

## 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 financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. When alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances. Financial statements are not precise as they include certain amounts based on estimates and judgments. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly, in all material respects. Financial information presented elsewhere in this annual report has been prepared on a basis consistent with that in the financial statements.

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.



M. Simon Hatfield  
Chief Executive Officer



Greg Stevenson  
Chief Financial Officer

February 22, 2010

# Auditor's report

February 22, 2010

Auditors' Report

## To the Shareholders of WesternZagros Resources Ltd.

We have audited the consolidated balance sheets of WesternZagros Resources Ltd. as at December 31, 2009 and 2008 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 Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

*PricewaterhouseCoopers LLP*

Chartered Accountants  
Calgary, Alberta

"PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership, or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate legal entity.

# Consolidated balance sheets

	<b>December 31</b>	
(United States \$ thousands)	<b>2009</b>	2008
<b>Assets</b>		
Current Assets		
Cash and Cash Equivalents	76,708	90,016
Short-term Investments (note 4)	-	39,967
Accounts Receivable	6,880	12,161
Prepaid Expenses	183	250
Income Tax Recoverable	1,738	-
Future Income Taxes (note 8)	231	330
	85,740	142,724
Long-term Assets		
Property, Plant and Equipment (note 5)	154,911	100,663
Deposit Held in Trust (note 6)	420	-
Future Income Taxes (note 8)	6	310
	155,337	100,973
	<b>241,077</b>	<b>243,697</b>
<b>Liabilities</b>		
Current Liabilities		
Accounts Payable and Accrued Liabilities	18,297	13,326
Income Tax Payable	-	4,679
	18,297	18,005
Long-term Liabilities		
Asset Retirement Obligation (note 7)	175	69
	18,472	18,074
<b>Shareholders' Equity</b>		
Share Capital (note 9)	253,583	253,583
Contributed Surplus (note 12)	8,749	6,276
Deficit	(39,727)	(34,236)
	222,605	225,623
	<b>241,077</b>	<b>243,697</b>
Commitments and Contingencies (note 17)		
Subsequent Events (note 20)		

Approved by the Board of Directors



Fred J. Dymant  
Director



Randall Oliphant  
Director

See Accompanying Notes to the Consolidated Financial Statements

# Consolidated statements of operations, comprehensive loss and deficit

	<b>For the Years Ended December 31</b>	
(United States \$ thousands, except per share amounts)	<b>2009</b>	2008
<b>Revenues</b>		
Interest Income	184	2,959
<b>Expenses</b>		
General and Administrative	6,260	7,339
Depreciation	737	240
Accretion on Asset Retirement Obligation	11	3
Foreign Exchange Loss	12	1,438
	7,020	9,020
<b>Net Loss and Other Comprehensive Loss Before Income Taxes</b>	<b>6,836</b>	<b>6,061</b>
Income Tax Expense (Recovery) (note 8)	(1,345)	4,039
<b>Net Loss and Other Comprehensive Loss</b>	<b>5,491</b>	<b>10,100</b>
Deficit at Beginning of Year	34,236	24,136
<b>Deficit at End of Year</b>	<b>39,727</b>	<b>34,236</b>
<b>Net Loss Per Share - Basic and Diluted (note 13)</b>	<b>0.03</b>	<b>0.05</b>

See Accompanying Notes to the Consolidated Financial Statements

# Consolidated statements of cash flows

	<b>For the Years Ended December 31</b>	
(United States \$ thousands)	<b>2009</b>	2008
<b>Cash Provided By (Used In)</b>		
<b>Cash From Operating Activities</b>		
Net Loss	(5,491)	(10,100)
Non-cash Items		
Depreciation	737	240
Accretion on Asset Retirement Obligation (note 7)	11	3
Stock-based Compensation (note 11)	1,938	1,938
Future Income Tax Expense (Recovery) (note 8 )	404	(640)
	(2,401)	(8,559)
(Increase) Decrease in Non-Cash Working Capital (note 15)	(6,440)	4,452
	(8,841)	(4,107)
<b>Cash From Financing Activities</b>		
Share Issuance Under Private Placement (note 9)	-	71,384
Exercise of Warrants (note 9)	-	6,048
	-	77,432
<b>Cash From Investing Activities</b>		
Short-term Investments	39,967	(39,967)
Capital Expenditures	(54,356)	(95,102)
Proceeds from Third Party Participant (note 5)	-	50,675
Deposits Held in Trust	(420)	4,148
Decrease (Increase) in Non-cash Working Capital (note 15)	10,342	(3,430)
	(4,467)	(83,676)
<b>Decrease in Cash and Cash Equivalents</b>	<b>(13,308)</b>	<b>(10,351)</b>
Cash and Cash Equivalents at Beginning of Year	90,016	100,367
<b>Cash and Cash Equivalents at End of Year</b>	<b>76,708</b>	<b>90,016</b>
Supplement Cash Flows Disclosure		
<b>Income Taxes Paid (Recovered)</b>	<b>4,669</b>	-

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. The Corporation, an international oil and gas company, is engaged in acquiring properties and exploring for, developing of 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 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, 2009. 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, its joint venture partner's continued participation in the exploration activities under the PSC, and the ability of the Corporation to obtain financing to develop reserves.

These consolidated financial statements have 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. During the year ended December 31, 2009, the Corporation utilized cash of \$54.4 million for oil and gas property expenditures. The Corporation will require additional funding to maintain ongoing exploration programs and property commitments as well as for administration expenses.

The Corporation's ability to continue operations and exploration activities as a going concern is dependent upon its ability to obtain additional funding. 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. The Corporation has no assurance that such financing will be available or be available on favorable terms. Factors that could affect the availability of financing include the progress and results of the Kurdamir-1 well, investor perceptions and expectations, and the condition of the financial and oil and gas markets.

These consolidated financial statements do not reflect adjustments 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. dollars. 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. Measurement Uncertainty**

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, future income taxes, and fair value of stock-based compensation.

**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 three months or less.

**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 5, 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, 2009, \$154.2 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, 2009.

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 two to three 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 interest 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 accretion expense on the liability and depletion on the asset 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 carrying values and tax basis 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. When stock options are exercised, the cash proceeds together with the amount previously recorded as contributed surplus is recorded as 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. The Corporation has not identified any material embedded derivatives in any of its financial instruments. The Corporation has not designated any of its derivatives as hedges.

The Corporation classifies fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The Corporation's fair value hierarchy has the following levels:

- Quoted prices (unadjusted) in active markets for identical assets and liabilities (Level I); and
- Inputs other than quoted prices included in Level I that are observable for the asset or liability, either directly or indirectly (Level II); and
- Valuation techniques with significant unobservable market inputs (Level III).

### 3. Changes In Accounting Policies and Future Accounting Pronouncements

#### Changes in accounting policies

##### i. Goodwill and Intangible Assets

As of January 1, 2009, the Corporation adopted the CICA Handbook Section 3064, "Goodwill and Intangible Assets", which replaced 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 did not have a material impact on the Corporations' Consolidated Financial Statements.

##### ii. Credit Risk and the Fair Value of Financial Assets and Financial Liabilities

In January 2009, the Emerging Issues Committee ("EIC") of the CICA approved an abstract EIC 173, "Credit Risk and the Fair Value of Financial Assets and the Financial Liabilities" which provides further information on the determination of the fair value of the financial assets and financial liabilities under Section 3855 "Financial Instruments - Recognition and Measurement". The Corporation incorporated the provisions of EIC 173 in its fair value determination as at December 31, 2009 with retrospective application, if any, to the beginning of its 2009 fiscal year. The adoption of this standard did not have material impact on the Corporation's consolidated financial statements.

#### Future accounting pronouncements

##### i. Business Combination

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

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

**ii. Consolidated Financial Statements**

“Consolidated Financial Statements”, Section 1601, which together with Section 1602 below replace the former consolidation financial statements standard. Section 1602 establishes the requirement for the preparation of consolidated financial statements. The two Sections are the equivalent to the corresponding provisions of the International Accounting Standard 27 “Consolidated and Separate Financial Statements” These Sections apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011, and should be adopted concurrently with Section 1582. Earlier adoption is permitted. The Company is currently evaluating the impact of the adopting this standard on its consolidated financial statements.

**iii. Non-controlling interests**

“Non-controlling interests”, Section 1602, which establishes the accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. The standard requires a non-controlling interest in a subsidiary to be classified as a separate component of equity. In addition, net earnings and components of other comprehensive income are attributed to both the parent and non-controlling interest. The Company is currently evaluating the impact of adopting this standard on its consolidated financial statements.

**4. 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.

**5. Property, Plant and Equipment**

	<b>Cost</b>	<b>Accum. DD&amp;A*</b>	<b>Net</b>
<b>December 31, 2009</b>			
Kurdistan Region Exploration Project	154,244	-	154,244
Corporate	1,684	(1,017)	667
	<b>155,928</b>	<b>(1,017)</b>	<b>154,911</b>
<b>December 31, 2008</b>			
Kurdistan Region Exploration Project	100,327	-	100,327
Corporate	616	(280)	336
	<b>100,934</b>	<b>(280)</b>	<b>100,663</b>

\* 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. 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 \$3.2 million of general and administrative costs (December 31, 2008 - \$2.1 million) including \$0.5 million of stock-based compensation (December 31, 2008 - \$0.7 million) directly related to exploration activities for the year ended December 31, 2009.

## 6. Deposits Held In Trust

The Corporation had deposited in trust certain amounts to be utilized to fund certain expenditures for drilling operations. The deposits bear interest at prevailing market rates. As of December 31, 2009, the Corporation had \$0.4 million deposit held in trust for a supplier.

## 7. 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 with industry practice. The Corporation’s share of total undiscounted amount of estimated cash flow required to settle the obligation is \$1.2 million, which is assumed to be paid in the year 2033 in the most likely case. The Corporation used a credit 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 summarizes the changes in asset retirement obligations for the years ended December 31, 2009 and 2008:

<b>December 31</b>	<b>2009</b>	<b>2008</b>
Balance, Beginning of Year	69	-
Liabilities incurred	95	66
Accretion expense	11	3
<b>Balance, End of Year</b>	<b>175</b>	<b>69</b>

## 8. Income Taxes

<b>Years Ended December 31</b>	<b>2009</b>	<b>2008</b>
Current Income Tax (Recovery) Expense	(1,749)	4,679
Future Income Tax (Recovery) Expense	404	(640)
<b>Income Tax (Recovery) Expense</b>	<b>(1,345)</b>	<b>4,039</b>

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

	<b>2009</b>	<b>2008</b>
<b>Current Future Income Tax Asset:</b>		
Non-Capital Loss Carry-forwards	27	1,341
Share Issue Costs	204	204
Unrealized Foreign Exchange Gains	-	(1,215)
	<b>231</b>	<b>330</b>

	<b>2009</b>	<b>2008</b>
<b>Long-term Future Income Tax Asset:</b>		
Share Issue Costs	387	408
Book Values in Excess of Tax Values	(198)	(98)
Allowance	(183)	-
	<b>6</b>	<b>310</b>

Income tax expense differs from that which would be expected from applying the effective Canadian federal and provincial tax rates of 29% (2008 - 29.5%):

<b>For the Years Ended December 31</b>	<b>2009</b>	<b>2008</b>
Net Loss Before Income Taxes	(6,836)	(6,061)
Income Tax Expense (Recovery) at Statutory Rate	(1,982)	(1,788)
Losses in Foreign Jurisdictions With No Tax Benefit	808	1,385
Stock-based Compensation	717	572
Valuation Allowance	183	(3,154)
Realized Foreign Exchange Gains	-	4,027
Unrealized Foreign Exchange Gains	-	1,684
Foreign Exchange Change on Non-Capital Loss Carry-Forwards	-	326
Effect of Tax Planning and Provision to Actual	(859)	-
Effect of Timing of Use	(154)	-
Other	(58)	987
<b>Income Tax Expense</b>	<b>(1,345)</b>	<b>4,039</b>

## 9. Share Capital

### i. Authorized

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

### ii. Common Shares Issued and Outstanding

	Number of Shares	Amount (000's)
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 9)	-	746
Issued - Under Private Placement	33,333,334	75,645
Share Issuance Costs	-	(4,261)
<b>Balance at December 31, 2008 and December 31, 2009</b>	<b>207,464,320</b>	<b>253,583</b>

On October 18, 2007, Western Oil Sands Inc. ("Western") announced the completion of a Plan of Arrange ("Arrangement") pursuant to which the Corporation, through a series of transactions, acquired all of the outstanding shares in WesternZagros Resources Inc. 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.

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).

## 10. 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.

The following table presents the reconciliation of warrants outstanding:

	Number of Warrants	Amount (000's)
Balance at December 31, 2007	14,858,865	4,570
Warrant Value Transferred to Share Capital on Exercise (note 8)	(2,426,939)	(746)
Warrant Value Transferred to Contributed Surplus on Expiry	(12,431,926)	(3,824)
<b>Balance at December 31, 2008 and December 31, 2009</b>	<b>-</b>	<b>-</b>

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

## 11. 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, employees and 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. Stock options expire not more than five years from the date of grant, or earlier if the individual ceases to be associated with the Corporation, and vest at the discretion of the Board of Directors.

During 2009 the Corporation granted 1,990,000 stock options exercisable for voting common shares of the Company. Stock options expire not more than five years from the grant date, or earlier if the individual ceases to be associated with the Company, and vest at the discretion of the Board of Directors. These options have a weighted average exercise price of Cdn\$0.8 per share.

The following table presents the reconciliation of options granted for the year ending December 31, 2009:

December 31	2009		2008	
	Number of Options	Weighted Average Exercise Price (Cdn\$)	Number of Options	Weighted Average Exercise Price (Cdn\$)
Outstanding, beginning of year	12,305,667	1.62	12,739,000	1.64
Granted	1,990,000	0.80	-	-
Forfeited	(1,288,333)	1.55	(433,333)	2.15
Outstanding, end of year	13,007,334	1.50	12,305,667	1.62

The following table summarizes Stock Options outstanding and exercisable under the Stock Option Plan at December 31, 2009:

Range of Exercise Price (Cdn\$)	Options Outstanding			Options Exercisable		
	Number of Options Outstanding	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price (Cdn\$)	Number of Options Exercisable	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price (Cdn\$)
\$ 0.51 - \$1.00	5,709,000	4.09	0.62	1,938,003	4.05	0.66
\$ 1.01 - \$2.00	450,000	3.87	1.39	118,333	3.71	1.30
\$ 2.01 - \$3.00	6,528,334	3.10	2.19	4,153,338	3.08	2.17
\$ 3.01 - \$3.33	320,000	3.46	3.32	106,666	3.46	3.32
	<b>13,007,334</b>	<b>3.57</b>	<b>1.50</b>	<b>6,316,340</b>	<b>3.39</b>	<b>1.71</b>

The fair values 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	2009	2008
Weighted Average Fair Value	\$ 0.79	\$ 0.64
Risk Free Interest Rate	1.64% to 1.73%	3.68%
Expected Life (In Years)	1 – 3 years	2.86 years
Expected Volatility	80%	58%
Dividend Per Share	Nil	Nil

During the year ended December 31, 2009, the Corporation recognized \$1.9 million (2008 - \$1.9 million) in stock-based compensation in general and administrative expense and capitalized \$0.5 million (2008 - \$0.7 million).

## 12. Contributed Surplus

<b>December 31</b>	<b>2009</b>	<b>2008</b>
Opening balance	6,276	-
Recognized on Expiry of Warrants (note 9)	-	3,824
Stock-based Compensation	2,473	2,452
<b>Ending balance</b>	<b>8,749</b>	<b>6,276</b>

## 13. Loss Per Share

Net loss per share has been calculated based on the weighted average number of common shares outstanding the year of 207,464,320 (2008 - 201,323,914).

No stock options or warrants have been included in the calculation of the diluted shares outstanding for the years ended December 31, 2009 and December 31, 2008 as their inclusion would be anti-dilutive.

## 14. 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 per cent 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.

## 15. Changes In Non-Cash Working Capital

<b>For the Years Ended December 31</b> Source/(Use)	<b>2009</b>	<b>2008</b>
<b>Operating Activities</b>		
Accounts Receivable	(68)	(58)
Prepaid Expenses	67	(139)
Accounts Payable and Accrued Liabilities	(22)	(30)
Income Tax Payable	(6,417)	4,679
	<b>(6,440)</b>	<b>4,452</b>
<b>Investing Activities</b>		
Accounts Receivable	5,349	(11,848)
Accounts Payable and Accrued Liabilities	4,993	8,418
	<b>10,342</b>	<b>(3,430)</b>

## 16. Related Party Transactions

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

## 17. Commitments And Contingencies

### Commitments

#### i. Production Sharing Contract (“PSC”)

Under the terms of its PSC, the Corporation has a 40 percent working interest 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), continue further exploration by entering into the second exploration sub-period or request to use a one-year extension for further exploration and appraisal activities prior to deciding to enter into the second exploration sub-period.

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

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

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

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

During the second exploration sub-period, the Contractor Group, or those parties 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.

Under the terms of the PSC the sharing of oil occurs as follows: of the total oil produced, operations oil is available to the Contractor Group 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 differ from those for oil as the net available gas for cost recovery is increased to 55 percent and the profit sharing terms are also increased. 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 to their 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.

## **ii. 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.

**iii. 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, 2009:

<b>For the Years Ending December 31</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014+</b>	<b>Total</b>
Exploration	1,260	-	-	-	-	1,260
Office	140	-	-	-	-	140
	<b>1,400</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>1,400</b>

**Contingencies****Litigation**

From time to time the Corporation may become involved in legal or administrative proceedings in the normal conduct of its business. Amounts involved in such matters are not reasonably estimable due to uncertainty as to the final outcome. The Company's assessment of the likely outcome of these matters is based on its judgment of a number of factors, including precedents and facts specific to the matter. The Corporation does not believe these matters in aggregate will have a material adverse effect on its consolidated financial position or results of operations.

**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, 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, 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 any successful exploration activities.

## 18. Financial Instruments And Risk Management

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 fair value, which approximates carrying value due to the short-term nature of these instruments. The Corporation's short-term investments are classified as "held-to-maturity" and are measured at amortized cost. The fair value of cash and cash equivalents is classified as Level I fair value measurement. 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 amortized 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 (i), 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. Accordingly, the ability of the Corporation to successfully carry out the exploration, appraisal and development of its PSC lands may be impacted by the continued participation of Talisman in these activities. As at December 31, 2009, the Corporation had \$6.9 million of receivables outstanding from Talisman, under credit terms defined by the PSC, including penalty provisions 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 equivalents. 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, 2009 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 not have been affected significantly.

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

### 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 Corporation under the terms of the PSC is committed to fund its 40 percent interest and the 20 percent interest of the KRG, with Talisman funding their 40 percent interest. If Talisman elects to not participate in future exploration and development activities this could either increase the Corporation's capital requirements to complete the exploration or development activities, or result in a new co-venturer being selected by the KRG.

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. In recent years, 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. 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.

## 19. Capital Structure

The Corporation's capital consists of shareholder's equity and working capital. The Corporation will adjust its capital structure to manage its drilling program through the issuance of shares and adjustments to capital spending.

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 to 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.

## 20. Subsequent Events

The Corporation has in place well control insurance. Subsequent to December 31, 2009, the Corporation is currently pursuing a claim for the associated costs of the well control operations for the Kurdamir-1 well.

## 21. Change In Financial Statement Presentation

Certain comparative information has been changed in conformity to the current year financial statement presentation.

## Abbreviations and conversion factors

In this Annual Report, the following abbreviations have the meanings set forth below.

<b>Natural Gas</b>		<b>Oil</b>	
cf	cubic feet	bbl	barrel
cm	cubic metre	bbl/d	barrels per day
Bcf	billion cubic feet	Mbbl	thousand barrels
Bcf/d	billion cubic feet per day	MMbbl	million barrels
Bcm	billion cubic metres	Bbbl	billion barrels
Mcf	thousand cubic feet		
Mcf/d	thousand cubic feet per day		
Mcm	thousand cubic metres		
MMcf	million cubic feet		
MMcf/d	million cubic feet per day		
<b>Other</b>			
API	American Petroleum Institute		
°API	an indication of the specific gravity of crude oil measured on the API gravity scale. Liquid petroleum with a specified gravity of 28°API or higher is generally referred to as light crude oil.		
BOE	barrels of oil equivalent. A barrel of oil equivalent is determined by converting a volume of natural gas to barrels using the ratio of 6 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.		
BOE/d	barrels of oil equivalent per day		
°C	degrees, Celsius		
ft	feet		
km	kilometre		
km <sup>2</sup>	square kilometre		
m	metre		
MMBOE	million barrels of oil equivalent		

The following table sets forth certain standard conversions between Standard Imperial Units and the International System of Units (or metric units)

<b>To Convert From</b>	<b>To</b>	<b>Multiply By</b>
ft	m	0.305
m	ft	3.281
miles	km	1.610
km	miles	0.621
acres	km <sup>2</sup>	0.004
km <sup>2</sup>	acres	247.1
bbl	Mcm	0.000159
Mcm	bbl	6.290
cf	cm	0.0283
cm	cf	35.315

## Definitions

In this Annual Report, the following words and phrases have the meanings set forth below, unless otherwise indicated.

**“Carbonate”** means rock formed from the hard parts of marine organisms, mainly consisting of calcite, aragonite and dolomite;

**“Casing”** means a series of tubular steel pipes joined by threads and couplings that lines the wellbore to prevent water and rock from entering;

**“Condensate”** means liquids recovered during the production of natural gas, consisting primarily of pentane and heavier hydrocarbons;

**“Contingent Resources”** means 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). Contingent Resources are not risked for the chance of development. There is no certainty that they will be commercially viable to produce any portion of the contingent resources;

**“Coring”** means collecting a cylindrical sample of rock, cut by a special bit during the drilling process;

**“Corporation”** or **“WesternZagros”** means WesternZagros Resources Ltd. and its subsidiaries, unless the context requires otherwise;

**“Discovered gas initially-in-place”** means that quantity of gas that is estimated, as of a given date, to be contained in known accumulations prior to production. The recoverable portion of discovered gas initially-in-place includes production, reserves and contingent resources; the remainder is unrecoverable;

**“Draft Federal Petroleum Law”** means the draft Iraq federal petroleum law for which consensus was reached on February 15, 2007 by a committee comprising representatives of Kurdistan and the parties included in the Council of Representatives (Cabinet) of the Government of Iraq;

**“Drilling Mud”** means specialized mud mixed at the drill site and pumped down the drillstring and up the annulus to prevent blowouts, remove cuttings and cool and lubricate the bit;

**“Drill Stem Test”** means a method of sampling fluid from a formation using a tool attached to the drill stem; the sample is used to assess the type and volume of fluids in the formation as well as their pressure and rate of flow;

**“Formation”** means a designated subsurface layer that is composed throughout of substantially the same kind of rock or rock types;

**“Gas”** means natural gas;

**“Iraq Constitution”** means the permanent constitution of Iraq approved by the people of Iraq in the general referendum on October 15, 2005;

**“Iraq Council of Ministers”** means the executive council of the Government of Iraq, appointed by the Presidency Council;

**“Iraq Council of Representatives”** means the main elected body of representatives in Iraq, who form the legislative branch of government;

**“Government of Iraq”** means the Federal Government of Iraq;

**“Hydrocarbon”** means a large class of liquid, solid or gaseous organic compounds, containing only carbon and hydrogen, which are the basis of almost all petroleum products;

**“Kirkuk Field”** means an oilfield in Iraq that was discovered in 1927 and is the basis of northern Iraqi oil production;

**“KRG”** means the Kurdistan Regional Government;

**“Kurdamir-1”** means the second commitment well under the PSC. It was drilled by WesternZagros from May 2009 to February 2010;

**“Kurdistan”** means the Kurdistan Region of Iraq;

**“Kurdistan Regional Oil & Gas Law”** means a law passed on August 6, 2007 by the Kurdistan Regional Government concerning management of the Kurdistan Region’s oil and gas resources;

**“Logging”** means gathering detailed depth-related records of certain significant details of an oil or gas well; usually obtained by lowering measurement instruments into a well;

**“Pay zone”** means the producing part of a formation;

**“Prospective Resources”** means those quantities of petroleum estimated, as of a given date, to be potentially recoverable from undiscovered accumulations by application of future development projects. Prospective Resources have both an associated chance of discovery (geological chance of success) and a chance of development (economic, regulatory, market and facility, corporate commitment or political risks). Prospective Resources are not 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 discovered, there is no certainty that it will be commercially viable to produce any portion of the prospective resources;

**“PSC”** means the Production Sharing Contract which was signed by the Corporation and the KRG on February 28, 2008;

**“PSC Lands”** means the area covered by the PSC consisting of a 2,120 km<sup>2</sup> exploration project area on Block 44 (the Kalar-Bawanoor Block) in the Garmian area of Kurdistan;

**“Region”** means a region of Iraq that is constitutionally established pursuant to the Iraq Constitution;

**“Reservoir”** means a porous and permeable underground rock formation containing a natural accumulation of crude oil or natural gas that is confined by impermeable rock or water barriers, and is separate from other reservoirs;

**“Sarqala-1”** means the first commitment well under the PSC. It was drilled from May 2008 to March 2009;

**“Seismic program”** means a study using sound waves to create detailed models of underlying geological formations and to find oil and natural gas reservoirs;

**“Talisman”** means Talisman (Block 44) B.V., a wholly-owned subsidiary of Talisman Energy Inc.;

**“Wellbore”** means a hole drilled or bored into the earth, usually cased with metal pipe, for the production of gas or oil;

**“Wildcat well”** means a well drilled in a previously unexplored area;

**“Wireline log”** means a measurement that was obtained by using special tools or equipment, such as logging tools, packers or measuring devices, designed to be lowered into the well on a wireline (small-diameter steel cable);

**“Undiscovered Resources”** means that quantity of petroleum that is estimated, as of a given date, to be contained in accumulations yet to be discovered; also referred to as “oil or gas initially-in-place.”

Note: WesternZagros thanks the Centre for Energy Information ([www.centreforenergy.com](http://www.centreforenergy.com)) for many of the definitions used in this report.