

# 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 "Corporation") should be read in conjunction with the Corporation's audited consolidated financial statements (the "Annual Financial Statements") and related notes for the years ended December 31, 2010 and 2009.

Additional information relating to the Corporation, including its quarterly MD & A for the year is available on SEDAR at [www.sedar.com](http://www.sedar.com)

This MD & A is dated April 11, 2011.

## Forward-Looking Information

This discussion offers management's analysis of the financial and operating results of WesternZagros and contains certain forward-looking statements relating to, but not limited to, operational information, future drilling plans and testing programs and the timing associated therewith, estimated Production Sharing Contract ("PSC") commitments, expected outcomes of ongoing PSC negotiations, anticipated capital and operating budgets, anticipated insurance recoveries, 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 Corporation cautions readers and prospective investors in the Corporation'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. Readers are also cautioned that disclosed test rates may not be indicative of ultimate production levels.

Forward-looking information is not based on historical facts but rather on management's current expectations and assumptions regarding, among other things, outcomes of future well operations, 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 Corporation's continued ability to employ qualified staff and to obtain equipment in a timely and cost-efficient manner, the resolution of PSC negotiations, the continued participation of the Corporation'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 outcomes of well operations and the results of drilling activity, the outcome of PSC negotiations or of the Corporation's force majeure claim, unexpected delays, availability of future financing and changes in market conditions. Although the Corporation 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; denial of any portion of the insurance claims; 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, the risk of rejection of the Corporation's force majeure claim and risk associated with international activity.

In addition, statements relating to "resources" contained herein 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 economically 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 which are as follows. "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, 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. All resource estimates presented are gross volumes for the indicated reservoirs, without any adjustment for working interest or encumbrances. A barrel of oil equivalent (BOE) is determined by converting a volume of natural gas to barrels using the ratio of 6 million cubic feet (Mcf) to one barrel. BOEs may be misleading, particularly if used in isolation. A BOE conversion ratio of 6 Mcf:1 BOE is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. The Corporation's material change reports filed on SEDAR at [www.sedar.com](http://www.sedar.com) and dated December 16, 2010, January 17, 2011 and February 22, 2011 contain additional detail on the information used in the resource assessments and include the risks and level of uncertainty associated with the recovery and development of the resources, the significant positive and negative factors relevant to the estimates and, in respect of contingent resources, the specific contingencies which prevent the classification of the resources as reserves.

Readers are cautioned that the foregoing 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. Additional information relating to WesternZagros is also available on SEDAR at [www.sedar.com](http://www.sedar.com), including the Corporation's Annual Information Form.

## Overview

WesternZagros is a publicly-traded, Calgary-based, international oil and gas company engaged in acquiring properties and exploring for, developing 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 kilometre 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 (the costs of which are carried by WesternZagros) and a wholly-owned subsidiary of Talisman Energy Inc. ("Talisman") holds the remaining 40 percent working interest (collectively the "Contractor Group").

## Basis of Presentation

### Reporting and Functional Currency

The reporting and functional currency of the Corporation 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.

### Going Concern Uncertainty

The financial data presented below has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") on the basis that the Corporation will continue to operate as a going concern, which implies the realization of assets and the settlement of liabilities and commitments in the normal course of business for the foreseeable future. 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, 2010.

Since inception, and typical with development stage companies, the Corporation has incurred losses from operations and negative cash flows from operating activities, and has an accumulated deficit at December 31, 2010. During the year ended December 31, 2010, the Corporation had expenditures of \$3.4 million, before net change in non-cash working capital, for operating activities and \$67.2 million for oil and gas property expenditures, and an overall decrease in non-cash working capital of \$1.0 million. The Corporation will require additional funding over time to maintain ongoing exploration programs and property commitments, as well as for administration expenses. This requirement for funding will occur during the fiscal year ending December 31, 2011, with the amount dependent on the level of exploration activities pursued by WesternZagros.

There are material uncertainties that could raise significant doubt about the Corporation's ability to continue as a going concern, as outlined below:

### Availability of Future Financing

Subsequent to December 31, 2010, the Corporation successfully obtained additional equity financing of Cdn\$43 million, by way of a brokered private placement of common shares that closed on March 10, 2011, which provided funds for planned operations at both Sarqala-1 and Mil Qasim-1 in 2011. The Corporation will require additional financing to re-drill the Kurdamir structure and to test the Oligocene, Eocene and Cretaceous formations that were originally encountered, but only partially evaluated, in Kurdamir-1.

In general, the Corporation's ability to continue operations and exploration activities as a going concern is dependent upon its ability to obtain additional funding over time. While the Corporation has been successful in obtaining its required funding in the past, there is no assurance that sufficient funds will be available to the Corporation in the future or, if available, available on favourable terms. Factors that could affect the availability of financing include, but are not limited to: the continued support of its shareholders; resolution of the PSC negotiations (see the "Future PSC Operations" section in this MD&A for further information); the results of its exploration activities; meeting all commitments under the PSC; the resolution of remaining political disputes in Iraq; 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 ability of the Corporation to obtain financing to develop reserves; and the timely receipt of the remaining anticipated proceeds from the current insurance claim associated with the Kurdamir-1 well control operations.

### Insurance Claim Related To Well Control Operations

The Corporation experienced two well control operations while drilling Kurdamir-1. The first of these began in the first quarter of 2010 and the second ended in the fourth quarter of 2010. Both were subject to an insurance claim. The Corporation received confirmation of coverage for the additional costs of these operations from the insurers during the second quarter of 2010. Subsequent to the conclusion of well control operations, the Corporation successfully completed and tested a portion of the well.

The insurance claim provides coverage for the Corporation's share of allowable costs up to a maximum of \$45 million. The Corporation has submitted claims for \$45.9 million and has received \$35.9 million (both net to the Corporation) in insurance proceeds as at April 11, 2011. The Corporation continues to pursue payment for the remainder of the claim. However, any change in the determination of insurance coverage or delay in payment could impair the Corporation's ability to fund ongoing activities under the PSC.

### Continued Participation of the Corporation's Co-Venturers in the PSC

WesternZagros is involved in ongoing discussions with both Talisman and the Kurdistan Regional Government ("KRG") regarding the optimal contractual arrangement for conducting future activities on the PSC Lands, see the "Future PSC Operations" section of this MD&A for further information. As a consequence of these discussions, it is likely that Talisman will continue to participate in the funding of their working interest share of the costs of drilling Kurdamir-2, but it is unlikely that Talisman will participate in activities on the remaining PSC Lands and that the Corporation will likely be required to initially, or entirely, fund 100 percent of the costs associated with the third commitment well at Mil Qasim-1. In addition, due to these ongoing discussions between the Contractor Group and the KRG, Talisman has elected not to participate in the Sarqala-1 re-entry operations.

The consolidated financial statements, and associated disclosures in this MD&A, do not reflect adjustments in the carrying values of assets and liabilities reported, revenue or expenses, nor the balance sheet classification used that would be necessary if the going concern assumption was not appropriate. Such adjustments could be material.

### Strategy

WesternZagros' main focus is the exploration and development of its PSC Lands in the Kurdistan Region of Iraq. 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 Corporation is committed to apply the lessons learned from its operations and from operations occurring elsewhere within the Kurdistan Region to improve our operating performance. The Corporation is committed to operating in 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 enabled access to opportunities and facilitated the cooperation needed to successfully execute projects.

## Highlights

WesternZagros is currently exploring for crude oil and natural gas in the Kurdistan Region of Iraq, and the Corporation currently has no reserves or production. WesternZagros' revenue is comprised entirely of interest earned on cash and cash equivalent balances and short-term investments. WesternZagros' highlights and activities to April 11, 2011 include the following.

## HSE&S

WesternZagros has operated in Kurdistan with few safety or security incidents since 2004. During the course of its operations, the Corporation has achieved a maximum total of four million person hours without any Lost Time Incidents ("LTIs"). This milestone was reached in December 2009, and subsequently, on March 2, 2010, the Corporation achieved another milestone of 1,000 days of operations without any LTIs. Unfortunately, on May 15, 2010, the Corporation experienced its first serious situation while undertaking well control operations in order to stabilize a zone of high pressure in the sidetrack well when the drill string parted and part of the drill string became stuck in the Blow Out Preventer ("BOP") at the wellhead. This resulted in a potentially dangerous situation and caused the Corporation to activate its Emergency Response Plan and begin various additional well control operations. As a precaution, the Corporation moved non-essential personnel and local inhabitants outside of its Emergency Planning Zone ("EPZ"). The Corporation was successful in safely securing the well on May 31, 2010 and the local residents who had been evacuated were able to return to their homes in early June. All of these achievements demonstrate the commitment of the Corporation's Board of Directors, Executive Management, employees and contractors to the safety and security of the local residents and to the staff and contractors involved in its operations.

## Operations

- On March 29, 2011, the Corporation re-entered the Sarqala-1 wellbore with the intent to drill a 100-metre sidetrack to evaluate and test the Miocene Jeribe Formation ("Jeribe") which is the primary reservoir target in the Sarqala-1 well. Sidetracking operations have drilled down to 3,873 metres. The Corporation is currently completing the remaining sidetrack drilling before wireline logging and testing. The Corporation originally drilled Sarqala-1 in 2008 and early 2009, suspending the well after equipment problems prevented logging. Subsequent analysis of the drilling cuttings from, and mud gas chromatograph data across, the Jeribe showed good oil potential and led to the decision to re-enter the wellbore and to undertake the current sidetrack operation.
- In the fall of 2009, the Corporation confirmed the presence of the Oligocene reservoir and completed high rate gas and condensate tests from the upper Oligocene of Kurdamir-1 (the Corporation's second exploration well). During the year ended December 31, 2010, the following operational activities were completed at Kurdamir-1:
  - During the first quarter of 2010, the well was drilled through the Eocene and Cretaceous formations to a total depth of 4,077 metres and encountered numerous oil and gas shows. Upon encountering high formation pressures at 4,077 metres, WesternZagros commenced well control operations that were completed in March 2010. The Corporation then began sidetracking the well.
  - During the second quarter of 2010, the well was sidetracked through the Eocene formation into the Aaliji Seal above the Cretaceous formations to a depth of 3,214 metres. At this depth, the well unexpectedly encountered a high pressure, hydrogen sulfide (H<sub>2</sub>S) bearing, hydrocarbon zone. The well was shut in while attempting to stabilize this zone.
  - On May 15, 2010, while attempting to stabilize the well, the drill string parted and the Corporation activated its Emergency Response Plan and began well control operations. As a precaution, the Corporation moved non-essential personnel and local inhabitants to locations outside of its Emergency Planning Zone ("EPZ"). The Corporation safely and successfully secured the well on May 31, 2010 and the local residents who had been evacuated were able to return to their homes in early June.
  - A hydraulic workover rig, known as a snubbing unit and which enables well intervention to be performed safely while the well is under pressure, was installed in June in order to recover the drill string from the well and complete well kill operations. Approximately 2,105 metres of the drill string was recovered through successful snubbing operations, and the Corporation subsequently removed the snubbing unit and abandoned the sidetrack.
  - On October 14, 2010, the open hole was plugged and cemented to approximately 2,500 metres, thus concluding well control operations. Although the Contractor Group decided not to pursue further drilling, it was decided to conduct further testing of the Oligocene formation, in its lower part, through the 9 5/8-inch casing.

- In November and December 2010, WesternZagros successfully concluded two cased hole tests of the lower Oligocene formation. The first cased hole test was conducted between 2,365 metres and 2,415 metres. The test achieved a maximum flow rate, after acidization, of 18.3 million cubic feet of gas per day at a flowing wellhead pressure of 1,960 pounds per square inch with a maximum yield of 86 barrels of high quality, 62 degrees API natural gas liquids (condensate) per million cubic feet of gas. No formation water was recovered during the testing. In addition, a mixture of light crude oil and condensate was recovered during the test prior to acidizing the formation. Subsequently, a second deeper cased hole test was conducted between 2,455 metres and 2,469 metres which proved an oil column in the Oligocene reservoir.
- Proving an oil column in the Oligocene reservoir beneath the gas cap resulted in an increase in the gross contingent resource estimates for this reservoir. The Corporation's best estimate, as audited by Sproule International Limited, of gross contingent gas, gas condensate, and oil resources for the Oligocene reservoir at Kurdamir as of December 14, 2010 increased to 850 billion cubic feet (Bcf), 33 million barrels (MMbbl) and 6.5MMbbl, respectively. These contingent resource numbers do not include any of the potential in the, as yet undrilled, downdip flanks of the Kurdamir structure in the Tertiary Oligocene reservoir. In the case where the oil column potentially extends below into the flanks, the Corporation's best estimate, as audited by Sproule International Limited, of gross unrisks prospective oil resources for this reservoir effective as of December 14, 2010 increased to 260 MMbbl.
- The gross costs for the Kurdamir-1 well were approximately \$76 million (\$46 million net to WesternZagros), including \$14 million (\$8 million net to WesternZagros) of costs associated with the cased hole tests. These gross costs exclude approximately \$70 million of incremental costs associated with well control and sidetrack activities (\$42 million net to WesternZagros) which are subject to the insurance claim being pursued by the Contractor Group.

## Exploration

- During the year ended December 31, 2010, WesternZagros undertook a range of exploration activities to further its understanding of the geology on its PSC Lands. Focusing on its lowest risk prospect areas at Kurdamir, Sarqala, Mil Qasim, Qulijan and Baran, the Corporation's exploration work included:
  - Completion of geochemical and basin modeling studies which indicate that the Aaliji Formation (the "Aaliji") is likely the source rock for the hydrocarbons on the PSC Lands. This is significant, because the Aaliji is both oil prone and likely to be generating oil at the present time, and this increases the probability that WesternZagros' exploration prospects contain oil and reduces the probability that they contain only natural gas. The specific studies undertaken include a geochemical study of the drill cuttings and hydrocarbons recovered from the Kurdamir-1 and Sarqala-1 wells, and analyses of oil from the natural oil seep at Aj Dagh (approximately nine kilometres from Kurdamir-1).
  - Completion of a re-analysis of the prospectivity of the Miocene Jeribe Formation (the "Jeribe") in the Sarqala structure. This consisted of detailed petrophysical analysis of the wireline logs obtained from Sarqala-1 in 2008/2009 and detailed analysis of the cuttings captured while drilling. This analysis suggests good oil potential in the Jeribe as it is analogous to the same formation in the nearby Qamar-1 well, which flowed 2,200 barrels of oil per day.
  - Completion of the evaluation of the high quality light oil shows (35 degree API gravity) that were encountered while drilling the Upper Fars interval at Sarqala-1. This evaluation indicated the prospectivity of the adjacent structure at Mil Qasim. The crestal location at Mil Qasim-1 is just three kilometres from the Sarqala-1 well.
  - Completion of the evaluation of the Oligocene, Eocene and Cretaceous formations of two additional prospects in the vicinity of the Kurdamir structure, i.e. Qulijan and Baran. Both Qulijan and Baran are anticline structures with upside potential extending to the fault that separates them from Kurdamir.
  - Integration of the encouraging test results from the Kurdamir-1 well and determination of the optimum location for Kurdamir-2.
- WesternZagros also continues to compile seismic data and information from wells adjacent to its PSC Lands and to integrate the data, together with the reprocessed seismic data on its PSC Lands, into its seismic interpretations to further define and update its prospects and leads inventory. The Corporation's efforts include re-evaluating the hydrocarbon potential beneath the Kalar thrust fault as part of its overall prospective resource re-assessment of its PSC Lands.
- All of the above exploration work in 2010 refined the Corporation's understanding of the regional geology, and reinforced management's view of the excellent prospects for significant oil discoveries on the Corporation's PSC Lands.

## Financial

- As at December 31, 2010, WesternZagros had \$37.5 million in working capital.
- For the year ended December 31, 2010, WesternZagros' share of capital expenditures associated with its PSC activities and other capitalized costs was \$67.2 million. Expenditures for 2010 included \$62.6 million of drilling-related costs; \$1.0 million of geological and geosciences related work; \$2.5 million of supervision and local office costs; \$0.2 million of PSC related expenditures; and \$0.9 million of corporate related expenditures.

## Insurance

- WesternZagros initiated a control of well insurance claim in the first quarter of 2010 related to the events at Kurdamir-1, which began when the well was drilled into a high pressure formation in the Gulneri Seal. These operations continued after a subsequent additional high pressure zone was encountered in the Aaliji Seal and continued until October 14, 2010, when the open hole was plugged and cemented up to approximately 2,500 metres, thus concluding well control operations.
- The control of well insurance policy covering these claims has a net aggregate limit to the Corporation of \$45 million, with a \$0.4 million deductible. Under the terms of the insurance policy, the Corporation submits claims for these costs as they are incurred and paid and these claims are then subject to the review and approval of an adjuster appointed by the insurers. WesternZagros submitted its initial claim in the first quarter of 2010 and received initial confirmation of coverage from the insurers during the second quarter of 2010.
- For the year ended December 31, 2010, WesternZagros credited \$42.0 million of insurance recoveries, net of the \$0.4 million deductible, related to the well control and recovery operations at Kurdamir-1 against the Kurdistan Region Exploration Project.
- During the year ended December 31, 2010, the Corporation received \$24.4 million of insurance proceeds from the insurers. Subsequent to December 31, 2010, further insurance proceeds of \$11.5 million were received related to further approved interim claims. The Corporation has submitted the remaining costs incurred and continues to pursue the required approval for these amounts.

## Corporate

- During the first quarter of 2010, WesternZagros announced the appointment of Mr. Ian McIntosh to the new position of Vice President, Kurdistan Business Unit, to be resident in the Kurdistan Region. Mr. McIntosh brings to the Corporation over 30 years of international oil and gas experience, encompassing development and production engineering, in-country management and business development. This appointment was a reflection of the Corporation's desire to have additional executive ability in-country. Subsequently, during the second quarter of 2010, WesternZagros announced that Mr. McIntosh had assumed the position of acting Senior Vice President, Engineering and Operations on an interim basis following the departure of Mr. Robert Theriault.
- Given the difficulties encountered during drilling operations, in the second quarter of 2010 WesternZagros undertook a comprehensive review of its operations to determine how to achieve better performance. The Corporation's Board of Directors and an external expert led this review, and the resulting recommendations were implemented. These recommendations included shifting certain technical roles from the head office to both the rig site and to the Corporation's office in Sulaymaniyah, increasing the technical resources available for planning and design for future wells, and working with our suppliers to improve the equipment and services available to the Corporation in the Kurdistan Region.

## Political

- The first fully democratic federal election, with all parties participating, was held in Iraq on March 7, 2010, with no one party winning a clear majority. During the fourth quarter of 2010, an agreement was reached to form a new coalition federal government with Nouri Al-Maliki and Jalal Talabani reappointed to their respective posts as Prime Minister and President. Prime Minister Maliki subsequently appointed Abdul Karim Luaibi as the new Minister of Oil.
- In late 2010 and early 2011, Prime Minister Maliki and Minister of Oil Luaibi were both quoted as voicing their support for the Kurdistan Region's PSC's in their current form. Further to this, an agreement was reached to resume exports from the Kurdistan Region from both the Taq Taq field and the Tawke field with a goal to export 100,000 barrels per day by the end of 2011. In March 2011, both of these fields were reported to be on production at a collective rate of approximately 85,000 bbls/day and the oil was being exported from the Kurdistan Region.

## Corporate Social Responsibility

- In 2010, 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. Activities included:
  - Providing road tanker services for the local delivery of water;
  - Providing low cost methods of obtaining water through extensive earthworks projects for over 40 villages;
  - Implementing a partnership project with Mercy Corp, an international NGO, and the local government in order to improve water access to two additional rural villages;
  - Providing training to the local communities to maintain the biosand water filter project that was completed in partnership with the Kurdistan Village Reconstruction Association, a local NGO;
  - Supporting the Garmian Sports Directorate's Youth Activity Festival, a seven-day event attended by 1,400 children, through the donation of uniforms, trophies, medals and equipment. Children learned and played various sports including football, volleyball, bicycling and basketball;
  - Partnering with Project Cure, an international NGO committed to donating medical equipment, in order to supply and distribute beds, examination tables, crutches, wheelchairs and IV stands to three local clinics and one hospital.

## FINANCIAL PERFORMANCE

### Selected Annual Information

US\$(000's), unless otherwise specified	2010	2009	2008
Total Revenue	87	184	2,959
Net Loss	5,748	5,491	10,100
Net Loss Per Share (US\$ Per Share) (Basic and Diluted)	0.03	0.03	0.05
Capital Expenditures	67,162	54,356	95,102
Total Assets	241,231	241,077	243,697
Total Long-term Liabilities	245	175	69
Dividends (US\$ Per Share)	Nil	Nil	Nil

### General and Administrative Expenses

For the year ended December 31, 2010, WesternZagros expensed \$6.4 million in general and administrative expenses ("G&A"), compared to \$6.3 million for the prior year, and capitalized \$3.0 million of G&A compared to \$3.2 million in 2009. The amounts capitalized are directly related to the supervision of the Corporation's drilling and geological capital programs. Total G&A costs were relatively consistent between 2010 and 2009, as the increase in US\$ costs incurred resulting from a stronger Canadian dollar in 2010, which impacts a large portion of the Corporation's G&A expenditures, was mostly offset by lower stock-based compensation expense as compared to the prior year.

### Depreciation, Depletion and Amortization (DD&A)

For the year ended December 31, 2010, WesternZagros had \$0.6 million depreciation related to certain administrative assets, compared to \$0.7 million for the year ended December 31, 2009. No depletion, which is calculated on a unit-of-production basis based on proved reserves, has been recorded on oil and gas related assets because there has been no production to date. Furthermore, WesternZagros has yet to determine whether proved reserves are attributable to the PSC Lands.

### Stock-Based Compensation

The Corporation recognized stock-based compensation expense for all stock options granted. For the year ended December 31, 2010, WesternZagros recorded \$1.6 million in stock-based compensation expense and \$1.0 million as part of capitalized G&A, with a corresponding increase to contributed surplus, for 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 capitalized G&A.

## Foreign Exchange

WesternZagros adopted the U.S. dollar as its measurement and reporting currency since the majority of its expenditures 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. As at December 31, 2010, WesternZagros held over 95 percent of its cash and cash equivalents in U.S. dollar accounts and U.S. dollar overnight term deposits. The Corporation also has certain assets and liabilities in currencies other than the U.S. dollar (mainly Canadian dollars). For financial statement presentation purposes, WesternZagros converts other currencies to U.S. dollars at the end of each period resulting in foreign exchange gains and losses. 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 tangible equipment procured from Canadian suppliers. For the year ended December 31, 2010, WesternZagros recorded a foreign exchange loss of \$0.06 million relating to these conversions, compared to a \$0.01 million foreign exchange loss for the year ended December 31, 2009.

## Income Taxes

For the year ended December 31, 2010, WesternZagros had a net income tax recovery of \$1.2 million (2009: \$1.3 million recovery), comprised of \$1.3 million of current income tax recovery (2009: \$1.8 million recovery) and reduced by \$0.1 million of future income tax expense (2009: \$0.4 million 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.

The Corporation received proceeds of \$2.2 million for prior year tax recoveries during the year ended December 31, 2010 (2009: \$4.7 million taxes paid).

## Revenue

WesternZagros' revenue is comprised entirely of interest earned on cash and cash equivalents and short-term investment balances. Interest of \$0.09 million was earned for the year ended December 31, 2010, compared to \$0.18 million for the year ended December 31, 2009. The decrease in revenue resulted mainly from a decrease in cash and cash equivalents as the Corporation expended funds for exploration activities during the year.

## Net Loss

For the year ended December 31, 2010, WesternZagros recorded a net loss of \$5.7 million compared to \$5.5 million for the year ended December 31, 2009. WesternZagros is an early stage exploration enterprise and, apart from its working interest in the PSC and cash and cash equivalents, the Corporation has no other significant assets. The increased net loss in 2010 resulted mainly from reduced tax recoveries as compared to 2009.

## Capital Expenditures

For the year ended December 31, 2010, total capital expenditures, prior to any insurance recoveries, related to the Kalar-Bawanoor Block were \$107.3 million, including \$100.1 million of drilling-related costs, \$1.3 million of geosciences-related work (reprocessing and interpretation of seismic data), \$5.7 million of supervision and local office costs in support of drilling operations, and \$0.2 million of PSC-related expenditures. Included in the drilling costs were \$93.3 million for operations at Kurdamir-1, \$4.8 million for planning and site preparation for Qulijan-1, \$1.3 million for planning costs related to the Sarqala-1 re-entry, and \$0.7 million for planning costs related to the Mil Qasim prospect.

By comparison, for the year ended December 31, 2009, total capital expenditures related to the Kalar-Bawanoor Block were \$73.3 million, including \$65.1 million of drilling-related costs, \$1.1 million of 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.

WesternZagros' share of capital expenditures, prior to any insurance recoveries, for the year ended December 31, 2010 associated with its PSC activities and other capitalized costs was \$67.2 million. Capital expenditures for 2010 included \$62.6 million of drilling-related costs; \$1.0 million of geosciences-related work; \$2.5 million of related field office and supervision costs; \$0.2 million for PSC-related costs, and \$0.9 million of corporate-related expenditures.

For the year ended December 31, 2010, the costs for Kurdamir-1 have been credited by approximately \$42.0 million, net to WesternZagros, for estimated claimable costs under the current insurance claim. This amount is net of deductibles.

By comparison, 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 PSC-related costs 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.

The Corporation's share of 2010 capital expenditures, net of the insurance recoveries, decreased in 2010 in comparison to 2009 as the costs associated with the Kurdamir-1 operations were mostly offset by the estimated claimable costs under the insurance claim. In addition, the PSC-related costs were lower in 2010 as the capacity building bonus payments were completed in 2009.

WesternZagros capitalized \$3.0 million of G&A expenses, including \$1.0 million of stock-based compensation, for the year ended December 31, 2010, compared to \$3.2 million of G&A expenses, including \$0.5 million of stock-based compensation, for the year ended December 31, 2009.

## Quarterly Information

The following table summarizes key financial information on a quarterly basis for the 2010 and 2009 fiscal periods:

(US\$ thousands, unless otherwise specified)	Year Ended		Three Month Periods Ended		
	Dec. 31 2010	Dec. 31 2010	Sep. 30 2010	June 30 2010	March 31 2010
Revenue	87	13	38	17	19
Net Loss	5,748	1,924	1,098	1,720	1,006
Net Loss Per Share (US\$ Per Share) (Basic and Fully Diluted)	0.027	0.009	0.005	0.008	0.005
Capital Expenditures	67,162	17,332	20,455	16,041	13,334
Total Assets	241,231	241,231	234,555	236,006	235,977
Total Long-term Liabilities	245	245	228	207	178
Dividend (US\$ per Share)	Nil	Nil	Nil	Nil	Nil

(US\$ thousands, unless otherwise specified)	Year Ended		Three Month Periods 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

## Fourth Quarter

In the fourth quarter of 2010, WesternZagros had a net loss of \$1.9 million compared to a net loss of \$1.0 million in the fourth quarter of 2009. The increased fourth quarter net loss in 2010 is mainly due to reduced income tax recoveries as well as increased professional and legal fees incurred as compared to the fourth quarter of 2009.

WesternZagros' capital expenditures totaled \$17.3 million, prior to insurance recoveries, in the fourth quarter of 2010 compared to \$11.5 million in the fourth quarter of 2009. This increase in 2010 is primarily due to the ongoing Kurdamir-1 operations, including completing and testing a portion of the well during the fourth quarter of 2010.

## Production Sharing Contract - Summary

Under the terms of its PSC, WesternZagros has a 40 percent working interest and the KRG has a 20 percent working interest which is carried by WesternZagros. The remaining 40 percent working interest is held by Talisman, which was allocated the interest 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 exploration 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 that the net available gas available for cost recovery is 55 percent and the profit sharing component is on a different scale. 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

The PSC provides the Contractor Group with the exclusive right to develop and produce any commercial discoveries. The development period for producing a commercial discovery is an initial term of 20 years from the date of declaring a commercial discovery with a further automatic right to a five-year extension. If commercial production is possible at the end of the last period then the Contractor Group shall be entitled to an extension of a further five years under the same terms as in the PSC if a request is made by the Contractor Group at least six months before the end of the first five year extension.

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 ended December 31, 2010, subject to an extension under a force majeure claim described below. During such time the Contractor Group is required to complete a minimum of 1,150 kilometres of seismic surveying (which has been completed), to drill three exploration wells (two of which have been drilled), and to commit a minimum of \$75 million in the aggregate on these activities (which has been completed). The PSC also includes capacity building support payments (which concluded in April 2009) and annual funding for certain technological, logistical, recruitment and training support during the exploration sub-periods.

During the drilling of the Kurdamir-1 well, certain situations occurred which caused additional time to be spent on well control and repair operations under conditions of force majeure. Under the terms of the PSC, when a force majeure event occurs, the timing resulting from any such delay and the time necessary to repair any damage resulting from the delay is to be added to any time period provided under the PSC, including the first exploration sub-period. The period of force majeure started on January 22, 2010 and continued until October 14, 2010, a period of 265 days. The Corporation, on behalf of the Contractor Group, has notified the KRG of a force majeure event under the terms of the PSC and claimed a corresponding 265-day extension of the first exploration sub-period, i.e. until September 22, 2011.

Following the submission of the force majeure claim to the KRG, the KRG proposed certain contractual amendments in order to resolve the timing issues created by the force majeure event and other commercial concerns. Negotiations between the Contractor Group are ongoing with respect to these proposed amendments. See the “Future PSC Operations” section in this MD&A for further information.

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), or continue further exploration operations by entering into the second exploration sub-period, or request a one-year extension for further exploration and appraisal activities prior to deciding to enter into the second exploration sub-period.

To meet its remaining commitments for the first exploration sub-period, WesternZagros estimates expenditures of approximately \$20 million to \$25 million, prior to the costs of any testing, if required, and assuming that the Corporation will be required to fund 100 percent of for the remaining exploration commitment well (see “Future PSC Operations” section in this MD&A for further information). This estimate includes the remaining costs associated with drilling this additional exploration commitment well by the end of the first exploration sub-period, and providing the associated supervision and local office costs in support of drilling operations.

During the second exploration sub-period, the Contractor Group, or those parties that have elected to participate in further exploration, is required to complete a minimum of 575 kilometres of seismic surveying, drill at least two exploration wells and commit a minimum of \$35 million to 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 at December 31, 2010:

**For the year ended December 31**

(\$ 000's)	2011	2012	2013	2014	2015+	Total
Exploration	2,335	—	—	—	—	2,335
Offices	614	234	—	—	—	848
Total	2,949	234	—	—	—	3,183

**Future PSC Operations**

In parallel with, and as an alternative to, the force majeure claim, WesternZagros remains involved in ongoing negotiations with both Talisman and the KRG regarding the optimal contractual arrangements for conducting future activities on the PSC Lands. Proposals discussed to date include, but are not limited to:

- A one-year extension, to December 31, 2011, for drilling the third exploration commitment well;
- A requirement to complete the drilling of Kurdamir-2 prior to June 30, 2012, and subsequent to Talisman drilling the Topkhana-1 well on its adjacent Block 39;

- Talisman becoming operator for all future activity on the Kurdamir structure, which is adjacent to Talisman's Block 39, with WesternZagros continuing as operator for all future activity on the remainder of the PSC Lands; and
- Talisman's future participation in activities on the PSC Lands being limited to the Kurdamir prospect, with the expectation that the KRG would assign Talisman's prior 40 percent interest in the remaining PSC Lands to a new third party participant following completion of the third exploration commitment well, which would be located on those remaining PSC Lands. As such, this would require the Corporation to initially, or entirely, fund 100 percent of the costs associated with the third commitment well.

While these negotiations proceed, WesternZagros continues to work toward drilling the third exploration commitment well under the terms of the force majeure provision in the PSC in order to ensure that it meets the current requirements of the PSC in the event that these negotiations are not successfully concluded.

### **Third Party Consulting Services Agreements**

In 2003, WesternZagros entered into a consulting service agreement that provides for a three percent right to participate indirectly in the future profits the Corporation may earn in respect to the PSC, in exchange for consulting services provided since that date. In the determination of profits under this agreement, WesternZagros is entitled to deduct the consultant's proportional share of all costs associated with acquiring the PSC and the exploration, appraisal, development and production expenditures incurred by the Corporation ("eligible costs"), together with interest on such percentage of eligible costs at LIBOR plus three percent. The Corporation is currently in negotiations to terminate this right.

Further, in 2004, WesternZagros entered into a consulting service agreement that provides for a two percent right to indirectly participate in the future profits the Corporation may earn in respect to the PSC, in exchange for the provision of consulting services during the period 2004 to 2006. In the determination of profits under this agreement, WesternZagros is entitled to deduct one percent of all eligible costs, together with interest on such percentage of eligible costs at LIBOR plus ten percent. The consultant is required to fund the additional one percent of all eligible costs. The Corporation is currently in negotiations to terminate this right.

### **Off Balance Sheet Arrangements**

The Corporation 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, 2010, WesternZagros did not enter into any off balance sheet transactions.

### **Insurance Claim Update**

WesternZagros initiated a control of well insurance claim in the first quarter of 2010 in relation to certain events at Kurdamir-1 which commenced when the well was drilled into a high pressure formation in the Gulneri Seal. These operations continued after a subsequent additional high pressure zone was encountered in the Aaliji Seal and continued until October 14, 2010, when the open hole in the Kurdami-1 well was plugged and cemented to approximately 2,500 metres, concluding well control operations.

The control of well insurance policy covering these claims has a net aggregate limit to the Corporation of \$45 million, with a \$0.4 million deductible. Under the terms of the insurance policy, the Corporation submits claims for these costs as they are incurred and paid and these claims are then subject to the review and approval by the adjuster appointed by the insurers. WesternZagros submitted its initial claim in the first quarter of 2010 and received initial confirmation of coverage from the insurers during the second quarter of 2010.

For the year ended December 31, 2010, WesternZagros credited \$42.0 million of insurance recoveries, net of the \$0.4 million deductible, related to the well control and recovery operations at Kurdamir-1 against the Kurdistan Region Exploration Project. During the year ended December 31, 2010, the Corporation received \$24.4 million of insurance proceeds from the insurers. Subsequent to December 31, 2010, further insurance proceeds of \$11.5 million have been received related to further approved interim claims. The Corporation has submitted the remaining costs incurred and continues to pursue the required approval for these amounts.

## OUTLOOK FOR 2011

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In 2011 and early 2012, WesternZagros plans to focus on a program of drilling and testing to evaluate the highly prospective formations discovered through the Sarqala-1 and Kurdamir-1 wells. This program will test the approximately one billion barrels of oil equivalent of mean gross un-risked prospective resources that these formations are estimated to contain as of December 14, 2010 and January 14, 2011, as audited by Sproule International Limited.

On March 29, 2011, the Corporation began the first of these operations by re-entering the Sarqala-1 wellbore with the intent to drill a 100-metre sidetrack to evaluate and test the Jeribe Formation which is the primary reservoir target in the Sarqala-1 well. Sidetracking operations have drilled down to 3,873 metres. The Corporation is currently completing the remaining sidetrack drilling before wireline logging and testing. The Corporation originally drilled Sarqala-1 in 2008 and early 2009, suspending the well after equipment problems prevented logging. Subsequent analysis of the drilling cuttings from, and mud gas chromatograph data across, the Jeribe showed good oil potential and led to the decision to re-enter the wellbore and to undertake the current sidetrack operation.

Following completion of the Sarqala sidetrack, WesternZagros plans to drill the third commitment well at Mil Qasim-1, located only three kilometres from Sarqala-1, in order to target potential oil-bearing sandstones in the Upper Fars reservoir. The Upper Fars reservoir is shallower than the Jeribe Formation and exhibited oil shows when penetrated in Sarqala-1. With a proposed total depth of 2,000 to 2,400 metres, Mil Qasim-1 will be a shallower well with less technical risk than either Sarqala-1 or Kurdamir-2.

Concurrent with the Corporation's drilling operations at Sarqala-1 and Mil Qasim-1, Talisman will be drilling the Topkhana prospect on its adjacent Block 39, where operations commenced on January 31, 2011. Topkhana-1 will be drilled to evaluate and test the Oligocene reservoir. Although WesternZagros has no working interest in Topkhana-1, results from the well could provide information confirming the potential coalescing of the Kurdamir and Topkhana structures into one large structure. The Contractor Group plans to drill the Kurdamir-2 well after Topkhana-1, with Talisman as operator. WesternZagros and Talisman are currently preparing the drilling plan for Kurdamir-2, including acquiring and preparing the drilling location lands and acquiring the long lead time materials.

With the objective of maximizing its options and flexibility to increase the likelihood of success, WesternZagros' priorities for 2011 are as follows:

- Re-enter the Sarqala-1 well in order to test the Miocene Jeribe Formation;
- Conclude PSC negotiations with the KRG and Talisman in a manner that gives flexibility around the timing of the third commitment well and provides for an orderly progression of drilling and other exploration activities to maximize the efficient use of capital;
- Drill Mil Qasim-1 to test the Upper Fars Formation;
- Begin drilling Kurdamir-2 to test the Oligocene, Eocene and Cretaceous formations; and
- Evaluate the commercial potential and design an appraisal program for the natural gas, gas condensate and oil discovered at Kurdamir, and evaluate the commercial potential for any discoveries from the Sarqala-1 re-entry and Mil Qasim-1.

WesternZagros estimates its 2011 capital and operating budget, including the likely requirement for the Corporation to fully fund the Sarqala-1 re-entry and Mil Qasim-1 and to fund its share of the costs of Kurdamir-2 well to be incurred in the fourth quarter of 2011, to be approximately \$95 million. This includes approximately \$80 million for drilling and related costs with the remainder of the budget comprised of funds for certain annual PSC payments, initial technical studies as part of the Kurdamir Discovery appraisal program, in-country operational support and corporate general and administrative costs.

## 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 with major Canadian financial institutions with investment grade credit ratings and in Government of Canada instruments. This is in accordance with an Investment Policy approved by the Board of Directors. WesternZagros had no outstanding bank debt or other interest bearing indebtedness as at December 31, 2010.

At December 31, 2010, WesternZagros had \$37.5 million in working capital. On March 10, 2011, WesternZagros successfully completed a brokered private placement for gross proceeds of approximately Cdn\$43 million (net proceeds of approximately Cdn\$41 million after fees). The working capital and the proceeds of this private placement will be used to fund a portion of the future capital expenditures as described in the "Outlook" section, specifically both the drilling operations for the Sarqala-1 re-entry and Mil Qasim-1 which the Corporation anticipates funding 100 percent. WesternZagros will be required to access further funding in 2011, in particular as it relates to the drilling of Kurdamir-2, and ultimately to fund any appraisal programs and future development programs from successful exploration activities. In considering the proper timing to access further financial resources, the Corporation will assess the following factors:

- The conclusion of discussions with both the KRG and Talisman as it relates to the PSC and associated timing of work commitments;
- The exploration results of both Sarqala-1 re-entry and Mil Qasim-1;
- The timing for settlement for all outstanding amounts under the control of well insurance claim;
- Participation of the Corporation's co-venturers in the PSC activities;
- The ability to export oil and natural gas from the Kurdistan Region of Iraq in accordance with the economic terms under the PSC, likely following the promulgation of the new Federal Petroleum Law of Iraq; and
- The current conditions in the financial markets, including the potential for further market instability.

## Outstanding Share Data

As at December 31, 2010, there were 207,464,320 shares issued and outstanding. The number of common shares reserved for issuance pursuant to options granted will not exceed 10 percent of the issued and outstanding common shares. Subsequent to December 31, 2010, WesternZagros completed a private placement of common shares in which 89,665,352 common shares were issued. As at April 11, 2011, the total number of shares outstanding was 297,129,672.

For the year ended December 31, 2010, there were 9,764,900 stock options granted to employees and 2,417,334 were forfeited by employees, bringing the total stock options outstanding as of December 31, 2010 to 20,354,900. Subsequent to December 31, 2010, there were 27,000 stock options granted to employees and 605,400 forfeited by employees, bringing the total stock options outstanding as of April 11, 2011 to 19,776,500.

## RISK FACTORS

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The oil and gas industry is very competitive and is subject to many risks. Many of these risks are outside of WesternZagros' control. Since inception and typical with development stage companies, WesternZagros has incurred losses from operations and negative cash flows from operating activities, and has an accumulated deficit at December 31, 2010. The ability of WesternZagros to successfully carry out its business plan beyond exploration is primarily dependent upon the continued support of its shareholders, resolution of the PSC negotiations referred to under the "Future PSC Operations" section of this MD&A, the discovery of economically recoverable reserves, meeting all commitments under the PSC, the resolution of remaining political disputes in Iraq, 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, the ability of WesternZagros to obtain financing to develop reserves, and the timely receipt of the remaining anticipated insurance proceeds from the current insurance claim associated with the Kurdamir-1 well control and recovery operations. Management of WesternZagros has identified certain key risks and their potential impact on WesternZagros' operations.

### Additional Funding Requirements

In general, the Corporation's ability to continue operations and exploration activities as a going concern is dependent upon its ability to obtain additional funding when required. WesternZagros anticipates making substantial capital expenditures for the acquisition, exploration, appraisal, development and production of oil and natural gas reserves in the future. These expenditures also 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 Corporation's capital requirements (see "Future PSC Operations").

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. While the Corporation has been successful in obtaining its required funding in the past, there is no assurance that debt or equity financing, or future cash generated by operations (if any), would be available or sufficient to meet these requirements or, if debt or equity financing is available, that it will be on terms acceptable to WesternZagros.

Financial market instability in the past few years has impacted WesternZagros' ability, and that of other exploration and development companies, to access equity or debt markets at all or on acceptable terms. 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 over time. In addition, the results of the Corporation's exploration activities or any prolonged delay in the resolution of remaining political disputes in Iraq, progress on the Federal Petroleum Law or in the export of oil from Kurdistan in accordance with the economic terms under the PSC could negatively impact the future ability of the Corporation to access equity or debt markets.

The inability of WesternZagros to access sufficient capital for its operations on a timely basis could have a material adverse effect on WesternZagros' financial condition, results of operations and prospects and its ability to continue as a going concern and could cause WesternZagros to forfeit its interest in certain properties, miss certain acquisition opportunities and reduce or terminate its operations.

### Foreign Activities

All of WesternZagros' assets are located in Kurdistan. As such, WesternZagros is subject to political, economic, and other uncertainties, including, but not limited to, the uncertainty of negotiating with foreign governments (including e.g. the Corporation's force majeure claim under the PSC), 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 Kurdistan, 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.

## **Continued Participation of the Corporation's Co-Venturers**

WesternZagros' ability to execute its exploration and development strategies in the manner in which the Corporation considers optimal may be affected by the continued participation of the Corporation's co-venturers and the conclusion of discussions related to PSC activities, the resulting timing of work commitments therefrom and the Corporation's percentage share of costs relating thereto. Any change in the continued participation of Talisman under the PSC could increase the Corporation's capital requirements, see "PSC Overview and Commitments" and "Future PSC Operations".

## **Political Issues**

The political and security situation in Iraq (outside Kurdistan) is unsettled and volatile. Kurdistan is the only Region that is constitutionally established pursuant to the Iraq Constitution. 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 Kurdistan and the PSC.

## **Legislative Issues**

No federal Iraq legislation has yet been agreed to or enacted by the Iraq Council of Ministers (Cabinet) and Council of Representatives (Parliament) 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 legislation could materially adversely impact WesternZagros' interest in Kurdistan and the PSC.

## **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, which will depend not only on its 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 exploration, development and 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.

## Resources Estimates

Resource estimates contained herein are only estimates, and the ultimate resources may prove to be significantly less than the mean estimates. Estimates of resources depend in large part upon the reliability of available geological and engineering data. Geological and engineering data are used to determine the probability that a reservoir of oil and/or natural gas exists at a particular location, and whether, and to the extent to which, such hydrocarbons are recoverable from the reservoir.

Basic reservoir parameters will vary within the reservoir of interest and some of these parameters such as porosity, net hydrocarbon pay thickness and water saturation may affect the volume of hydrocarbon estimated to be present. Additional reservoir parameters such as permeability, the presence or absence of bottom water and the specific mineralogy of the reservoir rock may affect the effectiveness of the recovery process. Recovery of the resources may also be affected by the availability and quality of source water, availability of fuel gas, and well and plant equipment malfunction or failure. There is no certainty that certain mineral interests are not affected by ownership considerations that have not yet come to light.

The Corporation has engaged professional geologists and engineers to evaluate the reservoir and prepare development and depletion plans, however implementation risk remains. This risk is related to factors such as the operational capacity and reliability of wells and facilities, the vertical and areal homogeneity of the reservoir, and the effectiveness of the drainage of oil in the reservoir to the vicinity of the production wells where it can be captured.

## Ability to Execute Exploration, Appraisal and Development Programs

It may not always be possible for WesternZagros to execute its exploration, appraisal 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;
- the hazards related to drilling and associated operations;
- 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 Kurdistan and/or Iraq; and
- the regulation of the oil and natural gas industry by various levels of government and governmental agencies in Kurdistan 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 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.

## **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.

## **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 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 2010, both oil and gas prices remained volatile as West Texas Intermediate ranging from US\$64 to US\$91 per barrel. WesternZagros originally negotiated the economic terms of its PSC in 2007 in a \$50 per barrel 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.

### **Third Party Credit Risk**

WesternZagros is 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 determine 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 ABCA.

### **Dilution**

WesternZagros may make future acquisitions or enter into financings or other transactions involving the issuance of securities of WesternZagros which may be dilutive.

### **Issuance of Debt**

From time to time, WesternZagros may enter into transactions to acquire assets or the shares of other organizations. These transactions may be financed in whole or in part with debt, which may increase WesternZagros' debt levels above industry standards for oil and natural gas companies of similar size. Neither WesternZagros' articles nor its by-laws limit the amount of indebtedness WesternZagros may incur. The level of WesternZagros' indebtedness from time to time, could impair WesternZagros' ability to obtain additional financing on a timely basis to take advantage of business opportunities that may arise.

### **Hedging**

From time to time, WesternZagros may enter into agreements to receive fixed prices on any future oil and natural gas production to offset the risk of revenue losses if commodity prices decline; however, if commodity prices increase beyond the levels set in such agreements, WesternZagros would not benefit from such increases. Similarly, from time to time, WesternZagros may enter into agreements to fix the exchange rate of various currencies used in its business in order to offset the risk of revenue or cost related losses in the event of currency fluctuations. There is no certainty that any such currency hedges which may be entered into will benefit WesternZagros.

### **Availability of Drilling Equipment and Access**

Oil and natural gas exploration and development activities are dependent on the availability of drilling and related equipment and supplies (typically leased from third parties) in the particular areas where such activities will be conducted. Demand for such limited equipment or access restrictions may affect the availability of such equipment and supplies to WesternZagros and may delay exploration and development activities.

### **Insurance and Liability**

WesternZagros' involvement in the exploration for and development of oil and natural gas properties may result in WesternZagros becoming subject to liability for pollution, blow outs, property damage, personal injury or other hazards. Although WesternZagros maintains insurance in accordance with industry standards to address certain of these risks, such insurance has limitations on liability and may not be sufficient to cover the full extent of such liabilities. In addition, such risks are not, in all circumstances, insurable or, in certain circumstances, WesternZagros may elect not to obtain insurance to deal with specific risks due to the high premiums associated with such insurance or other reasons. The payment of any uninsured liabilities would reduce the funds available to WesternZagros. The occurrence of a significant event that WesternZagros is not fully insured against, or the insolvency of the insurer of such event, could have a material adverse effect on WesternZagros.

## CRITICAL ACCOUNTING ESTIMATES

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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 3 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 relate 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, insurance recoveries receivable, asset retirement obligations, future incomes taxes, and fair value of stock-based compensation.

### Insurance Recoveries Receivable

WesternZagros has recognized an insurance recoveries receivable as at December 31, 2010. This receivable has been recognized on the basis of the acceptance of the insurance claim by the insurers (see the "Insurance Claim Update" section of this MD&A) and requires management to estimate the amount of the remaining claim that it believes it has virtual certainty in recovering.

### 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 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 Corporation 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 requires 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 as well as future economic and legislative changes.

## CHANGES IN ACCOUNTING POLICIES AND PRACTICES AND FUTURE ACCOUNTING PRONOUNCEMENTS

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### Changes in Accounting Policies

WesternZagros adopted the following new accounting standards effective January 1, 2010:

- Amendments to CICA Handbook Section 1506, Accounting Changes. These amendments to the standard resulted in excluding changes in accounting policies due to a complete replacement of an entity's primary basis of accounting. The implementation of these amendments had no significant impact on the Corporation's financial statements.

### Future Accounting Pronouncements

#### Convergence to 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. Companies will also be required to provide IFRS comparable information for the previous fiscal year. The transition date of January 1, 2010, will require WesternZagros to restate the 2010 comparative information for the 2011 financial statements to be prepared in accordance with IFRS.

In early 2010 the project team developed an IFRS implementation plan and performed preliminary assessments on the accounting policy choices for conversion to IFRS. During the second quarter of 2010 the project team focused on key IFRS transition issues and alternatives and commenced an analysis of IFRS financial statement presentation and disclosure requirements. A detailed implementation plan and timeline were also developed at that time. During the third quarter of 2010 the project team drafted IFRS accounting policies for Steering Committee review and completed an initial analysis on the opening balance sheet adjustments required upon conversion to IFRS. Since that time, the draft IFRS accounting policies have been formalized and the project team continues to execute the implementation phase under the IFRS conversion plan.

WesternZagros currently continues to review the required adjustments for the January 1, 2010 opening IFRS balance sheet. While still subject to change, the most significant impacts from conversion to IFRS are as follows:

#### IFRS 1, "First-Adoption of International Reporting Standards" ("IFRS 1")

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 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 entering into the PSC.

IFRS 1 sets out the procedures that an entity must follow when adopting IFRS as the basis for preparing financial statements. IFRS provides entities with a number of optional exemptions upon conversion to IFRS, the most significant of which that WesternZagros currently intends to utilize is the exemption that allows the December 31, 2009 full cost pool under previous GAAP to be reclassified as intangible exploration and evaluation assets under IFRS.

WesternZagros currently estimates that upon transition to IFRS, approximately \$154 million in costs will be reclassified from property, plant, and equipment to intangible evaluation and exploration assets on a deemed cost basis as at January 1, 2010.

#### IFRS 6, “Exploration for and Evaluation of Mineral Resources” (“IFRS 6”)

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 for 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.

After transition to IFRS on January 1, 2010, WesternZagros currently expects that E&E assets will continue to increase, during the E&E phase, due to ongoing expenditures related to its PSC Lands.

WesternZagros will also be required to complete an impairment test of exploration and evaluation assets as at January 1, 2010. For the purposes of completing an impairment test under IFRS 6, the E&E assets must be allocated to specific cash-generating units (CGUs). Due to the sizeable prospective resource estimates associated with its PSC Lands, WesternZagros does not currently expect to record any impairment of E&E assets upon transition to IFRS.

#### IFRS 2, “Share-Based Payment” (“IFRS 2”)

The valuation and expensing of share-based payments will be done using a graded vesting under IFRS, whereas under previous GAAP, entire stock option issuances were valued as a whole and expensed on a straight line over the expected lives of the options. This results in an accelerated expensing of the share-based payments as the fair value is weighted more heavily toward the periods closer to the date of issuance of the stock options but is partially offset by the impact of estimated forfeitures. WesternZagros currently estimates that at transition on January 1, 2010, contributed surplus will increase between \$1 million to \$2 million, with a corresponding increase in the accumulated deficit, due to the accelerated expensing associated with share based payments under IFRS.

#### IAS 37, “Provisions, Contingent Liabilities and Contingent Assets” (“IAS 37”)

The provisions for decommissioning obligations under IFRS are treated similarly to Canadian GAAP, which are currently disclosed as asset retirement obligations (“ARO”). However, IAS 37 requires that a risk-free discount rate, that is not credit risk adjusted, be applied to the present value calculation of estimated future abandonment costs. It is anticipated that the change in the discount rate will result in an increased provision for decommissioning obligations of between \$0.2 million to \$0.5 million upon transition to IFRS as at January 1, 2010.

#### Other IFRS Considerations

In addition to accounting policy changes necessary upon transition to IFRS, WesternZagros continues to work on the development of processes and systems to ensure that IFRS comparative data is captured, and to position the Corporation for reporting under IFRS in 2011. WesternZagros does not currently anticipate significant system modifications or significant changes in internal controls upon transition to IFRS.

Overall, WesternZagros continues to make progress on the convergence with IFRS. Presentation and disclosure requirements for each policy continue to be addressed. The project team also continues to work on the implementation phase, which includes determining the specific qualitative and quantitative impacts for each IFRS requirement that is relevant to the Corporation and anticipates completion of this phase in April 2011. The final determination of IFRS policy choices discussed in this MD&A, as well as the discussion of the optional exemptions that may be utilized, are still subject to final approval of the Audit Committee and the Board of Directors and the concurrence of WesternZagros’ auditors.