

**CENTRAL BANK OF IRAQ**

**FINANCIAL STATEMENTS**

**DECEMBER 31, 2005**

**AUDITORS' REPORT TO THE MINISTRY OF FINANCE  
GOVERNMENT OF IRAQ**

We were engaged to audit the accompanying financial statements of the Central Bank of Iraq (CBI), which comprise the balance sheet as of December 31, 2005, the income statement and the statement of changes in equity for the year then ended. These financial statements are the responsibility of the CBI's Board of Directors.

1. As further explained in note 2 to the financial statements, the accompanying financial statements do not include comparative figures as of December 31, 2004, as it was not practical to prepare an opening balance sheet as of January 1, 2004 as required by IFRS 1 and to restate the financial statements as of December 31, 2004 to be in accordance with IFRS. In addition, the statement of cash flows for the year ended December 31, 2005 has not been prepared.
2. The CBI did not receive the financial statements of its branches in Asulaymaniyah and Erbil and does not have access to the accounting records of these branches and therefore, the accompanying financial statements do not include the financial statements of Asulaymaniyah and Erbil branches. The CBI does not have any information to quantify the significance of the branches financial statements and its effect on the CBI's financial statements as of December 31, 2005. In addition, the CBI's liabilities as of December 31, 2005 include current accounts due to Asulaymaniyah and Erbil branches in the amount of ID 130,824 million that have neither been reconciled nor confirmed by the branches.
3. As further explained in note 6 to the financial statements, the CBI's financial statements as of December 31, 2005 include balances at foreign banks in the amount of ID 3,001,121 million, of which an impairment loss provision of ID 2,278,234 million has been made during 2005. In addition, during 2005 the CBI wrote off balances at foreign banks in the amount of ID 1,015,790 million. The provided for and written off balances include balances that have been transferred from the foreign banks to the Development Fund for Iraq (DFI) as required by the United Nations Security Council Resolution (UNSCR) 1483 (2003). However, the CBI management does not have sufficient information to confirm the total balances transferred to the DFI account and there is no confirmation from the Ministry of Finance to identify the amounts that could be refunded from the DFI to the CBI.
4. As further explained in note 14 to the financial statements, the CBI liabilities as of December 31, 2005 include certain past due foreign governments and banks loans, and current and time deposit accounts in the amount of ID 13,995,712 million. The CBI does not have sufficient information to support the completeness of these accounts. In addition, the CBI did not quantify and provide for the accrued interest that could be due on these accounts. Many of the past due foreign banks loans, and current and time deposit accounts are being reconciled and settled under the Iraqi External Debt Reconciliation Project. However, to the date of this report, the CBI does not have sufficient information regarding the balances that have been reconciled or settled as of December 31, 2005. Therefore, the balances due to foreign governments and banks are carried at cost, as these balances can not be reliably measured at amortized cost using the effective interest method as required by IAS 39. We did not receive confirmations for these accounts and no sufficient information is available to extend our audit procedures to ensure the completeness and valuation of the balances and the related accrued interest.

**AUDITORS' REPORT TO THE MINISTRY OF FINANCE  
GOVERNMENT OF IRAQ (continued)**

5. As explained in note 36 to the accompanying financial statements, the CBI has outstanding off balance sheet credit related commitment balances in the amount of ID 37,270,624 million, of which the CBI is the guarantor of the debt, letters of credit and letters of guarantees that are related to the CBI and other Governmental institutions. Due to inaccuracy of the off balance sheet records and the unavailability of sufficient information, we could not extend our audit procedures to ensure the completeness and valuation of these balances. In addition, the effect of these off balance sheet accounts on the CBI's financial statements as of December 31, 2005, if any, are uncertain and could not be quantified at this stage.
6. As further discussed in note 36, there are lawsuits in different countries against the CBI for the settlement of past due debts of the CBI and other Governmental institutions included in the amount of ID 6,754,678 million. The final outcome of these lawsuits and effects on the CBI's financial statements as of December 31, 2005, if any, is uncertain and have not been quantified and provided for. We did not receive confirmations from all CBI's legal advisors and due to the unavailability of sufficient information, we could not extend our audit procedures to ensure the completeness of these lawsuits and effect on the financial statements as of December 31, 2005, if any.
7. As further discussed in note 13, the CBI did not prepare reconciliations of local banks' current accounts as of December 31, 2005. Due to weaknesses in the internal control systems, we could not extend our audit procedures to ensure the completeness and accuracy of certain local banks current accounts balances in the amount of ID 1,687,874 million.
8. As further discussed in note 17 to the financial statements, the CBI's liabilities as of December 31, 2005 include many un-reconciled suspense accounts in the amount of ID 686,496 million and, as disclosed in note 11, there are suspense accounts with debit balances in the amount of ID 145,651 million. All suspense accounts with debit balances have been provided for in the accompanying financial statements. Due to weaknesses in the internal control systems, we could not extend our audit procedures to determine the effect of the suspense balances on the CBI's financial statements as of December 31, 2005.
9. As further discussed in notes 12 to the financial statements, during 2004, the CBI incurred a loss of ID 1,026,327 million as a result of the withdrawal of the old Iraqi Dinar currency from circulation, and the issuance of the new Iraqi Dinar currency. To the date of this report, the reconciliation process of the currency replacement has not been finalized with certain local banks and the result of such reconciliations and its effect on the CBI's financial statements have not been determined. Due to weaknesses in the internal control systems, we could not extend our audit procedures to ensure the accuracy of the currency replacement losses and to ensure the completeness of the issued currency balance as of December 31, 2005.

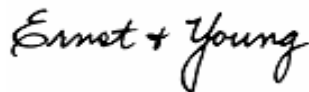
**AUDITORS' REPORT TO THE MINISTRY OF FINANCE  
GOVERNMENT OF IRAQ (continued)**

10. As further discussed in notes 25 and 35 to the financial statements, as part of its accounting records, the CBI maintains certain accounts related to the Development Fund for Iraq (DFI) and the Memorandum of Understanding (MOU) which are considered as fiduciary accounts managed on behalf of the MOF. As of December 31, 2005, the accounts balances that are related to the DFI and the MOU have been excluded from the CBI's financial statements, which resulted in un-reconciled differences between the DFI and the MOU assets balances and the related liability balances in the CBI records in the total amount of ID 250,483 million. A provision for impairment loss has been made for this difference in the accompanying financial statements. However, due to weaknesses in the internal control systems, the effect of the reconciliations of these differences on the CBI's financial statements as of December 31, 2005 have not been determined yet.
11. As disclosed in note 17 to the financial statements, the CBI's other liabilities as of December 31, 2005 includes un-reconciled inter-branch balance of ID 16,734 million which represent the net differences between the CBI's Basrah and Mousel current accounts balances per CBI's records and the branches records. Due to weaknesses in the internal control systems, the effect of the reconciliations of these differences on the CBI's financial statements as of December 31, 2005 have not been determined.
12. The CBI did not receive statement of accounts of the balances due to the Ministry of Finance and certain governmental parties disclosed in note 16 to the financial statements amounting to ID 3,458,528 million and ID 479,426 million, respectively, therefore; no reconciliations have been made as of December 31, 2005. We did not receive confirmations of these balances as of December 31, 2005, and due to weaknesses in the internal control systems, we could not extend our audit procedures to ensure the completeness, valuation and accuracy of these balances as of December 31, 2005.
13. The physical count of the gold reserve located at CBI's vault as of December 31, 2005 was based on the number of gold bars rather than the weight of ounces. As a result, the physical count of the gold has not been reconciled with the accounting records as in the records gold is measured in ounces rather than number of bars. In addition, the physical count of the gold bars has not been made in the presence of an independent gold expert. Therefore, we were not able to ensure accurate valuation of the gold at CBI's vault, amounting to ID 103,967 million.
14. The CBI management did not quantify the liquidity risk, foreign currency risk, interest rate risk and other risks that should be disclosed in the financial statements as required by International Accounting Standard 32 *Financial Instruments: Disclosure and Presentation*.

**AUDITORS' REPORT TO THE MINISTRY OF FINANCE  
GOVERNMENT OF IRAQ (continued)**

15. The CBI has an accumulated losses balance as of December 31, 2005 in the amount of ID 13,493,259 million. In addition, the CBI's total liabilities as of December 31, 2005 exceed its total assets by ID 13,347,772. As further discussed in note 20 to the financial statements, to the date of this report, the Ministry of Finance did not make any capital contribution to cover the CBI's accumulated losses and to cover the unpaid capital as required by the Central Bank of Iraq Law of 2004.
16. We have not obtained all the information and explanations that we have requested during the course of our audit.

Because of the significance of the matters discussed in the preceding paragraphs, we do not express an opinion on the financial statements.



October 1, 2006

Baghdad - Iraq

# Central Bank of Iraq

## INCOME STATEMENT

Year ended December 31, 2005

	<i>Notes</i>	<b>2005 ID Million</b>
<b>ASSETS</b>		
Gold reserve	4	142,902
Cash and balances with central banks	5	5,373,898
Due from banks	6	723,738
Treasury bills	7	10,896,779
Due from Ministry of Finance	8	5,393,890
Foreign currencies investments at IMF	9	3,124,262
Premises and equipment	10	20,974
Other assets	11	7,957
<b>TOTAL ASSETS</b>		<b>25,684,400</b>
<b>LIABILITIES AND EQUITY</b>		
<b>LIABILITIES</b>		
Currency issued	12	10,256,511
Deposits of local banks	13	6,813,378
Due to foreign governments and banks	14	13,995,712
Due to International Monetary Fund	15	2,918,825
Due to Governmental institutions	16	4,227,127
Other liabilities	17	820,619
		<b>39,032,172</b>
<b>EQUITY</b>		
Capital	18	500
General reserve	19	2,100
Gold revaluation reserve	19	142,887
Accumulated losses	20	(13,493,259)
		<b>(13,347,772)</b>
<b>TOTAL LIABILITIES AND NET EQUITY</b>		<b>25,684,400</b>

Dr. Sinan Shabibi  
Governor of the Central Bank of Iraq

# Central Bank of Iraq

## INCOME STATEMENT

Year ended December 31, 2005

	<i>Notes</i>	<i>2005 ID Million</i>
<b>REVENUES</b>		
Interest income	22	632,040
Interest expense	23	(189,359)
<b>Net interest income</b>		<b>442,681</b>
Net fee and commission income	24	22,015
Gold revaluation gain	19	22,053
Other income		37,509
		<b>524,258</b>
<b>EXPENSES</b>		
Staff expenses		10,113
Depreciation		156
Foreign currency translation loss		274,574
General and administrative expenses		38,927
Written off deposits at foreign banks	6	1,015,790
Provision for impairment of deposits at banks	6	2,278,234
Other provisions	25	535,864
		<b>4,153,658</b>
<b>NET LOSS FOR THE YEAR</b>		<b>(3,629,400)</b>

Central Bank of Iraq

STATEMENT OF CHANGES IN EQUITY

Year ended December 31, 2005

		<i>Capital ID Million</i>	<i>General reserve ID Million</i>	<i>Gold revaluation reserve ID Million</i>	<i>Accumulated losses ID Million</i>	<i>Total ID Million</i>
	<i>Notes</i>					
Restated balance at January 1, 2005	21	500	2,100	120,834	(9,841,806)	(9,718,372)
Net loss for the year		-	-	-	(3,629,400)	(3,629,400)
Gold revaluation reserve for the year	19			22,053	(22,053)	-
<b>Balance at December 31, 2005</b>		<b>500</b>	<b>2,100</b>	<b>142,887</b>	<b>(13,493,259)</b>	<b>(13,347,772)</b>



## NOTES TO THE FINANCIAL STATEMENTS

December 31, 2005

### 1 ACTIVITIES

The Central Bank of Iraq (CBI) is a governmental entity that was established under the Central Bank of Iraq Law Number 43 of 1947 as amended, and carrying out its activities under the Central Bank Law of 2004 issued by the Coalition Provisional Authority Order Number 56.

The primary objectives of the CBI are to achieve and maintain domestic price stability and to foster and maintain a stable and competitive market-based financial system. Subject to these objectives, the CBI shall promote sustainable growth, employment and prosperity in Iraq.

In accordance with the Central Bank Law, the main functions of the CBI in achieving its objectives include the following:

- a. Formulate and implement monetary policy, including exchange rate policy.
- b. Hold and manage all official foreign reserves of Iraq, other than working balances of the Government of Iraq.
- c. Hold gold and manage the Government of Iraq reserves of gold.
- d. Provide liquidity services to banks.
- e. Issue and manage Iraqi currency.
- f. Establish, oversee and promote sound and efficient payment systems.
- g. Issue licenses or permits to banks and to regulate and supervise banks.

The CBI's head office is located in Baghdad with four branches in Basrah, Mosul, Erbil and Asulaymaniyah. However, currently the CBI does not have control over Erbil and Asulaymaniyah branches.

The financial statements were authorized for issue in accordance with a resolution of the CBI's Board of Directors on October 1, 2006.

### 2 FINANCIAL STATEMENTS

The financial statements represent the CBI's first issued financial statements in accordance with International Financial Reporting Standards (IFRS) and include the CBI's financial position as of December 31, 2005, and the results of its operations and changes in equity for the year ended December 31, 2005.

The CBI does not have access to the accounting records of its Erbil and Asulaymaniyah branches. Therefore, the accompanying financial statements do not include the financial statements of Asulaymaniyah and Erbil branches. The CBI does not have any information to quantify the significance of the branches financial statements and its effect on the CBI's financial statements as of December 31, 2005.

Prior years' financial statements have been prepared in accordance with the Iraqi local generally accepted accounting standards. The accounting policies that were followed under the previous local accounting standards were significantly different from IFRS accounting policies. It is not practical to prepare an opening balance sheet at January 1, 2004 as required by IFRS 1, *First Time Adoption of International Financial Reporting Standards*. Therefore, the accompanying financial statements do not include comparative figures as of December 31, 2004. In addition, the statement of cash flows for the year ended December 31, 2005 has not been prepared.

NOTES TO THE FINANCIAL STATEMENTS

December 31, 2005

**3 SIGNIFICANT ACCOUNTING POLICIES**

The significant accounting policies adopted in the preparation of the financial statements are set out below:

**Basis of preparation**

The financial statements have been prepared under the historical cost convention in accordance with International Financial Reporting Standards (IFRS) except for the following major matters:

- The financial statements do not include comparative figures as of December 31, 2004.
- The statement of cash flows for the year ended December 31, 2005 has not been prepared.
- The financial statements of Asulaymaniyah and Erbil branches have not been included in the CBI financial statements.
- The financial statements do not include certain disclosures relating to liquidity risk, foreign currency risk, interest rate risk and other risks that should be disclosed in the financial statements as required by International Accounting Standard (IAS) 32.
- The balances due to foreign governments and banks are carried at cost, as these balances can not be reliably measured at amortized cost using the effective interest method as required by IAS 39.

The financial statements have been presented in Iraqi Dinar (ID), which is the functional currency of the CBI. All amounts in the financial statements are rounded to the nearest million ID unless otherwise stated.

**Gold**

Gold is stated on the basis of the closing price in London gold market as of December 31, 2005. The CBI maintains the gold as part of its foreign reserve management and does not have a present intent to dispose of it.

The gains or losses on the revaluation of gold at market price are taken to the income statement. The cumulative gain revaluation reserve is disclosed in a separate component in equity.

**Non-trading investments**

These are classified as follows:

- Held to maturity
- Available for sale

All investments are initially recognized at cost, being the fair value of the consideration given including directly attributable transaction costs.

**Available for sale**

After initial recognition, investments which are classified as “available for sale” are normally remeasured at fair value, unless fair value cannot be reliably determined in which case they are measured at cost less impairment. Fair value changes which are not part of an effective hedging relationship, are reported as a separate component of equity until the investment is derecognized or the investment is determined to be impaired. On derecognition or impairment the cumulative gain or loss previously reported as “cumulative changes in fair value” within equity, is included in the statement of income.

**3 SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Held to maturity investments**

Investments classified as held to maturity have fixed or determinable payments and fixed maturity and are intended to be held to maturity. They are carried at amortized cost using the effective interest method, less provision for impairment in value.

**De-recognition of financial assets and liabilities**

A financial asset (in whole or in part) is derecognized either when the CBI has transferred substantially all the risks and rewards of ownership or when it has neither transferred nor retained substantially all the risks and rewards and no longer has control over the asset or a proportion of the asset.

A financial liability is removed from the CBI balance sheet when, and only when, it is extinguished; when the obligation specified in the contract is discharged or cancelled or expires.

**Due from banks**

These are stated at cost less any amounts written off and provision for impairment.

**Due from Ministry of Finance and IMF**

These are stated at amortized cost less any amounts written off and provision for impairment.

**Premises and equipment**

All items of premises and equipment are initially recorded at cost. Depreciation is provided on a straight-line basis over the estimated useful lives of all premises and equipment, other than freehold land which is deemed to have an indefinite life.

The estimated useful lives of the premises and equipment for the calculation of depreciation are as follows:

Buildings	20 years
Furniture and equipment	3 to 5 years
Motor vehicles	5 years

**Issued currency**

The liability of the CBI towards banknotes and coins issued as a legal tender in Iraq under the Central Bank of Iraq Law of 2004 is stated at the face value. The issued banknotes and coins that are returned to the CBI are reduced from the issued currency balance. Any unissued and returned banknotes and coins kept in the CBI vaults are not reflected in the financial statements. The cost of printing the banknotes and melting of coins is recorded in the income statement when incurred.

**Local banks reserves and deposits**

All local banks reserves and deposits are carried at cost, less amounts repaid.

**Fair values**

The estimated fair value of the currency issued is the face value of the banknotes and coins issued.

The estimated fair value of deposits with no stated maturity, which includes non-interest bearing deposits, is the amount payable on demand.

NOTES TO THE FINANCIAL STATEMENTS

December 31, 2005

**3 SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Due to foreign governments and banks**

All due to foreign governments and banks balances are carried at cost, less amounts repaid, as these balances could not be reliably measured at amortized cost as of December 31, 2005.

**Provisions**

Provisions are recognized when the CBI has a present obligation (legal or constructive) arising from a past event and the costs to settle the obligation are both probable and able to be reliably estimated.

**Fiduciary assets**

Assets held in a fiduciary capacity are not treated as assets of the CBI in the balance sheet.

**Offsetting**

Financial assets and financial liabilities are only offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognized amounts and the CBI intends to either settle on a net basis, or to realize the asset and settle the liability simultaneously.

**Revenue recognition**

Interest income as well as fees which are considered an integral part of the effective yield of a financial asset, are recognized using the effective interest method. Commission income and other fees receivable are recognized as the services are provided.

**Foreign currencies**

The financial statements of the CBI are presented in Iraqi Dinar (ID) which is the CBI's functional currency.

Foreign currency transactions are recorded in ID at the rates of exchange prevailing at the time of the transactions. Monetary assets and liabilities in foreign currencies are translated into ID at rates of exchange prevailing at the balance sheet date. Any gains or losses are taken to the income statement.

**Impairment of financial assets**

An assessment is made at each balance sheet date to determine whether there is objective evidence that a specific financial asset may be impaired. If such evidence exists, any impairment loss is recognized in the income statement.

Impairment is determined as follows:

- (a) for assets carried at amortized cost, impairment is based on estimated cash flows which are discounted at the original effective interest rate.
- (b) for assets carried at fair value, impairment is the difference between cost or previously written down amount and fair value.
- (c) for assets carried at cost, impairment is the difference between cost and the present value of future cash flows discounted at the current market rate of return for a similar financial asset.

In addition, a provision is made to cover impairment for specific groups of assets where there is a measurable decrease in estimated future cash flows.

**Trade and settlement date accounting**

Purchases and sales of financial assets are recognized on the trade date, i.e. the date that the CBI commits to purchase or sell the asset.

NOTES TO THE FINANCIAL STATEMENTS

December 31, 2005

3 SIGNIFICANT ACCOUNTING POLICIES (continued)

**Judgements**

In the process of applying the CBI's accounting policies, management has made the following judgement, apart from those involving estimations, which has the most significant effect in the amounts recognized in the financial statements:

The CBI treats the deposits at banks as impaired when there has been a significant or prolonged decline in the fair value below its cost or where other objective evidence of impairment exists. The determination of what is "significant" or "prolonged" requires considerable judgment.

**Estimation uncertainty**

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

*Impairment losses on deposits at foreign banks*

The CBI reviews its problem deposits at foreign banks on an annual basis to assess whether a provision for impairment should be recorded in the income statement. In particular, considerable judgment by management is required in the estimation of the amount and timing of future cash flows when determining the level of provisions required. Such estimates are necessarily based on assumptions about several factors involving varying degrees of judgment and uncertainty, and actual results may differ resulting in future changes to such provisions.

*Due to foreign governments and banks and off balance sheet commitments*

The CBI liabilities as of December 31, 2005 include past due foreign banks loans, current and time deposits accounts and off balance sheet commitments. Many of the past due foreign banks loans, current and time deposits accounts are being reconciled and settled by the Government of Iraq under the Iraqi External Debt Reconciliation Project. The outcome of the final settlement of these liabilities and off balance sheet commitments is uncertain and its effect on the financial statements as of December 31, 2005 can not be reliably measured.

4 GOLD RESERVES

	<b>2005</b>
	<b>ID Million</b>
Gold reserve in CBI vault	<b>103,967</b>
Gold reserve at Bank for International Settlements	<b>38,741</b>
Gold coins at CBI vault	<b>194</b>
	<hr/>
	<b>142,902</b>
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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2005

**5 CASH AND BALANCES WITH CENTRAL BANKS**

	<i>2005</i> <i>ID Million</i>
Cash on hand	3,947,845
Current account with Federal Reserve Bank of New York	465
Overnight deposits with Federal Reserve Bank of New York	1,425,588
	<u>5,373,898</u>

**6 DUE FROM BANKS**

	<i>2005</i> <i>ID Million</i>
Due from local banks	19,048
Current accounts with foreign banks	296,603
Time deposits with foreign banks	396,922
Frozen and old outstanding deposits with foreign banks	2,307,596
	<u>3,020,169</u>
Provision for impairment losses of due from local banks	(18,197)
Provision for impairment losses of deposits with foreign banks	(2,278,234)
	<u>723,738</u>

The United Nations Security Council (UNSC) decided in its Resolution 1483 (2003), that all member states in which there are funds or other financial assets or economic resources of the previous Government of Iraq or its state bodies, corporations, or agencies, located outside Iraq as of May 22, 2003 shall freeze those funds or other financial assets or economic resources and, unless these funds or other financial assets or economic resources are themselves the subject of a prior judicial, administrative, or arbitral lien or judgment, immediately shall cause their transfer to the Development Fund for Iraq (DFI).

During 2005, a provision for impairment losses of ID 2,278,234 has been recorded against the frozen and old outstanding accounts with foreign banks as of December 31, 2005. In addition, during 2005 the CBI wrote off balances at foreign banks in the amount of ID 1,015,790 million. The provided for and written off balances include accounts that have been transferred from the foreign banks to the DFI as required by the UNSC Resolution 1483. However, CBI management does not have sufficient information to confirm the total balances transferred to the DFI account.

On November 22, 2005, the Iraqi Council of Ministries requested the Ministry of Finance (MOF) to make the necessary arrangements to refund all CBI balances at foreign banks that have been transferred to the DFI. To the financial statements issuance date, the MOF has not confirmed the amounts that may be refunded from the DFI to the CBI.

Due to the absence of the details, the CBI did not prepare reconciliations of certain frozen and old outstanding deposits at foreign banks as of December 31, 2005.

NOTES TO THE FINANCIAL STATEMENTS

December 31, 2005

**7 TREASURY BILLS**

	<i>2005 ID Million</i>
Face value	<b>11,000,550</b>
Unamortized discount	<b>(103,771)</b>
	<hr/> <b>10,896,779</b> <hr/>

Treasury bills are debt securities issued by the U.S. Treasury and purchased through the Federal Reserve Bank of New York. The Treasury bills have original maturities of 44 days to 182 days, with a fixed income determined based on the prevailing market rates on the date of executing the investment. The Treasury bills are classified as held to maturity and management intent to hold all Treasury bills until maturity dates.

**8 DUE FROM MINISTRY OF FINANCE**

	<i>2005 ID Million</i>
Past due Treasury bills	<b>3,234,637</b>
Overdraft account	<b>1,820,871</b>
Accrued interest	<b>338,382</b>
	<hr/> <b>5,393,890</b> <hr/>

Subsequent to the financial statements date, on February 21, 2006, a restructuring agreement was signed between the CBI and the MOF for the settlement of the total balance of ID 5,393,890 million due to the CBI as of December 31, 2005. The balance will be settled over 7.5 years starting March 31, 2006, through 30 equal quarterly installments of ID 179,796 million each. An annual interest of 5% will be charged on the outstanding balance (the same interest rate of 2005).

The MOF will finance the quarterly repayments by issuing one year Treasury bills every quarter bearing an annual interest rate of 5%, which CBI could then auction to local banks.

**9 FOREIGN CURRENCY INVESTMENTS AT IMF**

	<i>2005 SDR</i>	<i>2005 ID Million</i>
International Monetary Fund (IMF) Quota Subscription	<b>1,188,400,000</b>	<b>2,505,354</b>
Special Drawing Rights (SDR) Holdings with IMF	<b>293,575,190</b>	<b>618,908</b>
	<hr/> <b>1,481,975,190</b> <hr/>	<hr/> <b>3,124,262</b> <hr/>

The foreign currency investments at IMF are classified as available for sale investments.

NOTES TO THE FINANCIAL STATEMENTS

December 31, 2005

**10 PREMISES AND EQUIPMENT**

	<i>2005</i> <i>ID Million</i>
Land	20,108
Buildings	403
Furniture and equipment	2,709
Motor vehicles	244
	<hr/>
Premises and equipment cost	23,464
Accumulated depreciation	(2,601)
Project in progress	111
	<hr/>
<b>Net book value</b>	<b>20,974</b>
	<hr/> <hr/>

**11 OTHER ASSETS**

	<i>2005</i> <i>ID Million</i>
Interest receivables	115,961
Suspense accounts *	145,651
Loans to employees	2,950
Other	468
	<hr/>
	265,030
Provision for impairment	(257,073)
	<hr/>
	7,957
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\* The suspense balances comprise many debit balances that have not been reconciled as of December 31, 2005. Therefore, the effects of the reconciliation of these balances on the financial statements as of December 31, 2005 have not been determined.

During 2005, the CBI recorded a provision for the impairment of the following other assets:

	<i>2005</i> <i>ID 000,000</i>
Interest receivables	111,434
Suspense accounts	145,639
	<hr/>
	257,073
	<hr/> <hr/>



NOTES TO THE FINANCIAL STATEMENTS

December 31, 2005

**12 CURRENCY ISSUED**

	<i>2005 ID Million</i>
Coins	5,015
Banknotes	10,251,496
	<u>10,256,511</u>

During 2004, the CBI incurred a loss of ID 1,026,327 million as a result of the withdrawal of the old Iraqi Dinar currency from circulation, and the issuance of the new Iraqi Dinar currency. To the financial statements date, the reconciliation process of the currency replacement has not been finalized with certain local banks and the result of such reconciliations and its effect on the CBI's financial statements has not been determined.

**13 LOCAL BANKS RESERVES AND DEPOSITS**

	<i>2005 ID Million</i>
Current accounts	3,081,816
Overnight deposits	1,914,422
Time deposits	1,734,200
Others	82,940
	<u>6,813,378</u>

According to the CBI regulations, all banks operating in Iraq should maintain a legal reserve at the CBI equivalents to 20% of total customers' deposits in Iraqi Dinar and US Dollars. The local banks current accounts at the CBI include a legal reserve of ID 2,931,105 million as of December 31, 2005. No interest is due on the legal reserve balances.

The local banks reserves and deposits balance as of December 31, 2005 includes accounts in US Dollars in the amount of US Dollar 1,202,851,839 (ID 1,774,206 million).

NOTES TO THE FINANCIAL STATEMENTS

December 31, 2005

**14 DUE TO FOREIGN GOVERNMENTS AND BANKS**

	<i>2005 ID Million</i>
Due to foreign Governments and financial institutions	11,736,608
Foreign banks deposits	1,652,314
Overdraft accounts	551,849
Others	54,941
	<u>13,995,712</u>

The balance due to foreign Governments and banks represents past due accounts that are outstanding from many years. Many of these accounts could be reconciled and settled by the Government of Iraq under the Iraqi External Debt Reconciliation Project. However, to the financial statements date, there is insufficient information regarding the balances that have been reconciled or settled as of December 31, 2005 and the balances that will be settled subsequently. In addition, the CBI did not quantify and provide for the accrued interest that could be due on these accounts, except for ID 83,187 million due on certain accounts.

**15 DUE TO INTERNATIONAL MONETARY FUND**

	<i>2005 SDR</i>	<i>2005 ID Million</i>
SDR allocations	68,463,800	144,334
IMF securities	1,017,300,000	2,144,645
Currency Holdings:		
IMF EPCA loan	297,100,000	626,339
IMF No. 1 Account including Currency Valuation Adjustments	1,650,576	3,480
IMF No. 2 Account including Currency Valuation Adjustments	12,991	27
	<u>1,384,527,367</u>	<u>2,918,825</u>

The balance of SDR 68,463,800 represents an allocation of SDRs by the International Monetary Fund (IMF) to Iraq. SDRs are allocated by the IMF to members that are participants in the IMF's SDR Department at the time of allocation in proportion to their quotas in the IMF.

The Currency Holdings include an Emergency Post Conflict Assistance (EPCA) long term loan of ID 626,339 million (SDR 297,100,000) granted by the IMF to the CBI during 2004. The loan is repayable on 8 quarterly equal installments of SDR 37,137,500 each starting January 3, 2008. The charges on this loan are computed quarterly at rates set by the IMF.

NOTES TO THE FINANCIAL STATEMENTS

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**16 DUE TO GOVERNMENTAL INSTITUTIONS**

	<i>2005</i> <i>ID Million</i>
Due to Ministry of Finance*	3,458,528
Due to other governmental institutions*	551,420
Cash margins	8,604
Due to Asulaymaniyah and Erbil branches	130,824
Loan from a local governmental bank	9,375
Others	68,376
	<u>4,227,127</u>

\*The CBI did not receive statement of accounts of the balances due to the Ministry of Finance as of December 31, 2005. In addition, the CBI did not receive statement of accounts for part of the balance due to other governmental institutions in the amount of ID 479,426 million. Therefore, no reconciliations have been made to these accounts as of December 31, 2005.

**17 OTHER LIABILITIES**

	<i>2005</i> <i>ID Million</i>
Interest payable	95,573
Accounts payable	2,424
Inter-branch balances	16,734
Suspense balances*	686,496
Sundry provisions	16,995
Others	2,397
	<u>820,619</u>

\* Those are representing a liability balances that have not been reconciled as of December 31, 2005. Therefore, the effects of the reconciliation of these balances on the financial statements as of December 31, 2005 have not been determined.

**18 CAPITAL**

According to Article 5 of the Central Bank of Iraq Law of 2004, the authorized capital of the CBI shall be ID 100 billion and shall be fully paid by the Republic of Iraq in exchange for 100% of the CBI's capital stock. The authorized capital stock of the CBI shall be held solely by the Republic of Iraq, shall not pay any dividend and shall not be transferable or subject to any encumbrances.

As of December 31, 2005, CBI's paid capital is ID 500 million. To the financial statements date, the Ministry of Finance did not made any capital contribution to cover the CBI's accumulated losses and to cover the unpaid capital as required by the Central Bank of Iraq Law of 2004.

NOTES TO THE FINANCIAL STATEMENTS

December 31, 2005

**19 RESERVES**

According to Article 5 of the Central Bank of Iraq Law of 2004, the CBI shall hold a general reserve account, an unrealized profit reserve account and other reserves required by International Financial Reporting Standards.

The CBI has a gold revaluation gain reserve in the amount of ID 142,887, which represent the cumulative unrealized gain on the revaluation of gold at market prices.

The beginning accumulated losses balance has been restated to disclose the beginning balance of the gold unrealized revaluation reserve in a separate component in equity.

	<i><b>2005</b></i>
	<i><b>ID Million</b></i>
Gold revaluation reserve, beginning of year as restated	<b>120,834</b>
Gold revaluation gain for the year	<b>22,053</b>
	<hr/>
Gold revaluation reserve, end of year	<b>142,887</b>
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**20 ACCUMULATED LOSSES**

According to Article 5 of the Central Bank of Iraq Law of 2004, if the CBI incurs a net operating loss for any financial year, that loss shall first be charged to the general reserve and subsequently to the capital. However, to the financial statements date, there is no resolution from the CBI's Board of Directors to charge the accumulated losses to the general reserve and capital. The general reserve and capital balances are insignificant compared to the accumulated loss balance.

According to Article 5 of the Central Bank of Iraq Law of 2004, in the event that the audited annual balance sheet of the CBI shows that the value of its assets falls below the sum of its liabilities and unimpaired authorized capital, the CBI's Board of Directors shall assess the situation and prepare a report on the causes and extent of the shortfall. If the board determines that a capital contribution is required, the board shall consult with the Minister of Finance and request a capital contribution be made on behalf of the Republic of Iraq. Upon the receipt of this request, the Minister of Finance shall, within a period of no more than two months, make a request to the authorized governmental party for the approval of the capital contribution for the CBI over such period and in such amount as is necessary to remedy the shortfall. To the financial statements date, the Ministry of Finance did not make any capital contribution to cover the CBI's accumulated losses.

NOTES TO THE FINANCIAL STATEMENTS

December 31, 2005

**21 PRIOR YEARS ADJUSTMENTS**

	<i>2005</i> <i>ID Million</i>
Accumulated losses balance at January 1, 2005, before restatement	(10,026,826)
<b>Prior years expenses</b>	
Interest expense	49,249
Other expenses	9,998
<b>Prior years revenues</b>	
Interest income on MOF Treasury bills	(31,309)
Commission income	(28,527)
Interest income on foreign deposits	(292,795)
Other revenues	(12,470)
Net prior years adjustments	<u>305,854</u>
Restatement of gold revaluation reserve	<u>(120,834)</u>
Restated accumulated losses balance at January 1, 2005	<u><u>(9,841,806)</u></u>

All prior years expenses and revenues represent expenses and revenues that are related to prior years and had not been recorded in prior years financial statements.

**22 INTEREST INCOME**

	<i>2005</i> <i>ID Million</i>
Treasury bills	260,503
Due from banks	20,997
Due from Ministry of Finance	256,852
Overnight deposits	58,041
Others	35,647
	<u>632,040</u>

**23 INTEREST EXPENSE**

	<i>2005</i> <i>ID Million</i>
Local banks time deposits	40,716
Local banks overnight accounts	60,897
Loans to foreign governments and financial institutions	42,300
Others	45,446
	<u>189,359</u>

NOTES TO THE FINANCIAL STATEMENTS

December 31, 2005

**24 NET FEE AND COMMISSION INCOME**

	<i>2005 ID Million</i>
Fee and commission income	22,889
Fee and commission expense	(874)
	<hr/>
	22,015
	<hr/> <hr/>

**25 OTHER PROVISIONS**

	<i>2005 ID Million</i>
Provision for DFI accounts (Note 35)	156,028
Provision for MOU accounts (Note 35)	94,455
Provision for interest receivables	111,434
Others	173,947
	<hr/>
	535,864
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**26 TAXES**

According to Article 44 of the Central Bank Law of 2004, the CBI shall be exempted from taxes on income or profit and certain other taxes and customs as stated in the law.

**27 FAIR VALUE OF FINANCIAL INSTRUMENTS**

The estimated fair values of on balance sheet financial instruments are not materially different from their carrying amounts in the financial statements, except for the following:

- The fair value of the balance due from Ministry of Finance is estimated at ID 4,164,344 million as of December 31, 2005, which is less than the carrying amount by ID 1,229,546 million.
- The fair value of the balances due to foreign governments and banks and from Governmental institutions cannot be reliably measured due to the unavailability of sufficient information.

NOTES TO THE FINANCIAL STATEMENTS

December 31, 2005

**28 CREDIT RISK AND CONCENTRATION OF ASSETS, LIABILITIES AND OFF BALANCE SHEET ITEMS**

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The maximum credit risk of the CBI is limited to the amounts on the balance sheet plus commitments disclosed in note 36. However, the CBI does not have formal risk assessment policies.

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the CBI's performance to developments affecting a particular industry or geographic location.

- The CBI operates in one geographic market; Iraq. The current political destabilizations in the area increase the risk of carrying out business and could adversely affect the CBI's activities.
- Significant part of CBI's assets in foreign currencies are maintained in one currency; US Dollars.
- As of December 31, 2005, 87% of the local banks reserves and deposits at the CBI are related to Governmental banks.

The distribution of assets, liabilities, and off-balance sheet items by geographic location was as follows:

	<i>2005</i>		
	<i>Assets</i>	<i>Liabilities</i>	<i>Credit</i>
	<i>ID Million</i>	<i>ID Million</i>	<i>Commitments</i>
			<i>ID Million</i>
Local - Iraq	9,272,756	22,130,324	-
Other countries	16,411,644	16,901,891	60,244,777
	<u>25,684,400</u>	<u>39,032,215</u>	<u>60,244,777</u>

**29 MARKET RISK**

Market risk arises from fluctuations in interest rates, foreign exchange rates and equity prices. The CBI did not set limits on the value of risk that may be accepted.

**30 INTEREST RATE RISK**

Interest rate risk arises from the possibility that changes in interest rates will affect future profitability or the fair values of financial instruments. The CBI is exposed to interest rate risk as a result of mismatches of interest rate repricing of assets and liabilities. However, the CBI did not establish levels of interest rate risk and did not quantify the interest rate gaps as of December 31, 2005.

NOTES TO THE FINANCIAL STATEMENTS

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**31 CURRENCY RISK**

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The CBI views the Iraqi Dinar as its functional currency. The CBI does not have a policy to set limits on positions by currency. The currency positions have not been quantified as of December 31, 2005. However, significant part of CBI's assets in foreign currencies as of December 31, 2005 are maintained in US Dollars.

**32 LIQUIDITY RISK**

Liquidity risk is the risk that the CBI will be unable to meet its liabilities when they fall due. The CBI does not have a formal liquidity risk policy.

There is an arrangement between the CBI and the Ministry of Finance that enables the CBI to improve its liquidity in foreign currencies through the financing of the Ministry of Finance needs of local currency in exchange of US Dollars.

The maturity profile of the CBI's assets and liabilities based on contractual repayment arrangements has not been quantified as of December 31, 2005. However, all the CBI's assets are either current or do not have a defined maturity period except the Treasury bills and the balance due from the Ministry of Finance which have the following maturity profile as at December 31, 2005:

	<i>Up to 1 month ID Million</i>	<i>1 to 3 months ID Million</i>	<i>3 to 6 months ID Million</i>	<i>6 months to 1 year ID Million</i>	<i>Over 1 Year ID Million</i>	<i>Total ID Million</i>
Treasury bills	1,953,937	5,898,577	3,044,265	-	-	<b>10,896,779</b>
Due from Ministry of Finance	-	179,796	179,796	359,592	4,674,706	<b>5,393,890</b>
	<u><b>1,953,937</b></u>	<u><b>6,078,373</b></u>	<u><b>3,224,061</b></u>	<u><b>359,592</b></u>	<u><b>4,674,706</b></u>	<u><b>16,260,669</b></u>

All the CBI liabilities as of December 31, 2005 do not have specific maturity dates except the local banks time deposits which have original maturities of 14 to 90 days and the EPCA credit due to the IMF which should be repaid in 8 quarterly installments starting on January 3, 2008 to October 1, 2009.

The repayment dates and the amount that may be repaid from the due to foreign governments and banks balance of ID 13,995,712 million are uncertain.

The CBI did not quantify the net liquidity gap between its total assets and liabilities as of December 31, 2005.



NOTES TO THE FINANCIAL STATEMENTS

December 31, 2005

**33 SEGMENTAL INFORMATION**

**Primary segment information**

Management does not organize the CBI operations in business segments.

**Secondary segment information**

The CBI operates in one geographic market; Iraq. However, the CBI has assets and liabilities in foreign countries. Following are summary of the CBI's total assets and total liabilities in Iraq and in foreign countries and the total revenues generated in Iraq and in foreign countries:

	<u>Iraq</u> <u>2005</u> <u>ID Million</u>	<u>Foreign</u> <u>Countries</u> <u>2005</u> <u>ID Million</u>	<u>Total</u> <u>2005</u> <u>ID Million</u>
Revenues	<u>283,000</u>	<u>430,574</u>	<u>713,574</u>
Total Assets	<u>9,272,756</u>	<u>16,411,644</u>	<u>25,684,400</u>
Total Liabilities	<u>22,130,324</u>	<u>16,901,891</u>	<u>39,032,215</u>

**34 RELATED PARTY TRANSACTIONS**

The CBI is a governmental entity and enters into transactions with Governmental banks, ministries and other governmental institutions in the ordinary course of business at commercial interest and commission rates. Transactions with related parties included in the balance sheet and income statement are as follows:

	<u>2005</u> <u>ID Million</u>
<b>ASSETS</b>	
Cash at local governmental banks	851
Due from Ministry of Finance	5,393,890
Due from a governmental bank (provided for during the year)	8,758
	<u>5,403,499</u>
<b>LIABILITIES</b>	
Governmental local banks reserves and deposits	5,927,624
Due to Ministry of Finance	4,493,015
Due to Governmental institutions	768,600
Loan from Al Rafidain Bank	9,375
	<u>11,198,614</u>
Off balance sheet commitments on behalf of Government of Iraq	<u>60,244,777</u>
Interest income from Ministry of Finance	<u>256,852</u>
Interest expenses on governmental banks deposits	<u>95,912</u>

NOTES TO THE FINANCIAL STATEMENTS

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**35 ACCOUNTS MANAGED ON BEHALF OF THE MOF**

The CBI maintains the cash payments and receipts records of the Development Fund for Iraq (DFI), which was established during May 2003 and recognized by the United Nations Security Council Resolution (UNSCR) 1483 (2003). The DFI's bank accounts are managed by the CBI on behalf of the MOF and included as part of the CBI's accounting records. As of December 31, 2005, the DFI accounts have been excluded from the CBI's financial statements, which resulted in un-reconciled difference of ID 156,028 million between the DFI assets balances and the related liability balances in the CBI records. This difference has been provided for in the accompanying financial statements.

In addition, the CBI maintains certain accounts related to the Memorandum of Understanding (MOU) signed on May 20, 1996 between the Secretariat of the United Nations and the Government of Iraq on the implementation of Security Council Resolution 986 (1995). As of December 31, 2005, the balances of the MOU accounts have been excluded from the CBI's financial statements, which resulted in un-reconciled difference of ID 1,103,708 million between the MOU assets balances and the related liability balances in the CBI records. This difference has been provided for in the financial statements (ID 1,009,253 during 2004 and ID 94,455 during 2005).

**36 COMMITMENTS AND CONTINGENT LIABILITIES**

***Credit-related commitments***

Credit-related commitments include standby letters of credit and guarantees which are designed to meet the requirements of the Iraqi ministries and other governmental institutions.

Letters of credit, guarantees (including standby letter of credit) and acceptances commit the CBI to make payments on behalf of the Iraqi ministries and other governmental institutions contingent upon the failure to perform under the terms of the contract.

There are outstanding off balance sheet balances of which the CBI is the guarantor of the debt, letters of credit and letters of guarantees of the CBI and the Iraqi ministries and other Governmental institutions. The off balance sheet accounting records are inaccurate and there are no sufficient evidence to support these accounts and to ensure the completeness and valuation of these balances. In addition, the effects of these off balance sheet accounts on the CBI's financial statements as of December 31, 2005, if any, are uncertain and the CBI's management could not quantify their effect at this stage.

The CBI has the following credit related commitments:

	<b>2005</b>
	<b><i>ID Million</i></b>
Commitments on behalf of Government of Iraq:	
Loans guaranteed by CBI	29,512,188
Letters of credit	2,388,478
Letters of guarantees and acceptance	5,369,958
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	<b>37,270,624</b>
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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2005

**36 COMMITMENTS AND CONTINGENT LIABILITIES (continued)**

***Contingent liabilities***

There are lawsuits in different countries against the CBI for the settlement of past due debt of the CBI, Iraqi ministries and other governmental institutions in the amount of ID 6,754,678 million.

Many of the lawsuits could be reconciled or settled under the Government of Iraq's External Debt Reconciliation Project. However, to the financial statements issuance date, there are no sufficient information regarding the balances that have been reconciled or settled as of December 31, 2005, and the balances that will be reconciled and settled subsequent to year end.

Due to the unavailability of sufficient information, the final outcome of these lawsuits and its effect on the CBI's financial statements, if any, is uncertain and could not be quantified and provided for as of December 31, 2005.