that it will be commercially viable to produce any portion of the prospective resources.

Readers are cautioned that the forgoing list of important factors is not exhaustive. The forward-looking statements contained in this MD & A are made as of the date of this MD & A and, except as required by law, WesternZagros does not undertake any obligation to update publicly or to revise any of the included forward-looking statements, whether as a result of new information, future events or otherwise. The forward-looking statements contained in this MD & A are expressly qualified by this cautionary statement. See the Risk Factors section of this MD & A for a further description of these risks and uncertainties facing WesternZagros.

Overview

WesternZagros is a publicly-traded, Calgary-based, international oil and gas company engaged in acquiring properties and exploring for, development of and producing crude oil and natural gas in Iraq. WesternZagros holds a PSC with the Kurdistan Regional Government (“KRG”) which covers a 2,120 square kilometer exploration block (the “Kalar - Bawanoor Block” or “PSC lands”) in the Kurdistan Region of Iraq and it is on trend with, and adjacent to, a number of prolific historic oil and gas discoveries. WesternZagros (operator) holds a 40 percent working interest, the KRG holds a 20 percent working interest (carried by WesternZagros) and a wholly-owned subsidiary of Talisman Energy Inc. (“Talisman”) holds the remaining 40 percent working interest.

Strategy

WesternZagros' main focus is the exploration and development of its PSC lands. WesternZagros' objective is to be recognized, through consistently superior business performance and operations excellence, as one of the leading junior oil and gas companies active in Iraq. The Company is committed to operating in the Kurdistan Region of Iraq in a safe and secure manner. In executing its strategy, WesternZagros has made it a priority to recruit and retain local personnel and to actively participate in, and contribute to, community development projects. WesternZagros believes it has developed a relationship with government authorities, local communities and the business community in the Kurdistan Region that has allowed the Company to gain access to opportunities and to obtain the cooperation needed to successfully execute projects.

Highlights

WesternZagros' highlights and activities to February 22, 2010 include the following.

Operations

- The Company spudded the Kurdamir-1 well in May 2009 and reached total depth of 4,077 metres in February 2010.
 - Kurdamir-1 drilled first in the Tertiary interval to find a reservoir within the Oligocene formation and reservoir targets in the Pilaspi/Jaddala Formation, then in the Cretaceous interval to find reservoir targets within the Shiranish and Upper Qamchuqa Formations.
 - The Company confirmed a significant hydrocarbon accumulation and the presence of a reservoir within the Oligocene formation in the Tertiary interval in November 2009. The discovery was made while drilling to an intermediate depth of 2,700 metres, penetrating the reservoir within the Oligocene formation and reservoir targets within the Pilaspi/Jaddala Formation.
 - As drilling progressed through the Tertiary interval below the Oligocene formation, the Kurdamir-1 well encountered challenges related to wellbore instability in fractured carbonates. WesternZagros was able to overcome the challenge by undertaking two sidetrack operations, which allowed drilling to successfully reach intermediate depth.
 - The Company successfully completed logging, coring and two open-hole drill stem tests in the Tertiary interval. Combined test rates indicate approximately 27.5 million cubic feet per day of gas and 1,172 barrels per day of 61 degrees API natural gas liquids (condensate).
 - Test rates were limited due to testing equipment restrictions; however, initial well test analysis conducted by an independent third party indicates that reservoir production potential of approximately 52 million cubic feet per day of gas and 2,240 barrels per day of condensate could be expected from these intervals. No formation water was recovered during the testing.
 - WesternZagros completed a resource assessment on the Kurdamir-1 discovery, which was audited by Sproule International Ltd. As at November 23, 2009, the estimated range of gross unrisked contingent resources is from 379 billion cubic feet to 696 billion cubic feet of gas and from 13 million barrels to 32 million barrels of condensate. The contingent resources estimate was assigned across the crest of the Kurdamir structure down to a depth of 2,312 metres, which is the lowest known gas in the Kurdamir-1 wellbore as determined by wireline logs. Sproule International Ltd. also audited an assessment of the prospective resources on

the flanks of the structure. See WesternZagros' Material Change Report dated November 25, 2009 available at www.sedar.com.

- Due to the high formation pressures encountered at 4,077 metres, no deeper drilling will take place in the Kurdamir-1 well. Operations to control the high formation pressures encountered in the Gulneri Formation at 4,077 metres are ongoing. The Company has well control insurance in place and is currently pursuing a claim for the costs associated with the well control operations.
 - Numerous oil and gas shows were encountered while drilling through the Cretaceous interval. Once well control operations are completed, the forward plan is to evaluate the numerous oil and gas shows encountered in the Aaliji and Shiranish Formations by conducting a cased hole testing program.
 - As a result of drilling delays and additional evaluation and testing activities, gross costs for drilling Kurdamir-1 are expected to be approximately \$85 million to \$90 million, prior to the consideration of the insurance claim being pursued for the associated costs of the well control operations. The increased budget includes \$15 million of incremental costs associated with these well control activities and \$10 million for the incremental costs for the cased hole testing activities.
- WesternZagros incorporated key learnings from Sarqala-1 into the Kurdamir-1 drilling program to identify and mitigate possible drilling issues that could be encountered while drilling Kurdamir-1. These included additional intermediate casing strings, additional drilling expertise and enhanced drilling mud properties for the operations.
 - As of March 31, 2009, the Company's best estimate of gross unrisks prospective oil resources in Block 44 was 2.4 billion barrels. This estimate was audited by Sproule International Ltd. The resource estimate was completed after WesternZagros updated its inventory of prospects and leads, following the completion of its seismic program in 2008. See WesternZagros' Material Change Report dated May 11, 2009 available at www.sedar.com.
 - In 2009, the Company reprocessed 874 kilometres of 2D seismic data on Block 44. This reprocessing improved the quality of the original seismic data in order to better define and map prospects and to predict depths and formation pressures in potential drilling locations. The results were successfully used to predict pore pressures in the Kurdamir-1 well above the Gulneri Seal and will be incorporated into a revised Block 44 resource assessment to be conducted in 2010.
 - In December 2009, WesternZagros' operations achieved a combined total of four million person hours with no Lost Time Incidents (LTI). WesternZagros remains committed to the health and safety of all its employees and contractors as well as the security of its operations.

Financial

- As of April 2009, WesternZagros completed all its Capacity Building Support payments to the KRG required under its Production Sharing Contract.
- As at December 31, 2009, WesternZagros had \$67.4 million in working capital.
- For the year ended December 31, 2009, WesternZagros' share of capital expenditures for the year ended December 31, 2009 associated with its PSC activities and other capitalized costs were \$54.4 million. Year to date expenditures for 2009 included \$39.1 million of drilling-related costs; \$0.7 million of geological and geosciences related work; \$3.4 million of supervision and local office costs; \$10.8 million of PSC related expenditures; and \$0.4 million of corporate related expenditures.

Corporate

- During 2009, the Board of Directors of WesternZagros appointed Mr. Simon Hatfield as Chief Executive Officer and Mr. Greg Stevenson as Chief Financial Officer.
- In January 2010, Mr. Ian McIntosh was appointed to the position of Vice President, Kurdistan Business Unit. Mr. McIntosh will be resident in the Kurdistan Region of Iraq.

Political

- Recent events in the Kurdistan Region, including the export of oil and the election process, demonstrate that the Kurdistan Regional Government is firmly committed to the democratic and economic development of the Region. WesternZagros continues to monitor and assess the political developments in Iraq including progress on the Federal Petroleum Law, payment of revenues associated with oil exports from the Kurdistan Region, the state of the capital markets, and exploration activities prior to deploying future capital beyond its PSC commitments.

Corporate social responsibility

- During 2009, WesternZagros and its co-venturers continued to focus on three key corporate social responsibility initiatives in the Garmian region of Kurdistan - water supply, education and health care. In particular, during the peak of the drought, CSR activities focused extensively on providing potable water to villages near Kurdamir-1 and elsewhere within the PSC block.
- In 2009, WesternZagros constructed a six-kilometre pipeline to the Kurdamir village and subsequently installed a water storage and distribution system for the village, in addition to replacing and repairing the generator and pumping systems at the water treatment plant.
- Throughout 2009, WesternZagros delivered medical supplies to the clinic in Hazi Kani, a village in the northern part of the PSC operating block. The clinic is the main centre for health care for many surrounding villages, yet they lack the basic supplies to operate effectively. WesternZagros provided sufficient supplies so that they can continue to treat patients regularly.
- Many of the schools in the PSC operating area lack basic school supplies such as notebooks, paper, pens and pencils. In December 2009, WesternZagros donated over 300 kits containing various school supplies to children in 14 schools in the operating area.

Financial performance

Selected Annual Information

US \$(000s), unless otherwise specified	2009	2008	2007
Total Revenue	184	2,959	817
Net Loss	5,491	10,100	10,426
Net Loss Per Share (US\$ Per Share) (Basic and Diluted)	0.03	0.05	0.06
Capital Expenditures	54,356	95,102	34,556
Total Assets	241,077	243,697	160,777
Total Long-term Liabilities	175	69	-
Dividends (US\$ Per Share)	Nil	Nil	Nil

General and administrative expenses

For the year ended December 31, 2009, WesternZagros expensed \$6.3 million in general and administrative expenses ("G&A"), compared to \$7.3 million for the prior year, and capitalized \$3.2 million of G&A compared to \$2.1 million in 2008. The amounts capitalized that are directly related to the supervision of the Company's drilling and geological capital programs increased as a result of a full year of drilling operations occurring during 2009, which also resulted in the decrease in expensed G&A during 2009 compared to 2008.

Depreciation, depletion and amortization (DD&A)

For the year ended December 31, 2009, WesternZagros had \$0.7 million depreciation related to certain administrative assets, compared to \$0.2 million for the year ended December 31, 2008. The increase in depreciation is related to the addition of assets in late 2008 and in 2009 which are now being depreciated. No depletion on oil and gas related assets is recorded because WesternZagros has yet to determine whether proved reserves are attributable to the PSC lands.

Stock based compensation

The Company recognized stock based compensation expense for all stock options granted. For the year ended December 31, 2009, WesternZagros recorded \$1.9 million in stock based compensation expense and \$0.5 million in the capitalized G&A, with a corresponding increase to contributed surplus, for stock options granted. For the year ended December 31, 2008, WesternZagros recorded \$1.9 million in stock-based compensation expense, and \$0.7 million in capitalized G&A.

Foreign exchange

WesternZagros adopted the U.S. dollar as its measurement and reporting currency since the majority of its expenses are or will be directly or indirectly denominated in U.S. dollars and to facilitate a more direct comparison to other international crude oil and natural gas exploration and development companies. WesternZagros holds over 95 percent of its cash and cash equivalents in U.S. dollar accounts and U.S. dollar priced Government of Canada bonds; however, the Company has certain assets and liabilities in currencies other than the U.S. dollar, mainly Canadian dollars, and converts these to U.S. dollars at the end of each period resulting in foreign exchange gains and losses. The Canadian dollar balances are held for the purpose of funding WesternZagros' Canadian dollar expenditures, which are mainly related to the costs associated with general and administrative costs for its head office and certain drilling related services and tangibles procured from Canadian suppliers. For the year ended December 31, 2009, WesternZagros recorded a foreign exchange loss of \$0.01 million relating to these conversions, compared to a \$1.4 million foreign exchange loss for the year ended December 31, 2008.

Income taxes

For the year ended December 31, 2009, WesternZagros had an income tax recovery of \$1.3 million comprised of \$1.7 million of current income tax recovery and reduced by \$0.4 million of future income tax expense. The current tax recovery relates to the expected recovery of taxes incurred in 2008 on realized foreign exchange gains and losses in WesternZagros' wholly-owned Canadian subsidiary through the utilization of loss carry forwards and the associated G&A costs incurred by the subsidiary.

Revenue

WesternZagros' revenue is comprised entirely of interest earned on cash and cash equivalents and short-term investment balances. Interest of \$0.2 million was earned for the year ended December 31, 2009, compared to \$3.0 million for the year ended December 31, 2008. The decrease in revenue resulted from a decrease in cash and cash equivalents and short-term investment balances as the Company progressed on exploration activities and from lower average interest rates received on the cash and cash equivalents during the year.

Net Loss

For the year ended December 31, 2009, WesternZagros recorded a net loss of \$5.5 million compared to \$10.1 million for the year ended December 31, 2008. WesternZagros is an early stage exploration enterprise and, apart from its working interest in the PSC and cash and cash equivalents, the Company has no other significant assets. The decrease in net loss resulted from an income tax recovery during 2009 compared to an income tax expense in 2008, and from reduced expensed G&A and foreign exchange losses, partially offset by the decrease in interest earned on cash and cash equivalents and increased depreciation expense during 2009.

Capital expenditures

For the year ended December 31, 2009, the total capital expenditures on the Kalar-Bawanoor Block were \$73.3 million, including \$65.1 million of drilling related costs, \$1.1 million of geological and geosciences related work (reprocessing and interpretation of seismic data), \$5.7 million of supervision and local office costs in support of drilling operations and \$1.4 million of PSC related expenditures. Included in the drilling costs were \$46.6 million for operations at Kurdamir-1, \$11.5 million for operations at Sarqala-1, and \$7.0 million for long lead items, consumables and pre spud costs for subsequent wells.

For the year ended December 31, 2008, the total capital expenditures on the Kalar-Bawanoor Block were \$79.1 million, including \$49.4 million of drilling related costs, \$16.7 million associated with Phase II seismic operations, \$9.2 million of supervision and local office costs in support of both drilling and seismic operations and \$3.8 million of PSC related expenditures. Included in the drilling costs were \$37.3 million for operations at Sarqala-1, \$5.4 million for long lead items and pre spud costs for Kurdamir-1 and \$6.7 million for tangible items for subsequent wells and consumables for testing operations. As at December 31, 2009, gross well costs for Kurdamir-1 have totalled \$53.1 million and for Sarqala-1 have totalled \$48.8 million.

WesternZagros' share of capital expenditures for the year ended December 31, 2009 associated with its PSC activities and other capitalized costs was \$54.4 million. Capital expenditures for 2009 included \$39.1 million of drilling related costs; \$0.7 million of geological and geosciences related work; \$3.4 million of related field office and supervision costs; \$10.8 million for annual PSC payments and the remaining amounts owing under the capacity building bonus, which WesternZagros completed paying in April 2009; and \$0.4 million of corporate related expenditures.

WesternZagros' share of capital expenditures for the year ended December 31, 2008 associated with its PSC activities and other PSC costs was \$95.1 million. WesternZagros' share of capital expenditures was 100 percent of costs to June 30, 2008, prior to the allocation of the 40 percent third party working interest to Talisman by the KRG, and 60 percent of the costs subsequent to June 30, 2008, representing WesternZagros' 40 percent working interest and its obligation to fund the KRG's 20 percent working

interest. Upon the allocation of the 40 percent working interest to Talisman, Talisman paid \$50.7 million to WesternZagros, representing 50 percent of the estimated recoverable costs under the PSC at June 30, 2008, as per the terms of the PSC.

The decrease in capital expenditures from 2008 to 2009 mainly relates to the completion of the capacity building support payments under the PSC in April 2009 and the reduced funding requirement for WesternZagros associated with the operations on the PSC block after Talisman acquired its working interest at the end of June 2008.

WesternZagros capitalized \$3.2 million of G&A expenses, including \$0.5 million of stock-based compensation, for the year ended December 31, 2009, compared to \$2.1 million of G&A expenses, including \$0.7 million of stock-based compensation, for the year ended December 31, 2008.

Quarterly information

The following table summarizes key financial information on a quarterly basis for the 2009 and 2008 fiscal periods:

	Year Ended		Three Month Period Ended		
	Dec. 31, 2009	Dec. 31, 2009	Sep 30, 2009	June 30, 2009	March 31, 2009
Revenue	184	32	36	35	81
Net Loss	5,491	1,035	2,712	1,404	340
Net Loss Per Share (US\$ Per Share) (Basic and Fully Diluted)	0.026	0.005	0.013	0.006	0.002
Capital Expenditures	54,356	11,250	11,456	14,796	16,854
Total Assets	241,077	241,077	241,600	241,171	239,288
Total Long-term Liabilities	175	175	171	197	71
Dividend (US\$ per Share)	Nil	Nil	Nil	Nil	Nil

	Year Ended		Three Month Period Ended		
	Dec. 31, 2008	Dec. 31, 2008	Sep 30, 2008	June 30, 2008	March 31, 2008
Revenue	2,959	495	867	774	823
Net Loss	10,100	6,653	984	633	1,830
Net Loss Per Share (US\$ Per Share) (Basic and Fully Diluted)	0.05	0.030	0.005	0.005	0.010
Capital Expenditures	95,102	20,339	20,531	27,648	26,584
Total Assets	243,697	243,697	248,919	241,692	251,068
Total Long-term Liabilities	69	69	68	66	-
Dividend (US\$ per Share)	Nil	Nil	Nil	Nil	Nil

Fourth quarter

In the fourth quarter of 2009, WesternZagros had a net loss of \$1.0 million compared to a net loss of \$6.7 million in the fourth quarter of 2008. The decrease in net loss is mainly due to the recognition of an income tax recovery in the fourth quarter of 2009 compared to an income tax expense in the fourth quarter of 2008 and to a decreased foreign exchange loss in the fourth quarter of 2009 compared to the fourth quarter of 2008.

WesternZagros' capital expenditures totaled \$11.3 million in the fourth quarter of 2009 compared to \$20.3 million in the fourth quarter of 2008. This decrease is primarily due to payment of a portion of the capacity building bonus due under the PSC in the fourth quarter of 2008, compared to no payment in the fourth quarter of 2009 since the capacity building bonus payments were completed in April 2009.

Production sharing contract – summary

Under the terms of its PSC, WesternZagros has a 40 percent working interest and the KRG has a 20 percent interest in the PSC which is carried by WesternZagros. The remaining 40 percent was allocated to Talisman in June 2008 by the KRG. WesternZagros, the KRG and Talisman are collectively the "Contractor Group" under the PSC. WesternZagros is the operator of the PSC lands until the end of the first operating sub-period of the PSC, when a Joint Operating Company may be established if so elected by the Contractor Group.

Production sharing contract – commercial terms

Under the PSC, the sharing of oil occurs as follows: of the total oil produced, operations oil is available to WesternZagros for use in carrying out its obligations under the PSC; the remaining oil is subject to a 10 percent royalty payable to the KRG (the residual is considered to be "net available oil"). The net available oil is determined on a development by development basis. Up to 45 percent of the net available oil is available for cost recovery with the remainder as "profit oil." Costs subject to cost recovery include all costs and expenditures incurred by the Contractor Group for exploration, development, production and decommissioning operations, as well as any other costs and expenditures incurred directly or indirectly with these activities. The portion of profit oil available to the Contractor Group is based on a sliding scale from 35 percent to 16 percent depending on a calculated R-Factor. The R-Factor is established by reference to the ratio of cumulative revenues over cumulative costs. When the ratio is below one, the Contractor Group is entitled to 35 percent of the profit oil. The percentage is then reduced on a linear sliding scale to a minimum of 16 percent at an R-Factor ratio of two or greater.

The production sharing terms for natural gas are the same as the oil production share terms except for the net available gas available for cost recovery is 55 percent and the profit sharing component. For natural gas, the portion of profit natural gas available for the Contractor Group is based on a sliding scale from 40 percent to 20 percent depending on a calculated R-factor. The R-Factor is established by reference to the ratio of the Contractor Group's cumulative revenue over cumulative costs. When the R-Factor is below one, the Contractor Group is entitled to 40 percent of the profit oil. The Contractor Group's percentage is then reduced on a linear scale to a minimum of 20 percent at a ratio of 2.75 or greater.

Production

Pursuant to the terms of the PSC, WesternZagros maintains the right to market its share of oil on the world market. There is an obligation under the PSC to make oil production available to meet regional market demand. The price of such oil is a market-based oil price based on a basket of crudes. The price for natural gas is based on local commercial value and Iraq tariffs. Currently, no markets exist for natural gas within Iraq and there is no infrastructure for export.

Contract obligations and commitments

The PSC contemplates two exploration sub-periods of three years and two years, respectively, with two possible one-year extensions. The first exploration sub-period ends December 31, 2010. During such time the Contractor Group (WesternZagros, the KRG and Talisman) is required to complete a minimum of 1,150 kilometres of seismic surveying, which has been completed; drill three exploration wells; and commit a minimum of \$75 million in the aggregate on these activities. At the end of the first exploration sub-period, WesternZagros and the other parties to the PSC may relinquish the entire contract area, other than any discovery or development areas; continue further exploration operations by entering into the second exploration sub-period; or request to use a one-year extension for further exploration and appraisal activities prior to deciding to enter into the second exploration sub-period.

The PSC also includes capacity building support payments, which concluded in April 2009, and annual funding for certain technological, logistical, recruitment and training during the first exploration sub-period, and any subsequent sub-periods. To meet its remaining commitments for the first exploration sub-period, WesternZagros estimates expenditures of approximately \$40 million to \$45 million, prior to the costs of any testing, if required. This represents the Company's 60 percent funding requirement and includes the remaining costs associated with drilling Kurdamir-1; one additional exploration commitment well by December 31, 2010, which is the end of the first exploration sub-period; and the associated supervision and local office costs in support of drilling operations.

WesternZagros, on behalf of the Contractor Group, has made application to the KRG to extend the first exploration sub-period for a period of 12 months, i.e. to December 31, 2011, in order to allow sufficient time to analyze the results of the Kurdamir-1 cased hole testing program prior to the commencement of future exploration activities. Possibilities currently being analyzed for future exploration activities include:

1. drilling a well on the flank of the Kurdamir Structure to determine if the Oligocene Reservoir is oil bearing or gas-condensate bearing.
2. contracting an alternative rig to allow for greater flexibility in drilling to the reservoir targets for the third exploration commitment well.

The response to the application is expected from the KRG following the final results of the cased hole testing program are known.

During the second exploration sub-period, the Contractor Group, or those parties that have elected to participate in further exploration, are required to complete a minimum of 575 kilometres of seismic surveying, drill at least two exploration wells and commit a minimum of \$35 million on these activities. At the end of the second exploration sub-period, WesternZagros, and the other parties to the PSC who have elected to participate in the second exploration sub-period, may relinquish the entire contract area (other than any discovery or development areas) or continue further exploration and appraisal operations into the extension periods subject to the following relinquishment requirements. At the end

of the second exploration sub-period, and at the end of each subsequent extension period, the PSC requires WesternZagros, and other parties who have elected to participate, to relinquish 25 percent of the remaining undeveloped area within the PSC lands or the entire contract area (other than any discovery or development areas).

WesternZagros has entered into various exploration related contracts, including contracts for drilling equipment, services and tangibles. The following table summarizes the commitments WesternZagros has under these exploration related contracts and other contractual obligations.

For the year ended December 31

(United States \$000s)	2010	2011	2012	2013	2014+	Total
Exploration	1,260	-	-	-	-	1,260
Office	140	-	-	-	-	140
Total	1,400	-	-	-	-	1,400

Third party obligations and commitments

The Company has granted rights to certain participants to acquire an aggregate working interest equal to five percent of WesternZagros' interest, and subject to the same terms as WesternZagros' interest. Certain portions of the participation interest may be funded by interest bearing loans granted by WesternZagros.

Off balance sheet arrangement

The Company does not presently utilize any off balance sheet arrangements to enhance its liquidity and capital resource positions, or for any other purpose. During the period ended December 31, 2009, WesternZagros did not enter into any off balance sheet transactions.

Related party transactions

Included in accounts receivable is a loan to a senior officer of \$0.2 million, the loan is non-interest bearing and matures on December 31, 2010. This transaction has been recorded at the exchange amount, which is the amount of consideration established and agreed to by the related party.

Outlook 2010

WesternZagros' operational activities in 2010 will focus on the testing of the reservoir targets in the Cretaceous interval at Kurdamir-1; the evaluation of the commercial potential and technical feasibility of the gas and condensate discovered at Kurdamir-1 in the Tertiary interval together with any additional discoveries yet to be made; the evaluation of drilling alternatives to evaluate the flanks of the Kurdamir structure to determine both the presence and nature of fluids present (oil, gas and condensate, water or a combination thereof) on the flanks; and the final selection, design, procurement of required goods and services and drilling of the third exploration commitment well. In 2010, WesternZagros will also continue to assess additional investment opportunities beyond its PSC on the Kalar-Bawanoor Block.

WesternZagros and its co-venturers, Talisman and the KRG, have not yet decided the next operation to be conducted on the PSC lands, as they await the completion of the cased hole testing program at Kurdamir-1 and the decision of the KRG with respect to the extension application to extend the first

exploration sub-period. WesternZagros is continuing to monitor and assess the political developments in Iraq including the results of the Federal elections in Iraq held in March 2010; progress on the Federal Petroleum Law and the ability to export oil and natural gas from the Kurdistan Region of Iraq in accordance with the economic terms under the PSC; the state of the capital markets; and the results of its exploration activities prior to deploying future capital beyond those costs associated with the testing of Kurdamir-1.

An initial capital and operating budget for 2010 of \$43 million has been approved by the WesternZagros Board of Directors. This includes the Company's 60 percent share of the anticipated costs to drill and test the Kurdamir-1 well, certain geological and geophysical studies for PSC lands, certain long lead items and planning costs associated with the third commitment well, and supervision and local office costs in support of drilling operations, as well as the corporate G&A and related expenditures for fiscal 2010. This capital and operating budget does not include the costs associated with either drilling the third commitment well or any potential wells to evaluate the flanks of the Kurdamir structure, as the timing of these operations has not yet been determined.

Liquidity and capital resources

WesternZagros is currently exploring for crude oil and natural gas in the Kurdistan Region of Iraq and currently has no reserves, production or operational cash flows. WesternZagros' revenue is comprised entirely of interest earned on cash and cash equivalent balances and short-term investments. WesternZagros invests its cash and cash equivalents and short-term investments with major Canadian financial institutions with investment grade credit ratings and in Government of Canada instruments. This is in accordance with a Board of Directors approved Investment Policy with respect to investing funds. WesternZagros has no outstanding bank debt or other interest bearing indebtedness as at December 31, 2009.

At December 31, 2009, WesternZagros had \$67.4 million in working capital. This balance will be used to fund future capital expenditures including: the Company's work commitments with respect to the first exploration sub-period; any further testing or appraisal activities the Company may undertake during this sub-period or under any extensions to this sub-period as allowed under the PSC; the requirement for WesternZagros to fund the KRG's 20 percent carried interest; certain annual payments required under the PSC; G&A expenditures; and working capital requirements. Subsequent to December 31, 2009, WesternZagros has initiated an insurance claim related to well control operations at Kurdamir-1. WesternZagros anticipates that the proceeds of this claim will cover a significant portion of the well control costs associated with Kurdamir-1 that were incurred after drilling into a high pressure formation in the Gulneri seal.

WesternZagros assesses its financing requirements and its ability to access debt or equity markets on an ongoing basis. This assessment considers the stage and success of the Company's exploration activities; the current status of the disputed Federal Petroleum Law and the ability to export oil and natural gas from the Kurdistan Region of Iraq in accordance with the economic terms under the PSC; the continued participation of the Company's co-venturers in the PSC activities; the status and anticipated timing of receipt of insurance proceeds; and financial market conditions. Currently, WesternZagros assesses that it has the financial resources to complete the remainder of its work commitments under the first sub-period of the PSC. However, any further exploration or appraisal work that is undertaken during the first sub-period beyond these commitments, any extension of the first sub-period combined

with further exploration or appraisal activities, any significant delay in the timing of the insurance claim or any change in the participation of the Company's co-venturers in the PSC activities would require WesternZagros to access the equity markets sooner than anticipated.

While WesternZagros has seen improvements in financial market conditions, the Company will seek to maintain financial flexibility and will monitor and assess its financing requirements and ability to access the equity markets. It is possible that future global economic events and conditions may result in further volatility in the financial markets which, in turn, could negatively impact WesternZagros' ability to access equity or debt markets in the future. In addition, the results of the Company's exploration activities or any prolonged delay in the export of oil from the Kurdistan Region of Iraq in accordance with the economic terms under our PSC could negatively impact the ability to access equity or debt markets in the future. Any inability to access the equity or debt markets for sufficient capital, at acceptable terms, and within required timeframes, could have a material adverse effect on WesternZagros' financial condition, results of operations and prospects. Further discussion on these risks can be found in the "Risk Factors" section of the MD & A.

Outstanding share data

As of the date of this MD & A, WesternZagros has the following securities outstanding:

- 207,464,320 common shares; and
- 13,007,334 stock options.

Each stock option entitles the holder thereof to acquire one common share. The number of common shares reserved for issuance pursuant to options granted will not exceed 10 percent of the issued and outstanding common shares. As of the date of this MD & A, total stock options outstanding represents 6.27 percent of the total issued and outstanding common shares.

Risk Factors

The oil and gas industry is very competitive and is subject to many risks. Many of these risks are outside of WesternZagros' control. Management has identified certain other key risks and their potential impact on WesternZagros' operations. Financial market instability in 2008 and early fiscal 2009 has impacted WesternZagros' ability, and that of other exploration and development companies, to access equity or debt markets at all or with acceptable terms. For future capital requirements beyond the Company's current financing capability, which consists of its cash and cash equivalents balances at December 31, 2009, risks associated with the global economic conditions have increased significantly.

Foreign activities

All of WesternZagros' assets are located in the Kurdistan Region of Iraq. As such, WesternZagros is subject to political, economic, and other uncertainties, including, but not limited to, the uncertainty of negotiating with foreign governments; expropriation of property without fair compensation; adverse determinations or rulings by governmental authorities; changes in energy policies or in the personnel administering them; nationalization; currency fluctuations and devaluations; disputes between various levels of authorities; arbitrating and enforcing claims against entities that may claim sovereignty; authorities claiming jurisdiction; potential implementation of exchange controls and royalty and government take increases; and other risks arising out of foreign governmental sovereignty over the

areas in which WesternZagros' operations are conducted, as well as risks of loss due to civil strife, acts of war, guerrilla activities and insurrections.

WesternZagros' operations may be adversely affected by changes in government policies and legislation or social instability and other factors which are not within the control of WesternZagros including, among other things, adverse legislation in Iraq and/or the Kurdistan Region; a change in crude oil or natural gas pricing policy; the risks of war, terrorism, abduction, expropriation, nationalization, renegotiation or nullification of existing concessions and contracts; taxation policies; economic sanctions; the imposition of specific drilling obligations; and the development and abandonment of fields.

Political issues

The political and security situation in Iraq, outside the Kurdistan Region, is unsettled and volatile. The Kurdistan Region is the only "Region" of Iraq that is constitutionally established pursuant to the Iraq Constitution, which expressly recognizes the Kurdistan Region. The political issues of federalism and the autonomy of Regions in Iraq are matters about which there are major differences between the various political factions in Iraq. These differences could adversely impact WesternZagros' interest in the Kurdistan Region.

Legislative issues

No federal Iraq legislation has yet been agreed to or enacted by the Iraq Council of Ministers and Council of Representatives to address the future organization of Iraq's petroleum industry or the sharing of petroleum and other revenues within Iraq. Failure to enact legislation, or the enactment of federal legislation contradictory to Kurdistan Region legislation, could materially adversely impact WesternZagros' interest in the Kurdistan Region and the PSC. Disagreements have been reported to exist between the Iraq Minister of Oil and officials of the KRG in relation to the terms of the draft Federal Petroleum Law and the ability to export oil and natural gas from the Kurdistan Region of Iraq in accordance with the economic terms under the PSC. Certain officials of the federal Iraq government have also expressed an opinion that the Kurdistan Regional Oil & Gas Law is invalid.

Exploration, development and production risks

Oil and natural gas operations involve many risks which even a combination of experience, knowledge and careful evaluation may not be able to overcome. The long-term commercial success of WesternZagros depends on its ability to find, appraise, develop and commercially produce oil and natural gas resources and reserves, and will depend not only on the Company's ability to explore and develop any properties it may have from time to time, but also on its ability to select and acquire additional producing properties or prospects. No assurance can be given that WesternZagros will be able to locate satisfactory properties for acquisition or participation. Moreover, if such acquisitions or participations are identified, WesternZagros may determine that current markets, terms of acquisition and participation or pricing conditions make such acquisitions or participations uneconomic. There is no assurance that commercial quantities of oil and natural gas will be discovered or acquired by WesternZagros.

Future oil and natural gas exploration may involve unprofitable efforts, not only from dry wells, but from wells that are productive but do not produce sufficient petroleum substances to return a profit after drilling, operating and other costs. Completion of a well does not assure a profit on the investment or recovery of drilling, completion and operating costs. In addition, drilling hazards or

environmental damage could greatly increase the cost of operations, and various field operating conditions may adversely affect the production from successful wells. These conditions include delays in obtaining governmental approvals or consents; shut-ins of connected wells resulting from extreme weather conditions; insufficient storage or transportation capacity; or other geological and mechanical conditions. While diligent well supervision and effective maintenance operations can contribute to maximizing production rates over time, production delays and declines from normal field operating conditions cannot be eliminated and can be expected to adversely affect revenue and cash flow levels to varying degrees.

Oil and natural gas exploration, development and production operations are subject to all the risks and hazards typically associated with such operations, including hazards such as fire, explosion, blowouts, cratering, sour gas releases and spills, each of which could result in substantial damage to oil and natural gas wells, production facilities, other property and the environment or personal injury. In accordance with industry practice, WesternZagros is not fully insured against all of these risks, nor are all such risks insurable. Although WesternZagros maintains liability insurance in an amount that it considers consistent with industry practice, the nature of these risks is such that liabilities could exceed policy limits, in which event WesternZagros could incur significant costs that could have a material adverse effect upon its financial condition. Oil and natural gas production operations are also subject to all the risks typically associated with such operations, including encountering unexpected formations or pressures, premature decline of reservoirs and the invasion of water into producing formations. Losses resulting from the occurrence of any of these risks could have a material adverse effect on WesternZagros.

Ability to execute exploration and development program

It may not always be possible for WesternZagros to execute its exploration and development strategies in the manner in which WesternZagros considers optimal. WesternZagros' exploration and development programs in Iraq involve the need to obtain approvals from the relevant authorities, which may require conditions to be satisfied or the exercise of discretion by the relevant authorities. It may not be possible for such conditions to be satisfied.

Project risks

WesternZagros' ability to execute projects and market oil and natural gas will depend upon, or be impacted by, numerous factors beyond WesternZagros' complete control, including:

- the availability and proximity of pipeline capacity and sales markets;
- security issues;
- the supply of and demand for oil and natural gas;
- the effects of inclement weather;
- the availability of drilling, production and related equipment and supplies, as well as services, all of which may be disrupted for a number of reasons;
- unexpected cost increases;
- the continued participation of its co-venturers in the PSC activities;
- accidental events;
- currency fluctuations;

- the availability and productivity of skilled labour;
- adverse legislation in the Kurdistan Region and/or Iraq; and
- the regulation of the oil and natural gas industry by various levels of government and governmental agencies in the Kurdistan Region and/or Iraq.

Because of these factors, WesternZagros could be unable to execute projects on time, on budget or at all, and may not be able to effectively market the oil and natural gas that it may produce.

Operational experience

The management and directors of WesternZagros have significant international experience in the oil and gas industry; however, given the fact that WesternZagros was incorporated recently in 2007, the team has not, as a group, developed a conventional oil and gas project.

Competition

The petroleum industry is competitive in all its phases. WesternZagros competes with numerous other organizations in the search for, and the acquisition of, oil and natural gas properties and in the marketing of oil and natural gas. WesternZagros' competitors include oil and natural gas companies that have substantially greater financial resources, staff and facilities than WesternZagros. WesternZagros' ability to acquire or increase reserves in the future will depend not only on its ability to explore and develop its present properties, but also on its ability to select and acquire other suitable producing properties or prospects for exploratory drilling. Competitive factors in the distribution and marketing of oil and natural gas include price and methods and reliability of delivery.

Management of growth

WesternZagros may be subject to growth-related risks, including capacity constraints and pressure on its internal systems and controls. The ability of WesternZagros to manage growth effectively will require it to continue to implement and improve its operational and financial systems and to expand, train and manage its employee base. The inability of WesternZagros to deal with this growth could have a material adverse impact on its business, operations and prospects.

Reliance on key personnel

WesternZagros' success depends in large measure on certain key personnel. The loss of the services of such key personnel could have a material adverse affect on WesternZagros. WesternZagros does not have any key person insurance in effect for management. The contributions of the existing management team to the immediate and near term operations of WesternZagros are likely to be of central importance. In addition, the competition for qualified personnel in the oil and natural gas industry can be intense and there can be no assurance that WesternZagros will be able to continue to attract and retain all personnel necessary for the development and operation of its business. Investors must rely upon the ability, expertise, judgment, discretion, integrity and good faith of the management of WesternZagros.

Substantial capital requirements

WesternZagros anticipates making substantial capital expenditures for the acquisition, exploration, development and production of oil and natural gas reserves in the future. These expenditures include WesternZagros' requirement to carry the KRG's 20 percent interest under the PSC. In addition, any change in the continued participation of Talisman under the PSC could increase the Company's capital requirements.

WesternZagros' results will impact its access to the capital necessary to undertake or complete future drilling and development programs. WesternZagros' ability to access the equity or debt markets in the future may also be affected by any market instability. There can be no assurance that debt or equity financing, or future cash, if any, generated by operations, would be available or sufficient to meet these requirements or for other corporate purposes or, if debt or equity financing is available, that it will be on terms acceptable to WesternZagros. The inability of WesternZagros to access sufficient capital for its operations could have a material adverse effect on WesternZagros' financial condition, results of operations and prospects and its ability to continue as a going concern.

Additional funding requirements

WesternZagros' cash balances may not be sufficient to fund its ongoing activities at all times and to carry the KRG's 20 percent interest. From time to time, WesternZagros may require additional financing in order to carry out its oil and gas acquisition, exploration and development activities. Failure to obtain such financing on a timely basis could cause WesternZagros to forfeit its interest in certain properties, miss certain acquisition opportunities and reduce or terminate its operations. WesternZagros' ability to access the equity or debt markets in the future may be affected by any prolonged market instability.

Access to export infrastructure

WesternZagros' ability to export production from any potential oil and gas discoveries may depend on its ability to secure transportation. WesternZagros may also be affected by deliverability uncertainties related to the proximity of its potential production to pipelines and processing facilities and operational problems affecting such pipelines and facilities as well as potential government regulation in the Kurdistan Region of Iraq relating to price and the export of oil and gas.

Prices, markets and marketing

The marketability and price of oil and natural gas that may be acquired or discovered by WesternZagros is, and will continue to be, affected by numerous factors beyond its control including the impact that the various levels of government may have on the ultimate price received for oil and gas sales. WesternZagros' ability to market its oil and natural gas may depend upon its ability to secure transportation. WesternZagros may also be affected by deliverability uncertainties related to the proximity of its potential production to pipelines and processing facilities and operational problems affecting such pipelines and facilities as well as potential government regulation relating to price, the export of oil and natural gas and other aspects of the oil and natural gas business.

Both oil and natural gas prices are subject to wide fluctuation. During 2009, both oil and gas prices remained volatile with West Texas Intermediate ranging from US\$30 to US\$80 per barrel. WesternZagros originally negotiated the economic terms of its PSC in 2007 in a \$50 per bbl crude oil price environment and any significant and sustained decline in crude oil prices from this price may impact the feasibility of WesternZagros' business plan.

Foreign exchange

WesternZagros operations costs are generally incurred in U.S. dollars, while the funds it will have available to it may be in other currencies. There is a possibility that operations and development costs may increase as a result of currency fluctuation.

Credit risk

WesternZagros is or may be exposed to third party credit risk through its contractual arrangements with any potential joint venture partners, marketers of its petroleum and natural gas production, suppliers, contractors, and other parties. In the event such entities fail to meet their contractual obligations to WesternZagros or determines not to continue to participate in the PSC activities, such events could have a material adverse effect on WesternZagros and its cash flow from operations. In addition, poor credit conditions in the industry may impact a joint venture partner's willingness to participate in a future WesternZagros capital program.

Conflicts of interest

Certain directors of WesternZagros are also directors of other oil and gas companies and as such may, in certain circumstances, have a conflict of interest requiring them to abstain from certain decisions. Conflicts, if any, will be subject to the procedures and remedies of the Business Corporations Act (Alberta).

Critical Accounting Estimates

WesternZagros' critical accounting estimates are defined as those estimates that have a significant impact on the portrayal of its financial position and operations and that require management to make judgments, assumptions and estimates in the application of Canadian GAAP. Judgments, assumptions and estimates are based on historical experience and other factors that management believes to be reasonable under current conditions. As events occur and additional information is obtained, these judgments, assumptions and estimates may be subject to change. WesternZagros believes the following are the critical accounting estimates used in the preparation of its consolidated financial statements. WesternZagros' significant accounting estimates can be found in note 2 to its Annual Financial Statements.

Use of estimates

The preparation of the 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 assets and liabilities as at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Such estimates related to unsettled transactions and events as of the date of the consolidated financial

statements. Accordingly, actual results may differ from these estimated amounts as future confirming events occur. Significant estimates used in the preparation of the consolidated financial statements include, but are not limited to, recovery of exploration costs capitalized in accordance with full cost accounting, asset retirement obligations, stock-based compensation, and income taxes.

Property, plant and equipment (“PP&E”)

WesternZagros capitalizes costs related to crude oil and natural gas properties in accordance with the full cost method, whereby all costs associated with the acquisition of, exploration for and the development of crude oil and natural gas, including asset retirement obligations are capitalized and accumulated within cost centres on a country-by-country basis. Such costs include land acquisition, geological and geophysical activity, drilling and testing of productive and non-productive wells, carrying costs directly related to unproved properties, major development projects and administrative costs directly related to exploration and development activities.

Depletion on crude oil properties is anticipated to be provided over the life of proved and probable reserves (assuming such reserves are established) on a unit of production basis and commences when the facilities are substantially complete and after commercial production has begun. Other PP&E assets are depreciated on a straight-line basis over their useful lives, except for lease acquisition costs, which are amortized and depreciated over the life of proved and probable reserves once established.

PP&E assets are reviewed for impairment whenever events or conditions indicate that their net carrying amount may not be recoverable from estimated future cash flows. If an impairment is identified the assets are written down to the estimated fair market value. The calculation of these future cash flows are dependent on a number of estimates, which include reserves, timing of production, crude oil price, operating cost estimates and foreign exchange rates. As a result, future cash flows are subject to significant management judgment.

Asset retirement obligation

WesternZagros recognizes an asset and a liability for asset retirement obligations in the period in which they are incurred by estimating the fair value of the obligation. The Company determines the fair value by first estimating the expected timing and amount of cash flow, using third-party costs that will be required for future dismantlement and site restoration, and then calculating the present value of these future expenditures using a credit adjusted risk free rate appropriate for WesternZagros. Any change in timing or amount of the cash flow subsequent to initial recognition results in a change in the asset and liability, which then impacts the depletion on the asset and the accretion charged on the liability. Estimating the timing and amount of cash outflow to settle this obligation is inherently difficult and is based on management's current experience.

Stock based compensation

WesternZagros uses fair value accounting for stock-based compensation. Under this method, all equity instruments awarded to employees and the cost of the service received as considerations are measured and recognized based on the fair value of the equity instruments issued. Compensation expense is recognized over the period of related employee service, usually the vesting period of the equity instrument awarded.

Income tax

WesternZagros follows the liability method of accounting for income taxes whereby future income taxes are recognized based on the differences between the carrying values of assets and liabilities reported in the Annual Financial Statements and their respective tax basis. Future income tax assets and liabilities are recognized at the tax rates at which management expects the temporary differences to reverse. Management bases this expectation on future earnings, which require estimates for reserves, timing of production, crude oil price, operating cost estimates and foreign exchange rates. Management assesses, based on all available evidence, the likelihood that the future income tax assets will be recovered from future taxable income and a valuation allowance is provided to the extent that it is more than likely that future income tax assets will not be realized. As a result, future earnings are subject to significant management judgment and changes.

Changes In Accounting Policies and Practices and Future Accounting Pronouncements

Changes in accounting policies

WesternZagros adopted the following new accounting standards effective January 1, 2009:

- CICA Handbook Section 3064, Goodwill and Intangible Assets ("Section 3064"), which has replaced Section 3062. This new guidance reinforces a principles-based approach to the recognition of costs as assets in accordance with the definition of an asset and the criteria for asset recognition under Section 1000 "Financial Statement Concepts". The implementation of this section had no significant impact on the Company's financial statements.
- Emerging Issues Committee ("EIC") abstract 173 "Credit Risk and the Fair Value of Financial Assets and the Financial Liabilities". EIC 173 provides further information on the determination of the fair value of the financial assets and financial liabilities under Section 3855 "Financial Instruments - Recognition and Measurement". The implementation of this section had no significant impact on to the Company's financial statements.

Future accounting pronouncements

In January 2009, CICA issued Section 1582 "Business Combination", Section 1601 "Consolidated Financial Statements", and Section 1602 "Non-controlling Interests" which may have an impact on the Company's consolidated financial statements.

- Section 1582 replaces former guidance on business combination. The new Section expands the definition of a business subject to an acquisition and establishes significant new guidance on the measurement of consideration given, and the recognition and measurement of assets acquired and liabilities assumed in a business combination. The new Section requires that all business acquisitions be measured at the full fair value of the acquired entity at the acquisition date even if the business combination is achieved in stages, or if less than 100 percent of the equity interest in the acquiree is owned at the acquisition date.

This standard is equivalent to the International Financial Reporting Standard 3 "Business Combinations". This standard is applied prospectively to business combinations with acquisition dates on or after January 1, 2011. Earlier adoption is permitted. This new Section will only have an impact on the Company's consolidated financial statements for future acquisitions that will be made in periods subsequent to the date of adoption.

- Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. The two Sections are the equivalent to the corresponding provisions of the International Accounting Standard 27 "Consolidated and Separate Financial Statements" These Sections apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011, and should be adopted concurrently with Section 1582. Earlier adoption is permitted. The Company is currently evaluating the impact of the adopting these standards on its consolidated financial statements.

International financial reporting standards ("IFRS")

In February 2008, the Accounting Standards Board confirmed that all Canadian publicly accountable enterprises will be required to adopt IFRS for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011. WesternZagros has performed its preliminary review on the accounting policy choices upon its conversion to IFRS for the fiscal year beginning on January 1, 2011. The implementation of IFRS 6 "Exploration for and Evaluation of Mineral Resources" ("IFRS 6") is expected to have the most significance to the Company's results of operations, financial position and disclosures.

WesternZagros currently utilizes the full cost method for accounting for its exploration activities in the Kurdistan Region of Iraq under Canadian GAAP. Under the full cost method, all costs associated with the acquisition of, exploration for and the development of crude oil and natural gas, including asset retirement obligations, are capitalized and accumulated within cost centres on a country-by-country basis. Such costs include land acquisition, geological and geophysical activity, drilling and testing of productive and non-productive wells, carrying costs directly related to unproved properties, major development projects and administrative costs directly related to exploration and development activities. As WesternZagros is only currently operating in the Kurdistan Region of Iraq and has only one PSC in that region, it has capitalized all costs associated with those exploration activities, including certain costs incurred prior to the entering into of the PSC.

Under Canadian GAAP, amounts capitalized under the full cost method are reviewed for impairment whenever events or conditions indicate that their net carrying amount may not be recoverable from estimated future cash flows. If an impairment is identified, the assets are written down to the estimated fair market value. The calculation of these future cash flows is dependent on a number of estimates, which include reserves, timing of production, crude oil price, operating cost estimates and foreign exchange rates.

Upon conversion to IFRS, WesternZagros will be required to adopt IFRS 6, which is the standard that deals with accounting for exploration and evaluation ("E&E") assets in the extractive industries. Typical costs included in the E&E assets are acquisition of rights to explore, topographical, geological, geochemical and geophysical studies, exploratory drilling, trenching, sampling, and activities in relation to evaluating the technical feasibility and commercial viability of extracting mineral resources. Under IFRS 6, costs incurred prior to the legal rights to explore an area being obtained may no longer be capitalized within E&E assets and requires that upon initial recognition E&E assets should be measured at cost.

IFRS 6 allows either of two alternatives to be chosen as the accounting policy for E&E assets after initial recognition. The first alternative is the "cost model" whereby the item is carried at cost less impairment. The other alternative is the "revaluation model." The revaluation model requires that, after initial recognition, an asset, whose fair value can be reliably measured should be carried at a re-valued amount, being fair value at the date of measurement, less any subsequent accumulated

depreciation or accumulated impairment losses. For the purpose of completing an impairment test under IFRS 6, the E&E assets must be allocated to specific cash-generating units ("CGUs"). The level of grouping of CGUs for impairment testing purpose is based on how management makes decisions about continuing/disposing of assets and operations and the commercial terms associated with these assets and operations.

Upon adoption of IFRS, WesternZagros anticipates that the costs it has capitalized under the full cost method prior to the execution of its PSC will be expensed, but has not yet determined which method it will follow in respect of the E&E assets after initial recognition.

Other areas of potential impact include stock-based compensation. WesternZagros continues to develop an implementation plan, including the consideration of the resources required to complete the conversion to IFRS and the impact to its financial systems.