Management's Responsibility for Financial Reporting

Management is responsible for the reliability and integrity of the consolidated financial statements, the notes to the consolidated financial statements, and other financial information presented elsewhere in this annual report.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control and for reviewing and approving the consolidated financial statements. The Board is assisted in exercising its responsibilities through the Audit Committee of the Board.

The Audit Committee meets periodically with management and the auditors to satisfy itself that each is properly discharging its responsibilities, to review significant accounting and reporting matters and to review the consolidated financial statements. The Audit Committee reports its findings and recommends the approval of the consolidated financial statements to the Board.

The consolidated financial statements have been audited on behalf of the shareholders by the independent auditors, PricewaterhouseCoopers LLP, in accordance with Canadian generally accepted auditing standards.

Fred J. Dyment
Executive Chairman

Greg Stevenson
VP Finance

March 6, 2009

Auditors' Report

To the Shareholders of WesternZagros Resources Ltd.

We have audited the consolidated balance sheets of WesternZagros Resources Ltd. as at December 31, 2008 and 2007 and the consolidated statements of operations, comprehensive loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants
Calgary, Alberta

March 6, 2009

Consolidated Balance Sheets

December 31 (United States $ thousands)	**2008**	2007
Assets		
Current Assets		
Cash and Cash Equivalents	**90,016**	100,367
Short-term Investments (note 5)	**39,967**	–
Accounts Receivable	**12,161**	255
Prepaid Expenses	**250**	111
Future Income Taxes (note 9)	**330**	–
	142,724	100,733
Long-term Assets		
Property, Plant and Equipment (note 6)	**100,663**	55,896
Deposits Held in Trust (note 7)	**–**	4,148
Future Income Taxes (note 9)	**310**	–
	100,973	60,044
	243,697	160,777
Liabilities		
Current Liabilities		
Accounts Payable and Accrued Liabilities	**13,326**	4,938
Income Taxes Payable	**4,679**	–
	18,005	4,938
Long-term Liabilities		
Asset Retirement Obligation (note 8)	**69**	–
	18,074	s4,938
Shareholders' Equity		
Share Capital (note 10)	**253,583**	175,405
Warrants (note 11)	**–**	4,570
Contributed Surplus (note 13)	**6,276**	–
Deficit	**(34,236)**	(24,136)
	225,623	155,839
	243,697	160,777

Commitments and Contingencies (note 17)

See Accompanying Notes to the Consolidated Financial Statements

Approved by the Board of Directors

Fred J. Dyment, Director

Randall Oliphant, Director

Consolidated Statements of Operations, Comprehensive Loss and Deficit

For the years ended December 31 (United States $ thousands, except per share amounts)	**2008**	2007
Revenues		
Interest Income	**2,959**	817
Expenses		
Charges Under Service Agreement	–	9,072
General and Administrative	**7,342**	1,640
Depreciation	**240**	40
Foreign Exchange Loss	**1,438**	491
	9,020	11,243
Net Loss and Other Comprehensive Loss Before Income Taxes	**6,061**	10,426
Income Tax Expense (note 9)	**4,039**	–
Net Loss and Other Comprehensive Loss	**10,100**	10,426
Deficit at Beginning of Year	**24,136**	9,661
Warrants Issued Under Plan of Arrangement (note 4)	–	4,049
Deficit at End of Year	**34,236**	24,136
Net Loss Per Share – Basic and Diluted (note 14)	**0.05**	0.06

See Accompanying Notes to the Consolidated Financial Statements

Consolidated Statements of Cash Flow

For the years ended December 31 (United States $ thousands)	2008	2007
Cash Provided By (Used In)		
Cash From Operating Activities		
Net Loss	**(10,100)**	(10,426)
Non-cash Items		
Depreciation	**240**	40
Accretion on Asset Retirement Obligation (note 8)	**3**	–
Stock-based Compensation (note 12)	**1,938**	–
Future Income Tax Recovery (note 9)	**(640)**	–
	(8,559)	(10,386)
Decrease (Increase) in Non-Cash Working Capital (note 16)	**(4,452)**	(107)
	(4,107)	(10,493)
Cash From Financing Activities		
Share Issuance Under Private Placement (note 10)	**71,384**	12,766
Exercise of Warrants (note 11)	**6,048**	4,201
Share Issuance Under Plan of Arrangement (note 4)	**–**	83,980
Class C Shares Under Plan of Arrangement (note 4)	**–**	1,027
Increase in Due to Related Party	**–**	42,828
	77,432	144,802
Cash From Investing Activities		
Short-term Investments (note 5)	**(39,967)**	–
Capital Expenditures	**(95,102)**	(34,556)
Proceeds from Third Party Participant (note 6)	**50,675**	–
Deposits Held in Trust	**4,148**	(4,148)
Decrease in Non-cash Working Capital (note 16)	**(3,430)**	4,659
	(83,676)	(34,045)
Increase (Decrease) in Cash and Cash Equivalents	**(10,351)**	100,264
Cash and Cash Equivalents at Beginning of Year	**100,367**	103
Cash and Cash Equivalents at End of Year	**90,016**	100,367

See Accompanying Notes to the Consolidated Financial Statements

Notes to the Consolidated Financial Statements

(Tabular amounts in United States $ thousands)

1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

WesternZagros Resources Ltd. (the "Corporation") was incorporated on August 22, 2007 under the laws of the Province of Alberta. On October 18, 2007, the Corporation, Western Oil Sands Inc. (now Marathon Oil Canada Corporation) ("Western"), Marathon Oil Corporation, 1339971 Alberta Ltd. and WesternZagros Resources Inc. ("WZRI") completed a Plan of Arrangement (the "Arrangement"). In connection with the Arrangement, the Corporation, through a series of transactions, acquired all of the outstanding shares in WZRI. Further information on the Arrangement can be found in note 4.

The Corporation, an international oil and gas company, is engaged in acquiring properties and exploring for, developing and producing crude oil and natural gas in Iraq and is in the developmental stage. Through its subsidiaries, the Corporation's operations are related to its interest in a Production Sharing Contract ("PSC") with the Kurdistan Regional Government ("KRG") in respect of an exploration project area in the Kurdistan Region of Iraq.

Since inception and typical with developmental stage companies, the Corporation has incurred losses from operations and negative cash flows from operating activities, and has an accumulated deficit at December 31, 2008. The ability of the Corporation to successfully carry out its business plan beyond exploration is primarily dependent upon the continued support of its shareholders, the discovery of economically recoverable reserves, the resolution of remaining political disputes in Iraq, and the ability of the Corporation to obtain financing to develop reserves.

These financial statements have been prepared on the basis that the Corporation will continue to operate as a going concern, which contemplates the realization of assets and the settlement of liabilities and commitments in the normal course of business. These financial statements do not reflect adjustment in the carrying values of assets and liabilities reported, revenue or expenses and the balance sheet classification used that would be necessary if the going concern assumption was not appropriate. Such adjustment could be material.

2. SIGNIFICANT ACCOUNTING POLICIES

In these Consolidated Financial Statements, unless otherwise indicated, all dollar amounts are expressed in United States ("U.S.") dollars. The Corporation has adopted the U.S. dollar as its functional and reporting currency since most of its expenses are directly or indirectly denominated in U.S. dollar. When revenues are realized, it is expected that U.S. dollars will be received. In addition, the U.S. dollar facilitates a more direct comparison to other international crude oil and natural gas exploration and development companies. All references herein to U.S. $ or to $ are to United States dollars and references herein to Cdn $ are to Canadian dollars.

i. Principles of Consolidation

The Consolidated Financial Statements have been prepared in accordance with Canadian generally accepted accounting principles and include the accounts of the Corporation and its wholly owned subsidiaries.

ii. Use of Estimates

The preparation of the Consolidated Financial Statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities 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, asset retirement obligation, income taxes, fair value of stock-based compensation and the fair value of warrants.

iii. Foreign Currency Translation

Monetary assets and liabilities denominated in foreign currencies are translated to U.S. dollars at rates of exchange in effect at the end of the period. Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the income statement.

iv. Cash and Cash Equivalents

Cash and cash equivalents consist of cash in the bank, less outstanding cheques, and short-term deposits with a maturity of less than three months.

v. Revenue

The Corporation recognizes revenue, which is related to the interest income earned on the Corporation's cash and cash equivalents and short-term investments, on an accrual basis.

vi. Property, Plant and Equipment ("PP&E")

a) *Petroleum and natural gas assets*

The Corporation accounts for its petroleum and natural gas operations in accordance with the Canadian Institute of Chartered Accountants' ("CICA") guideline on full-cost accounting in the oil and gas industry. Under this method, all exploration and development costs, 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.

If the Corporation commences commercial production from the cost centres, capitalized costs accumulated within each cost centre will be depleted, depreciated and amortized on the unit-of-production method based on the estimated proved reserves of that country using estimated future prices and costs.

Proceeds from the disposal of properties are normally deducted from the full-cost pool without recognition of a gain or loss, unless that deduction would result in a change to the depletion rate by 20 percent or more, in which case a gain or loss is recorded.

In determining the depletion base, the Corporation will include estimated future costs to be incurred in developing proved reserves and will exclude the cost of unproved properties and major development projects. Costs of major development projects and costs of acquiring and evaluating significant unproved properties are excluded, on a cost centre basis, from costs subject to depletion until it is determined whether or not proved reserves are attributable to the properties or impairment has occurred. To date, no depletion related to the Corporation's properties has been recorded as commercial operations have not commenced.

The Corporation reviews the carrying amount of its properties relative to their recoverable amount (the "ceiling test") for each cost centre at each annual balance sheet date or more frequently if circumstances or events indicate impairment has occurred. The recoverable amount is calculated as the sum of:

- the undiscounted cash flow from proved reserves using expected future prices and costs;
- the cost of unproved properties; and
- the costs of major development projects less impairment.

If the carrying amount of the properties exceeds their recoverable amount, an impairment loss is recognized in depletion equal to the amount by which the carrying amount of the properties exceeds their fair value. Fair value is calculated as the sum of:

- the cash flows from proved and probable reserves using expected future prices and costs, discounted at a risk-free interest rate; and
- the cost, less impairment, of unproved reserves and major development projects that do not have probable reserves attributable to them.

The Corporation is currently engaged in the Kurdistan Region Exploration Project, as described in note 6, which is in the development stage. The Corporation has no proven or probable reserves to form the basis for an estimate of future net cash flow from the properties. The Corporation has considered the conditions in CICA Accounting Guideline 11 for impairment which includes significant unfavorable economic, legal, regulatory, environmental, political and other factors. In addition, the Corporation's continued execution of its business plan is a key factor considered as part of the assessment of the recoverability of the carrying amount of the properties. Whenever events or changes in circumstances indicate that the carrying amount of a property in the development stage may be impaired, capitalized costs are written down to the estimated recoverable amount. As at December 31, 2008, $100.3 million has been capitalized to date related to this project. No revenues have been generated from this project to date and no impairment was identified at December 31, 2008.

b) *Corporate PP&E assets*

Corporate PP&E assets are stated at historical cost less accumulated depreciation. Corporate assets are depreciated on a straight-line basis over their useful lives ranging from three to five years. The assets residual values and useful lives are reviewed and adjusted, if required, at each balance sheet date.

vii. Asset Retirement Obligation

The Corporation 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 fair value is determined by the Corporation by first estimating the expected timing and amount of cash flows, 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 that Management of the Corporation deem appropriate. Any change in timing or amount of the cash flows subsequent to initial recognition results in a change in the asset and liability. The Corporation recognizes the expense, depletion on the asset, and accretion on the liability over the estimated life of the asset and liability. Actual expenditures, when incurred, will be charged against the accumulated obligation.

viii. Income Taxes

The Corporation follows the liability method of income tax allocation. Under this method, future tax assets and liabilities are determined based on differences between the Consolidated Financial Statements and tax bases of assets and liabilities and are measured using the substantially enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Corporation assesses, based on all available evidence, the likelihood that the future income tax assets will be recovered from future taxable income. A valuation allowance is provided to the extent that it is more likely than not that future income tax assets will not be realized.

ix. Stock-Based Compensation

For the Corporation's stock option plan, compensation expense is recorded in the Consolidated Statements of Operations as General and administrative expenses with a corresponding increase in Contributed Surplus in the Consolidated Balance Sheets for all common share options granted. Compensation costs directly related to exploration activities are capitalized. The expense is based on the fair values of the options at the time of grant and is recognized in the Consolidated Statements of Operations over the requisite service period of the respective options on a straight-line basis. Fair values are determined, at the grant date, using the Black-Scholes option-pricing model. Consideration paid to the Corporation on exercise of options is credited to Share Capital and an amount equal to the compensation expense recognized to that date is reclassified from Contributed Surplus to Share Capital.

x. Financial Instruments

Financial assets and liabilities, including derivative instruments, are initially recognized and subsequently measured based on their classification as "held-for-trading", "available-for-sale" financial assets, "held-to-maturity", "loans and receivables", or "other" financial liabilities. Held-for-trading financial instruments are measured at their fair value with changes in fair value recognized in net income for the period. Available-for-sale financial assets are measured at their fair value and changes in fair value are included in other comprehensive income until the asset is removed from the balance sheet. Held-to-maturity investments, loans and receivables and other financial liabilities are measured at amortized cost using the effective interest rate method. Derivative instruments, including embedded derivatives, are measured at their fair value with changes in fair value recognized in net income for the period, unless the instrument is a cash flow hedge and hedge accounting applies, in which case changes in fair value are recognized in other comprehensive income.

3. CHANGES IN ACCOUNTING POLICIES AND FUTURE ACCOUNTING POLICY CHANGES

a) Capital Disclosures

On January 1, 2008, the Corporation adopted the CICA Handbook sections 1535, "Capital Disclosures". The adoption of this standard requires specific disclosure of (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such non-compliance.

b) Inventories

On January 1, 2008, the Corporation adopted CICA Handbook Section 3031, "Inventories", which eliminates the use of a LIFO (last-in-first-out) based valuation approach for inventory. As the Corporation at this time does not hold any inventory the adoption of this standard did not have an impact on the Corporation's net loss or financial position.

c) Financial Instruments – Disclosure and Presentation

On January 1, 2008, the Corporation adopted CICA Handbook Section 3862, "Financial Instruments – Disclosures" and CICA Handbook Section 3863, "Financial Instruments – Presentation". The adoption of these standards increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

d) Goodwill and Intangible Assets

As of January 1, 2009, WesternZagros will be required to adopt the CICA Handbook Section 3064, "Goodwill and Intangible Assets", which will replace the existing Goodwill and Intangible Assets standard. The new standard revises the requirement for recognition, measurement, presentation and disclosure of intangible assets. The adoption of this standard should not have a material impact on WesternZagros' Consolidated Financial Statements.

e) International Financial Reporting Standards ("IFRS")

In January 2006, the CICA Accounting Standards Board ("AcSB") adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, the AcSB confirmed in February 2008 that International Financial Reporting Standards ("IFRS") will replace Canadian GAAP in 2011 for profit-oriented Canadian publicly accountable enterprises. As WesternZagros will be required to report its results in accordance with IFRS starting in 2011, the Corporation is currently assessing the impact of these new accounting standards on its financial statements. A preliminary diagnostic of potential areas of impact has been completed to aid in the management of this transition, with the aim to ensure successful implementation within the required timeframe. The results of this preliminary diagnostic indicate that the significant impact to the Corporation's results of operations, financial position and disclosures will be on Property, Plant and Equipment, as it relates to the Corporation's policy of full-cost accounting for its exploration assets and the continued ability to utilize this policy, how these assets are ultimately depreciated and how impairment is ultimately determined and measured. Other areas of potential impact include stock-based compensation, asset retirement obligation and accounting for joint ventures. The Corporation continues to develop an implementation plan, including the consideration of the resources required to complete the conversion to IFRS and the impact to its financial systems.

4. PLAN OF ARRANGEMENT

On October 18, 2007, Western announced the completion of the Arrangement pursuant to which the Corporation, through a series of transactions, acquired all of the outstanding shares in WZRI. Under the Arrangement, the shareholders of Western received one share of the Corporation and one-tenth of a common share warrant to purchase the shares of the Corporation for each Western share held. Each whole warrant was exercisable at a price of Cdn$2.50 until January 18, 2008. In aggregate, 165,057,183 common shares and 16,505,729 warrants were issued to the former Western shareholders. Certain persons committed to exercise a portion of the warrants received pursuant to the Arrangement for Cdn$1.4 million to the Corporation. The Corporation's common shares, issued and outstanding as at October 18, 2007 prior to the Arrangement, were repurchased for cancellation.

Pursuant to the Arrangement, the shareholders of Western continued to hold their respective interests in the Corporation, resulting in no change of control. Therefore, the acquisition was accounted for assuming continuity of business for WZRI under Emerging Issues Committee 89 – Exchanges of ownership interests between enterprises under common control-wholly and partially-owned subsidiaries ("EIC-89"). Consequently, under EIC-89 no fair value adjustments were made.

The Consolidated Financial Statements of the Corporation reflect the assets and liabilities of WZRI at their book value as reported in the consolidated financial statements of WZRI. The continuity of business accounting requires that the results of operations presented in the consolidated financial statements of the Corporation include the operations of WZRI for the entire fiscal period in which the Arrangement took place. In addition, the comparative consolidated financial statements of the Corporation were restated to reflect the financial position and results of operation as if the Corporation and WZRI had been combined since their inception. The shares of the Corporation issued under the Arrangement were valued at the carrying value of the net assets of WZRI, excluding the accumulated deficit, as at October 18, 2007.

As at October 18, 2007, WZRI had the following assets, liabilities and shareholders' equity:

Assets	
Cash [1]	87,990
Property, Plant and Equipment	49,948
Deposits Held in Trust	4,800
	142,738
Liabilities	
Accounts Payable and Accrued Liabilities	4,912
Due to Related Party [2]	–
	4,912
Shareholders' Equity	
Share Capital [1,2]	157,932
Deficit	(20,106)
	137,826
	142,738

1. WZRI, under the Arrangement, was capitalized further with $84.0 million (Cdn$81.5 million) in cash through a series of transactions.
2. Prior to the Arrangement and the acquisition of WZRI by the Corporation, $63.0 million of inter-company debt between WZRI and subsidiaries of Western was settled with the issue of share capital on October 18, 2007.

Pursuant to the Arrangement, the Corporation received $1.0 million (Cdn$1.0 million) to purchase and cancel the Class C shares of Western that the Corporation had received as consideration for the issuance of the warrants. The Corporation recognized a charge to the deficit of $4.0 million representing the difference between the Black-Scholes fair value of the warrants as described in note 11 and the proceeds received.

Following the completion of the Arrangement and related subsequent transactions, the Corporation completed a private placement of 5.0 million common shares at a price of Cdn$2.50 per share for gross proceeds of US$12.8 million (Cdn$12.5 million).

5. SHORT-TERM INVESTMENTS

Short-term investments are carried at cost and are comprised of Government of Canada US Treasury Bills which mature within four to six months of purchase and will pay interest at a rate ranging from 0.15 percent to 0.35 percent.

6. PROPERTY, PLANT AND EQUIPMENT

December 31, 2008	Cost	Accum. DD&A*	Net
Kurdistan Region Exploration Project	**100,327**	**–**	**100,327**
Corporate	**616**	**(280)**	**336**
	100,943	**(280)**	**100,663**

December 31, 2007	Cost	Accum. DD&A*	Net
Kurdistan Region Exploration Project	55,320	–	55,320
Corporate	616	(40)	576
	55,936	(40)	55,896

* Accumulated Depreciation, Depletion and Amortization

On June 23, 2008, the Corporation announced that the KRG nominated a wholly-owned subsidiary of Talisman Energy Inc. ("Talisman") as the Third Party Participant in the PSC. Prior to June 30, 2008, the Corporation funded 100 percent of the PSC expenditures and subsequent to June 30, 2008 the Corporation funds 60 percent of the PSC expenditures, representing the Corporation's 40 percent working interest and its obligation to carry the KRG's 20 percent working interest. Under the terms of the PSC, Talisman paid the Corporation $50.7 million in costs incurred by the Corporation to June 30, 2008 and subsequently, Talisman has and will fund its 40 percent share of costs going forward. This amount has been credited against the total cost pool previously recorded.

All costs included in the Kurdistan Region Exploration Project are excluded from depletion as they represent costs incurred related to properties in cost centres that are considered to be in the development stage. Currently, there are no proved reserves. All costs, net of any associated revenues, have been capitalized. The Corporation capitalized $2.1 million of general and administrative costs and $0.7 million of stock-based compensation directly related to exploration activities for the year ended December 31, 2008 (December 31, 2007 – $ nil).

7. DEPOSITS HELD IN TRUST

The Corporation had deposited in trust certain amounts to be utilized to fund certain exploration expenditures and amounts due under the PSC as described in note 17(a). The funds for exploration expenditures relate to the drilling contract and the purchase of long lead time tangible items for drilling operations. The deposits bear interest at prevailing market rates. As at December 31, 2008, there were no funds remaining on deposit in the trust accounts (December 31, 2007 – $4.1 million).

8. ASSET RETIREMENT OBLIGATION

The Corporation records the fair value of legal obligations associated with the retirement and reclamation of tangible long-lived assets when incurred. The asset retirement cost, equal to the estimated fair value of the asset retirement obligation, is capitalized as part of the cost of the related long-lived asset. The estimation of this cost is based on engineering estimates using current costs and technology and in accordance industry practice. With the commencement of the drilling of Sarqala-1, the Corporation recognized a net $0.01 million liability. The Corporation's share of total undiscounted amount of estimated cash flow required to settle the obligation is $0.6 million, which is assumed to be paid in the year 2033 in the most likely case. The Corporation used a credit risk adjusted risk-free rate of 10 percent and an inflation rate of 4 percent to calculate the net present value of the future retirement obligation.

The following table presents the reconciliation of the Corporation's asset retirement obligation:

	For the year ended December 31, 2008
Balance at Beginning of Year	–
Liabilities Incurred	66
Accretion Expense	3
Balance at December 31, 2008	69

9. INCOME TAXES

	Years ended December 31,	
	2008	2007
Current Income Tax Expense	**4,679**	–
Future Income Tax Recovery	**(640)**	–
Balance at December 31, 2008	**4,039**	–

As at December 31 the Future Income Tax Assets are comprised of:

	2008	2007
Current Future Income Tax Asset:		
Non-Capital Loss Carryforwards	**1,341**	–
Share Issue Costs	**204**	–
Unrealized Foreign Exchange Gains	**(1,215)**	–
	330	–
Long-term Future Income Tax Asset:		
Non-Capital Loss Carryforwards	**–**	3,161
Share Issue Costs	**408**	–
Book Values in Excess of Tax Values	**(98)**	(7)
Allowance	**–**	(3,154)
	310	–

The following tables reconciles income taxes calculated at the Canadian statutory rate of 29.5 percent (December 31, 2007 – 32.12 percent):

	For the years ended December 31,	
	2008	2007
Net Loss Before Income Taxes	**(6,061)**	(10,426)
Income Tax Expense (Recovery) at Statutory Rate	**(1,788)**	(3,349)
Realized Foreign Exchange Gains	**4,027**	–
Unrealized Foreign Exchange Gains	**1,684**	–
Foreign Tax Rate Differentials	**1,385**	385
Stock-based Compensation	**572**	–
Foreign Exchange Change on Non-Capital Loss Carryforwards	**326**	–
Other	**987**	742
Valuation Allowance	**(3,154)**	2,222
Income Tax Expense	**4,039**	–

10. SHARE CAPITAL

a) Authorized

The Corporation is authorized to issue an unlimited number of ordinary and preferred shares. The common shares are without nominal or par value.

Issued and Outstanding

	Number of Shares	Amount
Common Shares		
Issued on Incorporation – August 22, 2007	1	1
Repurchased – Plan of Arrangement	(1)	(1)
Issued – Plan of Arrangement	165,057,183	157,932
Issued – Under Private Placement (note 4)	5,000,000	12,766
Issued – Exercise of Warrants	1,646,864	4,201
Issued – Warrant Value Transferred on Exercise of Warrants (note 11)	–	506
Balance at December 31, 2007	171,704,047	175,405
Issued – Exercise of Warrants	2,426,939	6,048
Issued – Warrant Value Transferred on Exercise of Warrants (note 11)	–	746
Issued – Under Private Placement	33,333,334	75,645
Share Issuance Costs	–	(4,261)
Balance at December 31, 2008	207,464,320	253,583

During the period January 1 to January 18, 2008, the Corporation received approximately $6.0 million in total proceeds from the exercise of 2.4 million warrants. This brought the total proceeds to $10.2 million from the exercise of 4.1 million warrants over the life of the warrants.

On March 7, 2008, the Corporation completed a private placement for 33.3 million common shares at a price of Cdn$2.25 per share for gross proceeds of Cdn$75 million (net Cdn$71 million).

11. WARRANTS

Pursuant to the Arrangement, the Corporation issued 16,505,729 warrants on October 18, 2007. Each whole warrant was exercisable at a price of Cdn$2.50 and expired on January 18, 2008. On October 18, 2007, the issue date of the warrants, the Black-Scholes calculated fair value was Cdn$0.30 per warrant. The following table summarizes the assumptions used in applying the Black-Scholes model:

Risk Free Interest Rate	4.4%
Expected Life (in months)	3
Expected Volatility	60%
Dividend Per Share	Nil

The following table presents the reconciliation of warrants outstanding:

	Number of Warrants	Amount
Warrants		
Issued – Plan of Arrangement (note 4)	16,505,729	5,076
Exercised	(1,646,864)	(506)
Balance at December 31, 2007	14,858,865	4,570
Warrant Value Transferred to Share Capital on Exercise	(2,426,939)	(746)
Warrant Value Transferred to Contributed Surplus on Expiry	(12,431,926)	(3,824)
Balance at December 31, 2008	–	–

The fair value originally recorded on the 12,431,926 warrants that expired on January 18, 2008 of $3.8 million has been reclassed to Contributed Surplus, as the warrants associated with this amount were not exercised.

12. STOCK OPTIONS AND STOCK-BASED COMPENSATION

On October 16, 2007, the shareholders approved a stock option plan for the Corporation. Under the stock option plan, the Board of Directors may grant options to directors, officers, other employees and other service providers. The aggregate number of shares that may be reserved for issuance pursuant to stock options may not exceed 10 percent of the issued and outstanding common shares on a non-diluted basis of the Corporation at the time of granting.

The following table presents the reconciliation of options granted for the year ending December 31, 2008:

	Number of Shares	Weighted Average Exercise Price ($)
Outstanding, beginning of the year	–	–
Granted	12,739,000	1.64
Exercised	–	–
Forfeited	433,333	2.15
Expired	–	–
Outstanding at December 31, 2008	12,305,667	1.62

The fair value of all options granted have been estimated at the grant date using the Black-Scholes option pricing model. The weighted average fair values of the options and weighted average assumptions used in their determination are as follows:

	Year ended December 31, 2008
Fair Value ($ Per Share)	0.64
Risk Free Interest Rate	3.68%
Expected Life (In Years)	2.86
Expected Volatility	58%
Dividend Per Share	–

During the year ended December 31, 2008, the Corporation recognized $1.9 million in stock-based compensation in general and administrative expense and capitalized $0.7 million.

The following table summarizes Stock Options outstanding and exercisable under the Stock Option Plan at December 31, 2008:

	Options Outstanding			Options Exercisable		
Exercise Price ($)	Number of Options Outstanding	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price ($)	Number of Options Exercisable	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price ($)
$0.51 – $1.00	4,279,000	4.95	0.55	–		–
$1.00 – $2.00	455,000	4.71	1.31	–		–
$2.01 – $3.00	7,251,666	4.12	2.21	2,193,333	3.97	2.15
$3.00 – $3.33	320,000	4.46	3.32	–		–
	12,305,666	4.42	1.62	2,193,333	3.97	2.15

13. CONTRIBUTED SURPLUS

The following table presents the reconciliation of Contributed Surplus:

	Year ended December 31, 2008
Balance at Beginning of Period	–
Recognized on Expiry of Warrants (note 11)	3,824
Stock-based Compensation	2,452
Balance at December 31, 2008	6,276

14. LOSS PER SHARE

The basic weighted average number of common shares outstanding calculated on this basis for December 31, 2008 are 201,323,914 (December 31, 2007 – 166,303,062). The Corporation has calculated basic loss per share for the year ending December 31, 2007 as if the shares issued under the Arrangement were issued effective January 1, 2007 and considering subsequent issuances after the completion of the Arrangement on October 18, 2007. Due to a loss for the years ended December 31, 2008 and 2007, no incremental shares were included in the diluted earnings per weighted average number because the effect would have been anti-dilutive.

15. SHAREHOLDER RIGHTS PLAN

On October 18, 2007, the Corporation adopted a shareholder rights plan (the "Plan"). Under the Plan, one right has been issued in respect of each currently issued common share and one right will be issued with each additional common share which is issued. The rights remain attached to the common shares and are not exercisable or separable unless one or more of certain specified events occur. If a person or group acting in concert acquires 20 percent or more of the common shares of the Corporation, the rights will entitle the holders thereof (other than the acquiring person or group) to purchase common shares at a substantial discount from the then market price. The rights are not triggered by a "Permitted Bid" as defined in the Plan. The Plan will remain in effect until termination of the annual meeting of shareholders in 2010, unless extended by resolution of the shareholders at such meeting.

16. CHANGES IN NON-CASH WORKING CAPITAL

	For the years ended December 31,	
Source/(Use)	**2008**	2007
Operating Activities		
Accounts Receivable	**(58)**	(50)
Prepaid Expenses	**(139)**	(111)
Accounts Payable and Accrued Liabilities	**(30)**	54
Income Tax Payable	**4,679**	–
	4,452	(107)
Investing Activities		
Accounts Receivable	**(11,848)**	(189)
Accounts Payable and Accrued Liabilities	**8,418**	4,848
	(3,430)	4,659

17. COMMITMENTS AND CONTINGENCIES

Commitments

a) Production Sharing Contract ("PSC")

Under the terms of its PSC, the Corporation has a 40 percent working and the KRG has a direct 20 percent interest in the PSC which is carried by the Corporation. The remaining 40 percent was allocated to a wholly-owned subsidiary of Talisman by the KRG as announced on June 23, 2008. Under the terms of the PSC, Talisman paid the Corporation $50.7 million in costs incurred by the Corporation and Talisman funds its share of costs going forward. The Corporation, the KRG and Talisman are collectively the "Contractor Group" under the PSC.

The PSC contemplates two exploration sub-periods of three years and two years, respectively, with two possible one-year extensions. The first exploration sub-period ends December 31, 2010. During such time, the Contractor Group is required to complete a minimum of 1,150 kilometres of seismic surveying which the Corporation has already met and exceeded, drill three exploration wells and commit a minimum of $75 million in the aggregate on these activities. At the end of the first exploration sub-period, the Corporation 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 during the second exploration sub-period which ends December 31, 2012.

The PSC also includes capacity building support, payable by the Corporation over a 15 month period and funding for certain technological, logistical, recruitment and training during the first exploration sub-period and any subsequent sub-periods. The Corporation estimates its remaining commitments under the PSC as at December 31, 2008 to be approximately $60 million to $70 million. This commitment includes the remaining costs associated with drilling the three exploration wells to total depth by December 31, 2010 (the end of the first exploration sub-period), the associated supervision and local office costs in support of drilling operations and the remaining PSC payments, including the remainder of the capacity building payments. The remaining costs associated with drilling the three exploration wells to total depth are estimated to be in the range of approximately $30 million to $40 million, which includes the costs associated with Sarqala-1, Kurdamir-1 and the third exploration well prior to the costs of any testing required. The Corporation estimates its share of costs to test these wells, if required, could range between $3 million to $6 million per well, depending on the number of potential zones that are required to be tested.

During the second exploration sub-period, the Contractor Group, or those parties who 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 on these activities. At the end of the second exploration sub-period, the Corporation or those parties 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 operations during two one-year extension periods, which would extend the total exploration period to December 31, 2014. At the end of the second exploration sub-period, and at the end of each subsequent extension period, the PSC requires the Corporation, and those parties who have elected to participate, to relinquish 25 percent of the remaining undeveloped area within the PSC lands.

The Corporation will be the operator of the PSC lands during the first exploration sub-period For subsequent sub-periods, a joint operating company will be established between the Corporation, the KRG and Talisman, if so elected.

b) *Participation Rights*

The Corporation has granted participation rights for up to five percent in respect to the Corporation's interest in the PSC to certain third parties at the same terms as the Corporation has under the PSC. Certain portions of the participation interest may be funded by interest-bearing loans granted by the Corporation.

c) *Other*

The Corporation has entered into various exploration related contracts, including drilling equipment, services and tangibles, and seismic surveying equipment and services, in order to meet contractual commitments under the PSC. The following table summarizes the commitments the Corporation has under these exploration related contracts and other contractual obligations at December 31, 2008:

	For the years ending December 31,					
	2009	2010	2011	2012	2013+	Total
Exploration	3,163	–		–	–	3,163
Office	375	94		–	–	469
	3,538	94		–	–	3,632

Contingencies

Regulatory

Oil and gas operations are subject to extensive controls and regulations imposed by various levels of government that may be amended from time to time. The Corporation's operations may require licenses and permits from various governmental authorities in the countries in which it operates. Under the PSC, the KRG is obligated to assist in obtaining all permits and licenses from any government agencies in the Kurdistan Region and from any other government administration in Iraq. There can be no assurance that the Corporation will be able to obtain all necessary licenses and permits that may be required to carry out exploration and development of its projects.

The political and security situation in Iraq is unsettled and volatile. The Kurdistan Region is the only "Region" of Iraq that is constitutionally established pursuant to the Iraq Constitution, which expressly recognizes the Kurdistan Region. The political issues of federalism and the autonomy of the Regions of Iraq are matters about which there are major differences between the various political factions in Iraq. These differences could adversely impact the Corporation's interest in the Kurdistan Region including the ability to export any hydrocarbons as a result of our activities.

18. FINANCIAL INSTRUMENTS

Financial instruments of the Corporation consist of cash and cash equivalents and short-term investments, accounts receivable, accounts payable and accrued liabilities. The Corporation's cash and cash equivalents are designated as held-for-trading and are measured at carrying value, which approximates fair value due to the short-term nature of these instruments. The Corporation's short-term investments are classified as "held-to-maturity" and is measured at amortized cost. Accounts receivable are designated as loans and receivables and recorded at amortized cost, which approximates fair value due to the short term nature of the instrument. Accounts payable and accrued liabilities are designated as other liabilities and are recorded at cost. The fair value of accounts payable and accrued liabilities approximate their carrying values due to the short term nature of these instruments.

The Corporation is exposed to credit risk, market risk, liquidity and funding risk. The following is a description of those risks and how the Corporation manages exposure to them:

Credit Risk

Credit risk is the risk of loss associated with counterparty's inability to fulfill its payment obligations. The Corporation is currently exposed to credit risk on its cash and cash equivalents and short-term investments, to the extent that these balances are invested with various institutions. The Board of Directors of the Corporation has approved an Investment Policy to dictate the various types of instruments and institutions that can be invested in and monitors these against this policy on a regular basis. Currently, the Corporation has entered into transactions for cash equivalents and short-term investments with major Canadian financial institutions with investment grade credit ratings, as well as purchases Government of Canada instruments.

Under the terms of the PSC, as described in note 17 (a), the KRG elected a wholly-owned subsidiary of Talisman as the third party participant under the PSC. The Corporation is subject to credit risk associated with Talisman's 40 percent interest in the PSC and its share of related expenditures. As at December 31, 2008, the Corporation had $12.0 million of receivables outstanding from Talisman. Under the terms of the PSC, penalty provisions are included for any amount in default.

Market Risk

Market risk is the risk of loss that may arise from changes in market factors such as interest rate, foreign exchange rates and equity or commodity prices. The Corporation is exposed to interest rate risk to the extent that changes in market interest rates will impact any interest earned on the Corporation's cash and cash equivalent and deposit held in trust balances. The Corporation is also exposed to foreign exchange risk, as the majority of costs are anticipated to be incurred in U.S. dollars and the funds it will have available to it may be in other currencies.

The Corporation's Investment Policy dictates the various types of instruments and institutions that can be invested in and monitors these against this policy on a regular basis. The Board of Directors has also approved a Foreign Exchange Policy to dictate the currencies held by the Corporation and the instruments that can be utilized by the Corporation to meet day to day needs. This Foreign Exchange Policy requires the Corporation to hold the majority of its cash and cash equivalents and short-term investments in U.S. dollars and sets out the type and duration of instruments that can be used to meet the Corporation's day to day foreign exchange needs. The Foreign Exchange Policy does allow the Corporation to hold other balances, mainly Canadian dollars, to meet the requirements to fund ongoing general and administrative and other spending requirements in these currencies. Neither policy permits the Corporation to enter into any economic hedging as it relates to interest or foreign exchange risks. As at December 31, 2008 had the U.S. dollar changed by one percent against the Canadian dollar, with all other variables held constant, the Corporation's foreign exchange loss would have been affected by $0.1 million.

The marketability and price of oil and natural gas that may be acquired or discovered by the Corporation 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. The Corporation's ability to market its oil and natural gas may depend upon its ability to secure transportation. The Corporation may also be affected by deliverability uncertainties related to the proximity of its potential production to pipelines and processing facilities and operational problems affecting such pipelines and facilities as well as potential government regulation relating to price, the export of oil and natural gas and other aspects of the oil and natural gas business.

Both oil and natural gas prices are subject to wide fluctuation. In the first half of 2008, there was a steady rise in crude oil prices from approximately $90 per barrel to a high of approximately $147 per barrel, which was followed by a precipitous drop to a low of $40 per barrel. The Corporation 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.

Liquidity and Funding Risks

Liquidity and funding risk is the risk that the Corporation may be unable to generate or obtain sufficient cash or its equivalent in a timely and cost-effective manner to meet its commitments as they come due. As the Corporation is engaged in acquiring properties and exploring for crude oil and natural gas and is in the developmental stage, it currently does not have a revenue source outside of interest on its cash and cash equivalent and short-term investment balances. The Corporation is therefore required to fund its share of all commitments from existing balances or access additional sources of cash from the equity markets. The Board of Directors reviews the Corporation's cash and cash equivalent balances against the Corporation's commitments and assesses the timing and need for additional equity financing on a regular basis. However, the Corporation's results will impact its ability to access the capital necessary to meet these commitments. There can be no assurance that debt or equity financing will be available or sufficient to meet these requirements or for other corporate purposes or, if debt or equity financing is available, that it will be on terms acceptable to the Corporation. The inability of Corporation to access sufficient capital for its operations could have a material adverse effect on the Corporation's financial condition, results of operations and prospects.

During the latter part of 2008 and early 2009 the capital markets have seen a period of significant market instability. The Corporation's ability to access the capital markets in the future may be affected by any prolonged period of market instability.

19. CAPITAL STRUCTURE

The Corporation's objectives when managing its capital structure are to:

i) Ensure adequate levels of available cash and cash equivalents and short-term investments to meet the Corporation's commitments under the PSC.

ii) To prudently fund expenditures related to the acquisition of properties, and for exploration, appraisal and development of crude oil and natural gas resources.

The Corporation funds its share of expenditures of all commitments from existing cash and cash equivalent balances received primarily from issuances of shareholders' equity. The Corporation has not entered into any debt financing arrangements at the balance sheet date and is not subject to any externally imposed capital requirements.

The Board of Directors regularly reviews the Corporation's cash and cash equivalents and short-term investments against the Corporation's expenditure commitments and assesses the timing and need for additional equity financing. The Corporation's results will impact its access the capital necessary to meet these expenditure commitments. There can be no assurance that equity financing will be available or sufficient to meet those commitments, or for other corporate purposes, or if equity financing is available, that it will be on terms acceptable to the Corporation. The inability of the Corporation to access sufficient capital for its operations could have a material adverse impact on the Corporation's financial condition, results of operations and prospects. During the latter part of 2008 and early 2009 the capital markets have seen a period of significant market instability. The Corporation's ability to access the capital markets in the future may be affected by any prolonged period of market instability.