CENTRAL BANK OF IRAQ

Financial Statements

31 December 2013

(With Independent Auditors' Report Thereon)

CENTRAL BANK OF IRAQ

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Independent auditors' report

To the Ministry of Finance of Iraq and to the Governor of the Central Bank of Iraq (CBI)

We have audited the accompanying financial statements of Central Bank of Iraq (CBI), which comprise the statement of financial position as at 31 December 2013 and the statements of comprehensive income, changes in equity, and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

KPMG

Independent auditors' report (continued)

Basis for Qualified Opinion

1 As further explained in note (10) to the financial statements, the CBI's financial statements as at 31 December 2013 include old outstanding balances at foreign banks or transfers to the Federal Reserve Bank of New York in the amount of IQD 1,742,892 million (2012: IQD 1,736,474 million) which are fully provided for as at 31 December 2013 and 2012. In addition, during the years 2005, 2006 and 2007 the CBI wrote off balances at foreign banks totaling IQD 1,071,942 million. The provided for and the written off accounts include an amount of IQD 401,310 million as at 31 December 2013 (2012: IQD 401,310 million) that have been transferred from certain foreign banks to the Development Fund for Iraq (DFI) account as required by the United Nations Security Council Resolution (UNSCR) 1483 (2003). The Ministry of Finance (MOF) has not returned the funds to the CBI although a resolution has been issued by the Council of Ministers ordering the return of the funds to the CBI. During 2012, a letter was sent to the Council of Ministers again requesting the return of these funds from the MOF and in 2013 a letter was sent to the Ministry of Finance (MOF).

2 As further discussed in note (30) to the financial statements, there are lawsuits in different countries against the CBI for the settlement of past due debts of the CBI and other Iraqi governmental institutions amounting to IQD 1,317,881 million (2012: IQD 859,955 million). The final outcome of these lawsuits and the effects on the CBI's financial statements as at 31 December 2013, if any, is uncertain and has not been quantified and provided for. We did not receive confirmations from some of the 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 their effect on the financial statements as at 31 December 2013, if any.

Qualified Opinion

In our opinion, except for the possible effects of the matters described in the Basis for Qualified Opinion paragraphs, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2013, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of a Matter

As further explained in note (1) to the financial statements, currently the CBI does not control the financial and administrative affairs of its Erbil and Sulaimaniyah branches, as these branches are technically related to CBI, while for all other matters they are related to Kurdistan Regional Government (KRG) and their operations are financed by KRG. In addition, the CBI did not receive the financial statements of its branches in Sulaimaniyah and Erbil and does not have access to their accounting records. Therefore, the accompanying financial statements do not include the financial statements of Sulaimaniyah 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 at 31 December 2013.

KPMG

Baghdad - Iraq
31 July 2014

Central Bank of Iraq

Statement of financial position

As at 31 December

In millions of IQD	Note	2013	2012
Assets			
Gold reserve	8	1,903,205	1,860,236
Cash and balances with central banks	9	20,835,296	14,302,088
Balances with banks	10	14,059,312	10,469,338
Held to maturity investment securities	11	51,093,138	50,773,153
Due from Ministry of Finance	12	2,755,519	3,155,520
Foreign currencies investments at International Monetary Fund	13	3,944,023	4,140,272
Property and equipment	17	144,191	119,746
Other assets	14	420,666	421,854
Total Assets		95,155,350	85,242,207
Liabilities and equity			
Liabilities			
Currency issued	15	40,630,036	35,784,805
Treasury bills issued	16	943,166	745,471
Deposits of local and governmental banks	18	42,210,246	34,790,945
Due to foreign governments and banks	19	18,375	22,471
Due to International Monetary Fund	20	3,825,566	3,870,733
Balances due to governmental institutions	21	2,020,541	6,857,796
Other liabilities	22	44,862	36,762
Total liabilities		89,692,792	82,108,983
Equity			
Capital	23	100,000	100,000
General reserve	23	2,069,144	474,511
Emergency reserve	23	517,286	118,628
Revaluation of gold reserve	23	(85,890)	446,794
Retained earnings	23	2,862,018	1,993,291
Total equity		5,462,558	3,133,224
Total liabilities and equity		95,155,350	85,242,207

The notes on pages 7 to 38 are an integral part of these financial statements.

The financial statements were authorized for issue by the Governor of the Central Bank of Iraq on 22 July 2014.

Haifa Peter

Head of accounting department

Governor of the Central Bank of Iraq

Central Bank of Iraq

Statement of comprehensive income

For the year ended 31 December

In millions of IQD	Note	2013	2012
Revenues			
Interest income	24	443,901	552,120
Interest expense	25	(193,957)	(184,468)
Net interest income		249,944	367,652
Net fee and commission income	26	1,466,354	1,303,959
(Losses) gains on revaluation of gold reserves	23	(532,684)	98,001
Gain (loss) on translation of foreign currency		1,190,581	328,703
Effect of derecognition of foreign creditors balances	19	–	54,858
Other income		75,550	8,455
Profit from operations		2,449,745	2,161,628
Personnel expenses		(39,812)	(29,369)
Depreciation		(1,962)	(2,607)
General and administrative expenses		(78,637)	(38,361)
Profit for the year		2,329,334	2,091,291
Total comprehensive income for the year		2,329,334	2,091,291

The notes on pages 7 to 38 are an integral part of these financial statements.

Central Bank of Iraq

Statement of changes in equity

For the year ended 31 December

In millions of IQD	Notes	Capital	General reserve	Emergency reserve	Revaluation of gold reserve	Retained earnings	Total
Balance at 1 January 2012		100,000	–	–	348,793	593,140	1,041,933
Total comprehensive income for the year							
Profit for the year		–	–	–	–	2,091,291	2,091,291
Total comprehensive income for the year		–	–	–	–	2,091,291	2,091,291
Transfers							
Transfer to general reserve	23	–	474,511	–	–	(474,511)	–
Transfer to emergency reserve	23	–	–	118,628	–	(118,628)	–
Gain on revaluation of gold reserve	23	–	–	–	98,001	(98,001)	–
Total transfers		–	474,511	118,628	98,001	(691,140)	–
Balance at 31 December 2012		100,000	474,511	118,628	446,794	1,993,291	3,133,224
Balance at 1 January 2013		100,000	474,511	118,628	446,794	1,993,291	3,133,224
Total comprehensive income for the year							
Profit for the year		–	–	–	–	2,329,334	2,329,334
Total comprehensive income for the year		–	–	–	–	2,329,334	2,329,334
Transfers							
Transfer to general reserve	23	–	1,594,633	–	–	(1,594,633)	–
Transfer to emergency reserve	23	–	–	398,658	–	(398,658)	–
Losses on revaluation of gold reserve	23	–	–	–	(532,684)	532,684	–
Total transfers		–	1,594,633	398,658	(532,684)	(1,460,607)	–
Balance at 31 December 2013		100,000	2,069,144	517,286	(85,890)	2,862,018	5,462,558

The notes on pages 7 to 38 are an integral part of these financial statements.

Central Bank of Iraq

Statement of cash flows

For the year ended 31 December

In millions of IQD	**Notes**	**2013**	**2012**
Cash flows from operating activities			
Profit for the year		2,329,334	2,091,291
Adjustments for:			
Effect of derecognition of foreign creditors balances	19	–	(54,858)
Depreciation	17	1,962	2,607
(Losses) gains on revaluation of gold reserves	23	532,684	(98,001)
		2,863,980	1,941,039
Change in due from Ministry of Finance	12	400,001	406,022
Change in other assets	14	1,188	19,123
Change in currency issued	15	4,845,231	3,627,361
Change in deposits of local and governmental banks	18	7,419,301	2,306,565
Change in due to foreign governments and banks	19	(4,096)	27
Change in due to International Monetary Fund	20	(45,167)	(88,365)
Change in balances due to governmental institutions	21	(4,837,255)	571,042
Change in other liabilities	22	8,100	(1,532)
Net cash flows from operating activities		10,651,283	8,781,282
Cash flows from investing activities			
Held to maturity investment securities	11	(319,985)	(4,379,212)
Foreign currencies investments at IMF	13	196,249	21,403
Purchase of property and equipment	17	(26,407)	(35,865)
Purchase of gold	8	(575,653)	(1,413,426)
Net cash flows used in investing activities		(725,796)	(5,807,100)
Cash flows from financing activities			
Treasury bills issued	16	197,695	249,379
Net cash flows from financing activities		197,695	249,379
Net increase in cash and cash equivalents		10,123,182	3,223,561
Cash and cash equivalents as at 1 January		24,771,426	21,547,865
Cash and cash equivalents as at 31 December	27	34,894,608	24,771,426

The notes on pages 7 to 38 are an integral part of these financial statements.

(1) Activities

The Central Bank of Iraq ("CBI" - also referred to in these financial statements as "the Bank") 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 for 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 Sulaimaniyah. However, currently the CBI does not control the financial and administrative affairs of Erbil and Sulaimaniyah branches, as these branches are technically related to CBI, while for all other issues they are related to Kurdistan Regional Government (KRG) and they are financed by KRG.

As a result, the CBI does not have access to the accounting records of its Erbil and Sulaimaniyah branches. Therefore, these financial statements do not include the financial statements of Sulaimaniyah 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 at 31 December 2012 and 2013.

(2) Basis of preparation

a) Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS).

Details of the Bank’s accounting policies, including changes during the year, are included in Notes 3 and 4.

b) Basis of measurement

The financial statements have been prepared on the historical cost basis except for the gold which is measured at fair value.

(2) Basis of preparation (continued)

c) Functional and presentation currency

The financial statements are presented in Iraqi Dinar (IQD), which is the Bank's functional currency. All financial information presented in IQD has been rounded to the nearest million.

d) Use of estimates and judgements

The preparation of the financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to estimates are recognized prospectively.

(3) Changes in accounting policies

Except for the changes below, the Bank has consistently applied the accounting policies as set out in Note 4 to all years presented in these financial statements.

The Bank has adopted the following new standards and amendments to standards, with a date of initial application of 1 January 2013.

IFRS 13 Fair Value Measurement

In accordance with the transitional provisions of IFRS 13, the Bank has applied the new definition of fair value, as set out in Note 4, prospectively. The change had no significant impact on the measurements of the Bank's assets and liabilities, but the Bank has included new disclosures in the financial statements, which are required under IFRS 13. These new disclosure requirements are not included in the comparative information. However, to the extent that disclosures were required by other standards before the effective date of IFRS 13, the Bank has provided the relevant comparative disclosures under those standards.

(4) Significant accounting policies

Except for the changes explained in Note 3, the Bank has consistently applied the following accounting policies to all years presented in these financial statements.

a) Foreign currency transactions

Transactions in foreign currencies are translated to the functional currency of the Bank at the spot exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the spot exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the year, adjusted for effective interest and payments during the year, and the amortised cost in foreign currency translated at the spot exchange rate at the end of the year. Foreign currency differences arising on retranslation are recognized in profit or loss. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

(4) Significant accounting policies (continued)

b) Gold

Gold is stated on the basis of the price in London gold market (USD 1,201.5 per ounce) as at 31 December 2013. 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 prices are recorded in the statement of comprehensive income. The cumulative gain (loss) on the gold revaluation is then disclosed in a separate component in equity.

c) Financial assets and liabilities

Recognition

The Bank initially recognizes loans and advances, deposits and debt securities issued on the date that they are originated. All other financial instruments are recognized on the trade date at which the Bank becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is measured initially at fair value plus, for an item not at fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue.

Classification

Financial assets

The Bank classifies its financial assets in one of the following categories:

- loans and receivables;
- held to maturity;
- available-for-sale; or
- at fair value through profit or loss and within the category as :
  - held for trading or
  - designated at fair value through profit or loss

Financial liabilities

The Bank classifies its financial liabilities as measured at amortized cost.

Derecognition

Financial assets

The Bank derecognizes a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all the risks and rewards of ownership and it does not retain control of the financial asset. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Bank is recognized as a separate asset or liability in the statement of financial position.

(4) Significant accounting policies (continued)

c) Financial assets and liabilities (continued)

Derecognition (continued)

Financial assets (continued)

On derecognition of a financial asset, the difference between the carrying amount of the asset, and the sum of (1) the consideration received (including any new asset obtained less any new liability assumed) and (2) any cumulative gain or loss that had been recognized in other comprehensive income is recognized in profit or loss.

In transactions in which the Bank neither retains nor transfers substantially all the risks and rewards of ownership of a financial asset and it retains control over the asset, the Bank continues to recognize the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset.

In certain transactions, the Bank retains obligation to service the transferred financial asset for a fee. The transferred asset is derecognized if it meets the derecognition criteria. An asset or liability is recognized for the servicing contract, depending on whether the servicing fee is more than adequate (asset) or is less than adequate (liability) for performing the servicing.

Financial liabilities

The Bank derecognizes a financial liability when its contractual obligations are discharged or cancelled or expire.

Offsetting

Financial assets and liabilities are offset and the net amount is presented in the statement of financial position when, and only when, the Bank has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted under IFRS, or for gains and losses arising from a group of similar transactions such as in the Bank's trading activities.

Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognized and the maturity amount, minus any reduction for impairment.

Fair value measurement

Policy applicable from 1 January 2013

'Fair value' is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Bank has access at that date. The fair value of a liability reflects its non-performance risk.

(4) Significant accounting policies (continued)

c) Financial assets and liabilities (continued)

Fair value measurement (continued)

Policy applicable from 1 January 2013 (continued)

When available, the Bank measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

If there is no quoted price in an active market, then the Bank uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price – i.e. the fair value of the consideration given or received. If the Bank determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price. Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.

If an asset or a liability measured at fair value has a bid price and an ask price, then the Bank measures assets and long positions at a bid price and liabilities and short positions at an ask price

Portfolios of financial assets and financial liabilities that are exposed to market risk and credit risk that are managed by the Bank on the basis of the net exposure to either market or credit risk are measured on the basis of a price that would be received to sell a net long position (or paid to transfer a net short position) for a particular risk exposure. Those portfolio-level adjustments are allocated to the individual assets and liabilities on the basis of the relative risk adjustment of each of the individual instruments in the portfolio.

The fair value of a demand deposit is not less than the amount payable on demand, discounted from the first date on which the amount could be required to be paid.

The Bank recognises transfers between levels of the fair value hierarchy as of the end of the reporting period during which the change has occurred.

(4) Significant accounting policies (continued)

c) Financial assets and liabilities (continued)

Fair value measurement (continued)

Policy applicable before 1 January 2013

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date.

When available, the Bank measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

If a market for a financial instrument is not active, the Bank establishes fair value using a valuation technique. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates related to the Bank, incorporates all factors that market participants would consider in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments.

The best evidence of the fair value of a financial instruments at initial recognition is the transaction price, i.e. the fair value of the consideration given or received, unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable markets. When transaction price provides the best evidence of fair value at initial recognition, the financial instruments is initially measured at the transition price and any difference between this price and the value initially obtained from a valuation model is subsequently recognised in profit or loss on an appropriate basis over the life of the instrument but not later than when the valuation is supported wholly by observable market data or the transaction is closed out.

Any difference between the fair value at initial recognition and the amount that would be determined at that date using a valuation technique in a situation in which the valuation is dependent on unobservable parameters is not recognised in profit or loss immediately but is recognised over the life of the instrument on an appropriate basis or when the instrument is redeemed, transferred or sold, or the fair value becomes observable.

Identification and measurement of impairment

At each reporting date, the Bank assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. A Financial asset or a group of financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset(s), and that the loss event has an impact on the future cash flows on the asset(s) that can be estimated reliably.

Objective evidence that financial assets are impaired can include significant financial difficulty of the borrower or issuer, default or delinquency by a borrower, restructuring of a loan or advance by the Bank on terms that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group.

(4) Significant accounting policies (continued)

c) Financial assets and liabilities (continued)

Identification and measurement of impairment (continued)

Impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Impairment losses are recognized in profit or loss and reflected in an allowance account against loans and advances. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

d) Investment securities

Investment securities are initially measured at fair value plus, in case of investment securities not at fair value through profit or loss, incremental direct transaction costs, and subsequently accounted for depending on their classification as either held to maturity, fair value through profit or loss, or available for sale.

All the Bank's investment securities are classified as held to maturity.

Held-to-maturity

Held-to-maturity investments are non-derivative assets with fixed or determinable payments and fixed maturity that the Bank has the positive intent and ability to hold to maturity, and which are not designated as at fair value through profit or loss or as available for sale.

Held-to-maturity investments are carried at amortised cost using the effective interest method less any impairment losses. A sale or reclassification of a more than insignificant amount of held-to-maturity investments would result in the reclassification of all held-to-maturity investments as available for sale, and would prevent the Bank from classifying investment securities as held to maturity for the current and the following two financial years. However, sales and reclassifications in any of the following circumstances would not trigger a reclassification:

- Sales or reclassifications that are so close to maturity that changes in the market rate of interest would not have a significant effect on the financial asset's fair value;
- Sales or reclassifications after the Bank has collected substantially all of the asset's original principal; and
- Sales or reclassifications attributable to non-recurring isolated events beyond the Bank's control that could not have been reasonably anticipated.

e) Loans and due from banks

Loans and due from banks are financial assets with fixed or determinable payments that are not quoted in an active market or classified as financial assets held for sale or for trading or financial assets designated at fair value through profit or loss. After initial measurement, loans and amounts due from banks are subsequently measured at amortised cost using the effective interest method, less allowance for impairment. The amortisation is included in 'Interest and similar income' in the income statement. The losses arising from impairment are recognized in the income statement as credit loss expenses.

(4) Significant accounting policies (continued)

f) Interest

Interest income and expense are recognized in the profit or loss using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. When calculating the effective interest rate, the Bank estimates future cash flows considering all contractual terms of the financial instrument.

Interest income and expense presented in the statement of the comprehensive income include:

- Interest on treasury bills and bonds,
- Interest on due from banks and due from Ministry of Finance,
- Interest on treasury bills issued.

g) Fees and commissions

Fees and commission income, including account servicing fees, investment management fees, sales commission, placement fees and other finance fees on loans are recognized as the related services are performed.

Fees and commission expense relates mainly to transaction and service fees, which are expensed as the services are received.

h) Recognition of income

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured.

i) Local banks reserves and deposits

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

j) Due to foreign governments and banks

All due to foreign governments and banks balances are carried at cost less amounts repaid.

k) Cash and cash equivalents

Cash and cash equivalents include notes and coins on hand and highly liquid financial assets with original maturities of three months or less from the acquisition date that are subject to insignificant risk of changes in their fair value, and are used by the Bank in the management of its short-term commitments.

Cash and cash equivalents are carried at amortised cost in the statement of financial position.

l) Property and equipment

Recognition and measurement

Items of property and equipment are measured at cost less accumulated depreciation and accumulated impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

(4) Significant accounting policies (continued)

l) Property and equipment (continued)

Recognition and measurement (continued)

Gains and losses on disposal of an item of property and equipment are determined by comparing the proceeds from disposal with the carrying amount of property and equipment and are recognized net in profit or loss.

Subsequent costs

The cost of replacing a part of an item of property or equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Bank and its cost can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing of property and equipment are recognized in profit or loss as incurred.

Depreciation

Depreciation is based on the cost of an asset less its residual value. Depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property and equipment. Land is not depreciated.

The estimated useful lives for the current and comparative years are as follows:

•	Buildings	20 years
•	Vehicles	5 years
•	Furniture and other equipment	3 – 5 years

Depreciation methods, useful lives and residual values are reassessed at each financial year-end and adjusted if appropriate.

m) Impairment of non-financial assets

The carrying amounts of the Bank’s non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset’s recoverable amount is estimated.

An impairment loss is recognized if the carrying amount of an asset exceeds its recoverable amount. The recoverable amount of an asset is the greater of its value in use and its fair value less cost to sell. Impairment losses are recognized in profit or loss.

Impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset’s carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

(4) Significant accounting policies (continued)

n) Provisions

A provision is recognized if, as a result of a past event, the Bank has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by using management best estimates to the risk specific to the liability.

o) Fiduciary assets

Assets held in a fiduciary capacity are not reported in the financial statements, as they are not the assets of the Bank.

p) Issued currency

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

q) Taxes

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

r) Treasury bills issued

Subsequent to initial recognition, treasury bills issued are measured at their amortized cost using the effective interest method.

s) New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 1 January 2013, and have not been applied in preparing these financial statements. Those which may be relevant to the Bank are set out below. The Bank does not plan to adopt these standards early.

IFRS 9 Financial Instruments (2010) and IFRS 9 Financial Instruments (2009) (together IFRS 9)

IFRS 9 (2009) introduces new requirements for the classification and measurement of financial assets. IFRS 9 (2010) introduces additions relating to financial liabilities. The IASB currently has an active project to make limited amendments to the classification and measurement requirements of IFRS 9 and add new requirements to address the impairment of financial assets and hedge accounting.

The IFRS 9 (2009) requirements represent a significant change from the existing requirements in IAS 39 in respect of financial assets. The standard contains two primary measurement categories for financial assets: amortised cost and fair value. A financial asset would be measured at amortised cost if it is held within a business model whose objective is to hold assets in order to collect contractual cash flows, and the asset's contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding. All other financial assets would be measured at fair value.

(4) Significant accounting policies (continued)

s) New standards and interpretations not yet adopted (continued)

IFRS 9 Financial Instruments (2010) and IFRS 9 Financial Instruments (2009) (together IFRS 9) (continued)

The standard eliminates the existing IAS 39 categories of held to maturity, available-for-sale and loans and receivables. For an investment in an equity instrument which is not held for trading, the standard permits an irrevocable election, on initial recognition, on an individual share-by-share basis, to present all fair value changes from the investment in other comprehensive income. No amount recognised in other comprehensive income would ever be reclassified to profit or loss at a later date. However, dividends on such investments are recognised in profit or loss, rather than other comprehensive income unless they clearly represent a partial recovery of the cost of the investment. Investments in equity instruments in respect of which an entity does not elect to present fair value changes in other comprehensive income would be measured at fair value with changes in fair value recognised in profit or loss.

The standard requires that derivatives embedded in contracts with a host that is a financial asset within the scope of the standard are not separated; instead the hybrid financial instrument is assessed in its entirety as to whether it should be measured at amortised cost or fair value.

IFRS 9 (2010) introduces a new requirement in respect of financial liabilities designated under the fair value option to generally present fair value changes that are attributable to the liability's credit risk in other comprehensive income rather than in profit or loss. Apart from this change, IFRS 9 (2010) largely carries forward without substantive amendment the guidance on classification and measurement of financial liabilities from IAS 39.

IFRS 9 is effective for annual periods beginning on or after 1 January 2015 with early adoption permitted. The IASB decided to consider making limited amendments to IFRS 9 to address practice and other issues.

Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)

The amendments to IAS 32 clarify the offsetting criteria in IAS 32 by explaining when an entity currently has a legally enforceable right to set-off and when gross settlement is equivalent to net settlement. The amendments are effective for annual periods beginning on or after 1 January 2014. Earlier application is permitted.

(5) Financial risk management

Introduction and overview

The Bank has exposure to the following risks from its use of financial instruments:

- Credit risk
- Liquidity risk
- Market risks

This note presents information about the Bank's exposure to each of the above risks, the Bank's objectives, policies and processes for measuring and managing risk, and the Bank's management of capital.

Risk management framework

During the year 2011 the Bank established a risk management unit that manages the CBI's operational and financial risks which the CBI is to a certain extent exposed to. A detailed risk management program was developed. This program includes a general risk management framework which involves identifying, analyzing, measuring, evaluating and monitoring risk, evaluating performance, and monitoring the compliance with the limits and standards set for the risks. The Bank also has drafted procedures to deal with financial risks represented by investment guidelines issued by the board of directors which sets limits and standards for dealing with these risks and allows the management of these risks within the limits and levels set forth in these principle guidelines, as well as monitoring cases of exposure to risk to determine if that exposure extends beyond the acceptable limits. For the purpose of assessing the strengths and weaknesses in performances, the standards set by the risk management unit for dealing with operational and financial risks faced by the Bank, are reviewed on a regular basis according to the prevailing macroeconomic conditions and the possible effects of financial and macroeconomic shocks, and corrective measures are taken to mitigate these effects.

a) Credit risk

Credit risk is the risk that the Bank will incur a loss because any of the Bank's counterparties fail to discharge their contractual obligations. The maximum exposure to credit risk without taking into account any collateral or other credit enhancements is as per the schedule below:

In millions of IQD		**Gross maximum exposure**	
		2013	**2012**
Balances with central banks	9	15,490,579	11,991,966
Balances with banks	10	14,059,312	10,469,338
Held to maturity investment securities	11	51,093,138	50,773,153
Due from Ministry of Finance	12	2,755,519	3,155,520
Foreign currencies investments at International Monetary Fund	13	3,944,023	4,140,272
Other assets	14	420,666	421,854
Total credit risk exposure		87,763,237	80,952,103

(5) Financial risk management (continued)

a) Credit risk (continued)

- Balances with foreign banks: the CBI is exposed to credit risk related to deposits with foreign banks including correspondent banks which are selected based on their credit ratings set by the credit rating agencies S&P or Moody’s for investor services. The Board of Directors therefore sets limits as per the credit ratings that the Bank has exposure on, where deposits are not made with foreign banks with a credit rating below AA-. The ratings of these banks are monitored; and in any instance of deviation from the set limits, a report is submitted to the investment committee for corrective measures to be taken.

  The schedule below presents the credit ratings of the central banks the CBI has credit exposure to according to Moody’s or S&P credit rating agency:

	Credit rating as at 31 December 2013	
Country	**Moody's**	**S&P**
United States	Aaa	AA+
England	Aaa	AAA
Netherlands	Aa	AA
France	Aa1	AA+
Italy	Baa2	BBB

- Investment securities: the CBI relies on long term credit ratings from Standard and Poors and Moody’s. According to risk management policy, the qualified party issuing securities to the CBI must fall above a credit rating of AA – given by these two institutions. The credit ratings are monitored on a daily basis by the risk management department to check that the Bank’s investments are within the set criteria.

  The credit ratings for the treasury securities that are held by the Bank for 2013 are as follows according to Moody’s and S&P credit rating agency:

	Credit rating as at 31 December 2013	
Country	**Moody's**	**S&P**
United States	Aaa	AA+
Netherlands	Aa	AA
France	Aa1	AA+
Italy	Baa2	BBB

- Local banks: the CBI provides 3 types of banking facilities to the local banks that are experiencing liquidity shortages, and they are the following:

  - Primary credit facilities
  - Secondary credit facilities
  - Last resort facilities

(5) Financial risk management (continued)

a) Credit risk (continued)

- In order to hedge the risk of defaulting on payment, the Bank imposes the following conditions to reduce the likelihood of this type of risk:
  - Submitting real estate or securities as collateral
  - The maximum loan period is 90 days
  - In case a bank requests the last resort loan, the Ministry of Finance needs to guarantee the payment in case the bank defaults.

Concentration arises when a number of counterparties which are engaged in similar business activities, or activities in the same geographic region, or when they have similar economic features and for which have an impact on their ability to meet contractual obligations in case they are faced by changes in economic, political or other conditions. Concentration indicates the relative sensitivity of the Bank's performance towards the developments affecting a particular industry or geographic location.

In order to avoid concentration risk, the CBI has diversified its risk by investing in several foreign banks as follows:

In millions of IQD	**2013**	**2012**
France	8,566,552	7,801,701
Italy	3,681,935	4,803,059
England	4,387,646	2,654,861
Netherlands	6,918,721	6,562,647
United States of America	43,027,680	40,941,670
Other countries	14,060,495	10,470,519
	80,643,029	73,234,457

Impaired loans and advances

Impaired loans are loans and advances for which the Bank determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loan. Interest on the impaired loans is suspended and a provision for impairment loss is recognized in the income statement according to management best estimates taking into consideration collaterals if any.

Allowances for impairment

In order to reduce credit risk, the CBI establishes an allowance for impairment losses on its doubtful loans and frozen deposits, especially balances with local and foreign banks which suffer from liquidity problems. The CBI has fully provided for its impaired loans which amount to IQD 1,749,657 million in 2013 (2012: IQD 1,743,090 million).

Write-off policy

The Bank writes off a loan or an investment in a debt security balance and any related allowances for impairment losses, when the Bank determines that the loan or security is uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower's financial position such that the borrower can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

(5) Financial risk management (continued)

b) Liquidity risk

Liquidity risk is the risk that the CBI will be unable to meet its liabilities when they fall due. In extreme circumstances, lack of liquidity could result in reductions in the balance sheet and sales of assets, or potentially an inability to fulfill lending commitments. The risk that the Bank will be unable to do so is inherent in all banking operations and can be affected by a range of institution-specific and market-wide events including, but not limited to, credit events, merger and acquisition activity, systemic shocks and natural disasters.

The CBI takes into consideration the following criteria to avoid those risks:

- The party issuing securities is rated AA- or above.
- The extent of the financial instruments to be easily liquidated without incurring loss on the investment.
- The term of the deposits does not exceed six months.
- The value of reserves invested in term deposits for each bank must not exceed USD 10 billion.

c) Market risk

Market risk is the risk that changes in market prices, such as interest rates, equity prices, foreign exchange rates will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk.

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. In order to avoid this risk, the CBI depends on diversifying its foreign currency reserves according to best international practices and standards in this field that define the limits and parameters for each currency reserve and the weight of each major currency in the global economy.

The risk management department and investment committee review these components and weights to measure deviations from the basic standards for currencies and take the required corrective measures to return to the basic standards. The Bank's weighted currency asset portfolio consists of the following:

Currency	**Weight**
Iraqi Dinar	3.51
US Dollar	64.70
Euro	19.83
Others	7.81
Special Drawing Rights	4.14

(5) Financial risk management (continued)

c) Market risk (continued)

Currency risk (continued)

Below is the Bank’s statement of financial position by currency:

31 December 2013 *In millions of IQD*	**IQD**	**USD**	**EUR**	**Others**	**SDR**	**Total**
Assets						
Gold reserve	–	1,903,205	–	–	–	1,903,205
Cash and balances with banks	22,433	26,907,123	534,597	7,430,455	–	34,894,608
Held to maturity investment securities	–	32,759,448	18,333,690	–	–	51,093,138
Due from Ministry of Finance	2,755,519	–	–	–	–	2,755,519
Foreign currencies investments at IMF	–	–	–	–	3,944,023	3,944,023
Property and equipment	144,191	–	–	–	–	144,191
Other assets	420,666	–	–	–	–	420,666
Total assets	3,342,809	61,569,776	18,868,287	7,430,455	3,944,023	95,155,350
Liabilities and equity						
Currency issued	40,630,036	–	–	–	–	40,630,036
Treasury bills issued	943,166	–	–	–	–	943,166
Deposits of local and governmental banks	36,689,504	5,520,742	–	–	–	42,210,246
Due to foreign governments and banks	18,375	–	–	–	–	18,375
Due to International Monetary Fund	–	–	–	–	3,825,566	3,825,566
Balances due to governmental institutions	1,911,231	109,284	26	–	–	2,020,541
Other liabilities	44,862	–	–	–	–	44,862
Equity	5,462,558	–	–	–	–	5,462,558
Total liabilities and equity	85,699,732	5,630,026	26	–	3,825,566	95,155,350
Net	(82,356,923)	55,939,750	18,868,261	7,430,455	118,457	–

(5) Financial risk management (continued)

c) Market risk (continued)

Currency risk (continued)

31 December 2012 *In millions of IQD*	**IQD**	**USD**	**EUR**	**Others**	**SDR**	**Total**
Assets						
Gold reserve	–	1,860,236	–	–	–	1,860,236
Cash and balances with banks	33,197	17,833,811	1,279,609	5,624,809	–	24,771,426
Held to maturity investment securities	–	32,883,626	17,889,527	–	–	50,773,153
Due from Ministry of Finance	3,155,520	–	–	–	–	3,155,520
Foreign currencies investments at IMF	–	–	–	–	4,140,272	4,140,272
Property and equipment	119,746	–	–	–	–	119,746
Other assets	421,854	–	–	–	–	421,854
Total assets	3,730,317	52,577,673	19,169,136	5,624,809	4,140,272	85,242,207
Liabilities and equity						
Currency issued	35,784,805	–	–	–	–	35,784,805
Treasury bills issued	745,471	–	–	–	–	745,471
Deposits of local and governmental banks	31,353,560	3,437,385	–	–	–	34,790,945
Due to foreign governments and banks	22,471	–	–	–	–	22,471
Due to International Monetary Fund	–	–	–	–	3,870,733	3,870,733
Balances due to governmental institutions	5,609,084	1,248,712	–	–	–	6,857,796
Other liabilities	36,762	–	–	–	–	36,762
Equity	3,133,224	–	–	–	–	3,133,224
Total liabilities and equity	76,685,377	4,686,097	–	–	3,870,733	85,242,207
Net	(72,955,060)	47,891,576	19,169,136	5,624,809	269,539	–

Central Bank of Iraq

Notes to the financial statements

31 December 2013

(5) Financial risk management (continued)

c) Market risk (continued)

Interest rate risk

Following are the interest rate gaps as at 31 December 2013:

In millions of IQD	Less than month	1 month to 3 months	3 months to 6 months	6 months to 1 year	More than 1 year	Non interest items	Total
Assets							
Gold reserve	–	–	–	–	–	1,903,205	1,903,205
Cash and balances with central banks	15,490,579	–	–	–	–	5,344,717	20,835,296
Balances with banks	14,059,312	–	–	–	–	–	14,059,312
Held to maturity investment securities	–	–	29,959,601	–	21,133,537	–	51,093,138
Due from Ministry of Finance	–	100,000	100,000	200,000	2,355,519	–	2,755,519
Foreign currencies investments at IMF	–	–	–	–	3,944,023	–	3,944,023
Property and equipment	–	–	–	–	–	144,191	144,191
Other assets	–	–	–	–	–	420,666	420,666
Total Assets	29,549,891	100,000	30,059,601	200,000	27,433,079	7,812,779	95,155,350
Liabilities							
Currency issued	–	–	–	–	–	40,630,036	40,630,036
Treasury bills issued	–	943,166	–	–	–	–	943,166
Deposits of local and governmental banks	3,134,180	–	–	–	–	39,076,066	42,210,246
Due to foreign governments and banks	–	–	–	–	–	18,375	18,375
Due to International Monetary Fund	–	1,783,175	–	–	–	2,042,391	3,825,566
Balances due to governmental institutions	–	–	–	–	–	2,020,541	2,020,541
Other liabilities	–	–	–	–	–	44,862	44,862
Total liabilities	3,134,180	2,726,341	–	–	–	83,832,271	89,692,792
Total equity	–	–	–	–	–	5,462,558	5,462,558
Total liabilities and equity	3,134,180	2,726,341	–	–	–	89,294,829	95,155,350
Interest rate sensitivity gap	26,415,711	(2,626,341)	30,059,601	200,000	27,433,079	(81,482,050)	–
Cumulative gap	26,415,711	23,789,370	53,848,971	54,048,971	81,482,050	–	–

(5) Financial risk management (continued)

c) Market risk (continued)

Interest rate risk (continued)

Following are the interest rate gaps as at 31 December 2012:

In millions of IQD	Less than month	1 month to 3 months	3 months to 6 months	6 months to 1 year	More than 1 year	Non interest items	Total
Assets							
Gold reserve	–	–	–	–	–	1,860,236	1,860,236
Cash and balances with central banks	11,991,966	–	–	–	–	2,310,122	14,302,088
Balances with banks	10,469,338	–	–	–	–	–	10,469,338
Held to maturity investment securities	–	–	32,883,626	–	17,889,527	–	50,773,153
Due from Ministry of Finance	–	100,000	100,000	200,000	2,755,520	–	3,155,520
Foreign currencies investments at IMF	–	–	–	–	4,140,272	–	4,140,272
Property and equipment	–	–	–	–	–	119,746	119,746
Other assets	–	–	–	–	–	421,854	421,854
Total Assets	22,461,304	100,000	32,983,626	200,000	24,785,319	4,711,958	85,242,207
Liabilities							
Currency issued	–	–	–	–	–	35,784,805	35,784,805
Treasury bills issued	–	745,471	–	–	–	–	745,471
Deposits of local and governmental banks	3,114,670	–	–	–	–	31,676,275	34,790,945
Due to foreign governments and banks	–	–	–	–	–	22,471	22,471
Due to International Monetary Fund	–	1,832,271	–	–	–	2,038,462	3,870,733
Balances due to governmental institutions	–	–	–	–	–	6,857,796	6,857,796
Other liabilities	–	–	–	–	–	36,762	36,762
Total liabilities	3,114,670	2,577,742	–	–	–	76,416,571	82,108,983
Total equity	–	–	–	–	–	3,133,224	3,133,224
Total liabilities and equity	3,114,670	2,577,742	–	–	–	79,549,795	85,242,207
Interest rate sensitivity gap	19,346,634	(2,477,742)	32,983,626	200,000	24,785,319	(74,837,837)	–
Cumulative gap	19,346,634	16,868,892	49,852,518	50,052,518	74,837,837	–	–

(5) Financial risk management (continued)

Market risk (continued)

Interest rate risk (continued)

The main objective behind managing interest rate risk is limiting the potential adverse effects on net interest revenue, future cash flows, and fair values of financial instruments resulting from fluctuations in market interest rates. The principal risk to which non-trading portfolios are exposed to is the risk of loss from fluctuations in the future cash flows or fair values of financial instruments because of a change in market interest rates. Interest rate risk is managed by the risk management department principally through monitoring interest rate gaps and by having pre-approved limits for repricing bands.

(6) Use of estimates and judgments

The preparation of the financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Management is responsible for the development, selection and disclosure of the Bank's critical accounting policies and estimates, and the application of these policies and estimates. These disclosures supplement the commentary on financial risk management (see note 4).

Impairment of financial instruments

Assets accounted for at amortised cost are evaluated for impairment on the basis described in accounting policy 4(c).

The specific counterparty component of the total allowances for impairment applies to financial assets evaluated individually for impairment and is based upon management's best estimate of the present value of cash flows that are expected to be received. In estimating these cash flows, management makes judgements about a counterparty's financial situation and the net realizable value of any underlying collateral. Each impaired asset is assessed on its merits, and the workout strategy and estimate of amounts considered recoverable.

(7) Fair value of financial instruments

The fair values of financial assets and financial liabilities that are traded in active markets are based on quoted market prices or dealer price quotations. For all other financial instruments, the Bank determines fair values using other valuation techniques.

For financial instruments that trade infrequently and have little price transparency, fair value is less objective, and requires varying degrees of judgment depending on liquidity, concentration uncertainty of market factors, pricing assumptions and other risks affecting the specific instrument.

(7) Fair value of financial instruments (continued)

a) Valuation models

The Bank measures fair values using the following fair value hierarchy, which reflects the significance of the inputs used in making the measurements.

- Level 1: inputs that are quoted market prices (unadjusted) in active markets for identical instruments.

- Level 2: inputs other than quoted prices included within Level 1 that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques in which all significant inputs are directly or indirectly observable from market data.

- Level 3: inputs that are unobservable. This category includes all instruments for which the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Valuation techniques include net present value and discounted cash flow models, comparison with similar instruments for which market observable prices exist. Assumptions and inputs used in valuation techniques include risk-free and benchmark interest rates, bond and equity prices and foreign currency exchange rates.

The objective of valuation techniques is to arrive at a fair value measurment that reflects the price that would be received to sell the asset or paid to transfer the liability in an orderly transaction between market participants at the measurement date.

The Bank uses widely recognised valuation models for determining the fair value of common and more simple financial instruments, like interest rate and currency swaps that use only observable market data and require little management judgment and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity security exchange-traded derivatives and simple over the counter derivatives such as interest rate swaps. Availability of observable market prices and model inputs reduces the need for management judgement and estimation and also reduces the uncertainty associated with determining fair values. Availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

(7) Fair value of financial instruments (continued)

b) Financial instruments not measured at fair value

The following table sets out the fair values of financial instruments not measured at fair value and analyses them by the level in the fair value hierarchy into which each fair value measurements is categorized.

In millions of IQD	Note	Level 1	Level 2	Level 3	Total fair values	Total carrying amount
		31 December 2013				
Assets						
Cash and balances with central banks	9	–	20,835,296	–	20,835,296	20,835,296
Balances with banks	10	–	14,059,312	–	14,059,312	14,059,312
Held to maturity investment securities	11	51,337,825	–	–	51,337,825	51,093,138
Due from Ministry of Finance	12	–	2,755,519		2,755,519	2,755,519
Foreign currencies investments at IMF	13	–	3,944,023	–	3,944,023	3,944,023
		51,337,825	41,594,150	–	92,931,975	92,687,288
Liabilities						
Currency issued	15	–	40,630,036	–	40,630,036	40,630,036
Treasury bills issued	16	–	943,166	–	943,166	943,166
Deposits of local and governmental banks	18	–	42,210,246	–	42,210,246	42,210,246
Due to foreign governments and banks	19	–	18,375	–	18,375	18,375
Due to International Monetary Fund	20	–	3,825,566	–	3,825,566	3,825,566
Balances due to governmental institutions	21	–	2,020,541	–	2,020,541	2,020,541
		–	89,647,930	–	89,647,930	89,647,930

(8) Gold reserve

In millions of IQD	**2013**	**2012**
Gold reserve in CBI vault	192,491	266,588
Gold reserve abroad	1,709,234	1,591,598
Gold coins at CBI vault	1,480	2,050
	1,903,205	1,860,236

During December 2013, the CBI purchased 399,737 Ounces from Banque De France amounting to USD 493,698,555 equivalent to IQD 575,653 million.

(9) Cash and balances with central banks

In millions of IQD	**2013**	**2012**
Cash on hand	5,344,717	2,310,122
Current account with Federal Reserve Bank of New York	(83,127)	(1,584,516)
Time deposits with Federal Reserve Bank of New York	10,351,359	9,642,560
Current account with Central Bank of United Arab Emirates	1,183	1,181
Current account with Banque De France	303,171	6,723
Current account with Banca D'Italia	548	1,553
Time deposits with Bank of England	4,387,646	2,654,861
Time deposits with Banca D'Italia	529,246	1,113,926
Current account with De Nederlandsche Bank N.V.	553	155,678
	20,835,296	14,302,088

(10) Balances with banks

In millions of IQD	**Note**	**2013**	**2012**
Current accounts with local banks		22,433	33,198
Due from governmental banks	28	6,765	6,616
Current accounts with foreign banks		11,456	70,018
Time deposits with foreign banks		14,025,423	10,366,122
Frozen deposits with foreign banks		1,742,892	1,736,474
		15,808,969	12,212,428
Allowance for impairment losses of due from governmental banks	28	(6,765)	(6,616)
Allowance for impairment losses of frozen deposits with foreign banks		(1,742,892)	(1,736,474)
		14,059,312	10,469,338

(10) Balances with banks (continued)

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

On November 22, 2005, the Iraqi Council of Ministers 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 as required by UNSC Resolution number 1483 (2003). As of the date the financial statements were authorized for issuance, the MOF has not confirmed the amounts of IQD 401,310 million, equivalent to US Dollar 343 million (2012: IQD 401,310 million, equivalent to US Dollar 343 million) 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 at 31 December 2013.

(11) Held to maturity investment securities

In millions of IQD	**2013**	**2012**
Federal Reserve Bank of New York	32,764,600	32,895,075
Unamortized discount	(5,152)	(11,449)
	32,759,448	32,883,626
Banque De France - Bills and bonds	8,263,381	7,794,978
Banca D'Italia - Bonds	3,152,141	3,687,580
De Nederlandsche Bank N.V. - Bonds	6,918,168	6,406,969
	51,093,138	50,773,153

(12) Due from Ministry of Finance

In millions of IQD	**Note**	**2013**	**2012**
Due from Ministry of Finance	28	2,755,519	3,155,520

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

The MOF shall 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.

(12) Due from Ministry of Finance (continued)

The MOF did not settle installments related to the year 2008 that should be settled and paid to the CBI in 2009 amounting to IQD 719,184 million. On 24 December 2009, the CBI and the MOF agreed to reschedule the remaining balance due to the CBI, amounting to IQD 3,955,519 and to start making payments to the CBI from 1 March 2011, through equal quarterly installments of IQD 100,000 million each. During the years 2011, 2012 and 2013, twelve installments were paid amounting to IQD 1,200,000 million.

(13) Foreign currencies investments at International Monetary Fund

	2013		2012	
	SDR	**IQD Million**	**SDR**	**IQD Million**
International Monetary Fund Quota Subscription	1,184,000,000	2,133,939	1,184,000,000	2,129,671
Special Drawing Rights Holdings with IMF	1,008,044,121	1,810,084	1,121,956,716	2,010,601
	2,192,044,121	3,944,023	2,305,956,716	4,140,272

(14) Other assets

In millions of IQD	**2013**	**2012**
Interest receivable	337,695	348,395
Loans to employees	82,863	73,241
Others	108	218
	420,666	421,854

(15) Currency issued

In millions of IQD	**2013**	**2012**
Banknotes	40,630,036	35,784,805

(16) Treasury bills issued

In millions of IQD	**2013**	**2012**
Face value	949,080	750,040
Unamortized discount	(5,914)	(4,569)
	943,166	745,471

The discounted treasury bills are auctioned off to local banks with interest rates that range between 3.8% and 8.9% (2012: interest rates range between 4.5% and 6%) in accordance with the instructions issued by CBI.

Treasury bills are issued with original maturity of three months. Total treasury bills issued during the year 2013 amounted to IQD 3,307,130 million (2012: IQD 3,900,330 million). The purpose of issuing these Treasury bills is to ensure that proper control over market liquidity is maintained.

(17) Property and equipment

In millions of IQD	Land	Buildings	Fixtures and fittings	Vehicles	Building Under construction	Total
Cost						
Balance at 1 January 2012	75,993	2,771	8,746	4,101	2,021	93,632
Additions	–	–	13,527	141	22,197	35,865
Balance at 31 December 2012	75,993	2,771	22,273	4,242	24,218	129,497
Balance at 1 January 2013	75,993	2,771	22,273	4,242	24,218	129,497
Additions	–	50	903	12	25,442	26,407
Balance at 31 December 2013	75,993	2,821	23,176	4,254	49,660	155,904
Depreciation						
Balance at 1 January 2012	–	(532)	(4,164)	(2,447)	–	(7,143)
Depreciation for year 2011 (prior year adjustment)	–	–	(8)	(140)	–	(148)
Depreciation for year 2012	–	(139)	(1,670)	(651)	–	(2,460)
Balance at 31 December 2012	–	(671)	(5,842)	(3,238)	–	(9,751)
Balance at 1 January 2013	–	(671)	(5,842)	(3,238)	–	(9,751)
Depreciation for year 2013	–	(141)	(1,256)	(565)	–	(1,962)
Balance at 31 December 2013	–	(812)	(7,098)	(3,803)	–	(11,713)
Carrying amounts						
At 1 January 2012	75,993	2,239	4,582	1,654	2,021	86,489
At 31 December 2012	75,993	2,100	16,431	1,004	24,218	119,746
At 1 January 2013	75,993	2,100	16,431	1,004	24,218	119,746
At 31 December 2013	75,993	2,009	16,078	451	49,660	144,191

(18) Deposits of local and governmental banks

In millions of IQD	**2013**	**2012**
Current accounts	39,052,435	31,652,644
Time deposits	3,134,180	3,114,670
Others	23,631	23,631
	42,210,246	34,790,945

According to the CBI regulations, all banks operating in Iraq should maintain a compulsory reserve at the CBI equivalent to 10% of total customers' deposits in Iraqi Dinar and 15% of total customers' deposits in foreign currencies and to keep cash in their books equivalent to 5% of total customers' deposits in Iraqi Dinar. Compulsory reserve represents a non-interest bearing liability.

The deposits of local banks as at 31 December 2013 includes compulsory reserve in IQD deposited in the CBI amounted to IQD 5,454,147 million (2012: IQD 4,623,497 million) and a balance in USD amounted to USD 1,214,908,484 equivalent to IQD 1,416,583 million (2012: balance in USD amounted to USD 1,427,467,760 equivalent to IQD 1,664,427 million).

(19) Due to foreign governments and banks

In millions of IQD	2013	2012
Due to foreign governments and financial institutions *	9	9
Overdraft accounts *	13,839	18,216
Balances for international institutions	4,527	4,246
	18,375	22,471

* During years 2007 to 2012 the CBI resolved to derecognize certain old outstanding balances due to foreign governments and banks in its records. In 2012, the CBI has recognized revenue amounting to IQD 54,858 million as a result of derecognition. The CBI believes that these balances are the liability of the Ministry of Finance as part of the Iraqi sovereign debt and the Ministry of Finance confirmed the relief of the CBI from all these liabilities.

(20) Due to International Monetary Fund

	2013		2012	
	SDR	IQD Million	SDR	IQD Million
SDR allocations	1,134,495,508	2,037,146	1,134,495,508	2,033,072
IMF securities	1,014,329,000	1,783,175	1,014,329,000	1,832,271
Currency Holdings:				
IMF no. 1 account including currency valuation adjustments	2,971,000	5,223	2,971,000	5,367
IMF no. 2 account including currency valuation adjustments	12,580	22	12,580	23
	2,151,808,088	3,825,566	2,151,808,088	3,870,733

The balance of Special Drawing Rights (SDR) 1,134,495,508 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.

(21) Balances due to governmental institutions

In millions of IQD	Note	2013	2012
Due to Ministry of Finance		1,042,718	5,262,158
Due to other governmental institutions		962,519	1,516,141
Due to Sulaimaniyah and Erbil branches		15,304	25,445
Others		–	54,052
	28	2,020,541	6,857,796

(22) Other liabilities

In millions of IQD	**2013**	**2012**
Interest payable	9,883	8,293
Accounts payable	8,905	2,881
Suspense balances *	(1,029)	8,006
Others	27,103	17,582
	44,862	36,762

* These balances represent liability balances that have not been reconciled as at 31 December 2013. The effects of the reconciliation of these balances on the financial statements have not been determined as at 31 December 2013.

(23) Equity

In millions of IQD	**2013**	**2012**
Capital (a)	100,000	100,000
General reserve (b)	2,069,144	474,511
Emergency reserve (b)	517,286	118,628
Revaluation of gold reserve (c)	(85,890)	446,794
Retained earnings (d)	2,862,018	1,993,291
	5,462,558	3,133,224

a) Capital

According to Article 5 of the Central Bank of Iraq Law of 2004, the authorized capital of the CBI shall be IQD 100,000 million 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 and shall not pay any dividend and shall not be transferable nor be subject to any encumbrances.

b) 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 as may be appropriate under international accounting standards.

c) Revaluation of gold reserve

In millions of IQD	**2013**	**2012**
Revaluation of gold reserve, beginning of year	446,794	348,793
(Losses) gains on revaluation of gold reserves	(532,684)	98,001
Revaluation of gold reserve, end of year	(85,890)	446,794

(23) Equity (continued)

d) Retained earnings

Within three months after the end of each financial year, the CBI shall determine its net profits available for distribution or its net losses. 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 Capital.

In a period of three months after the end of each financial year, the Board shall distribute the net profits available for distribution as follows:

- 80 percent of any profits available for distribution shall be transferred to the general reserve account until this reserve reaches a sum equal to 10% of the total assets of the CBI;
- Any remaining net profits available for distribution shall be transferred to emergency reserve.

On 5 October 2013, the CBI's Board of directors decided to allocate the retained earnings as at 31 December 2012 which amounted to IQD 1,993,291 million to the general reserve and emergency reserves accounts.

(24) Interest income

In millions of IQD	**Note**	**2013**	**2012**
Treasury bills and bonds		218,687	312,935
Due from banks		53,106	55,312
Due from Ministry of Finance	28	150,228	172,196
Overnight deposits		4,385	8,296
Others		17,495	3,381
		443,901	552,120

(25) Interest expense

In millions of IQD	**Note**	**2013**	**2012**
Local and governmental banks deposits	28	130,814	107,965
Treasury bills issued		39,676	47,783
Others		23,467	28,720
		193,957	184,468

(26) Net fee and commission income

In millions of IQD	**2013**	**2012**
Fee and commission income	1,468,447	1,306,436
Fee and commission expense	(2,093)	(2,477)
	1,466,354	1,303,959

Fee and commission income for the year 2013 includes the commission income of IQD 734,580 million (2012: IQD 652,960 million) earned from the transfers transactions ordered by the Ministry of Finance from the Development Fund of Iraq account (see note 28). The CBI buys the dollars from the Ministry of Finance with a commission equivalent to 1% of the exchange rate applied to translate the amounts ordered into Iraqi Dinar.

(27) Cash and cash equivalents

In millions of IQD	**2013**	**2012**
Cash and balances with central banks	20,835,296	14,302,088
Current accounts with foreign banks	11,456	70,018
Current accounts with local banks	22,433	33,198
Time deposits with foreign banks	14,025,423	10,366,122
	34,894,608	24,771,426

(28) 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 statement of financial position and income statement are as follows:

In millions of IQD	**Note**	**2013**	**2012**
(A) Assets			
Due from Ministry of Finance	12	2,755,519	3,155,520
Due from governmental banks	10	6,765	6,616
Allowance for impairment losses of due from governmental banks	10	(6,765)	(6,616)
		2,755,519	3,155,520
(B) Liabilities			
Deposits of governmental banks	18	36,353,886	29,760,382
Balances due to governmental institutions	21	2,020,541	6,857,796
		38,374,427	36,618,178
(C) Related party transactions			
Interest income from Ministry of Finance	24	150,228	172,196
Interest expenses on governmental banks deposits	25	68,455	77,593
Fee and commission income from Ministry of Finance	26	734,580	652,960

(29) 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 Ministry of Finance (MOF). As at 31 December 2007 the DFI accounts have been excluded from the CBI's financial statements, which resulted in un-reconciled debit difference of IQD 11,823 million between the DFI assets balances and the related liability balances in the CBI records. This difference has been provided for in the CBI's financial statements and an audit has been performed in the later years for the difference to become USD 4,623,657.

(30) Commitments and 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 for the amount of IQD 1,317,881 million as at 31 December 2013 (2012: IQD 859,955 million).

Many of the lawsuits may relate to debts 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 /settled or exempted as at 31 December 2013, 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 at 31 December 2013.

(31) Off-balance sheet

The Central Bank of Iraq, in its role as the banker of the Ministry of Finance and the fiscal agent of the Government of Iraq, as stipulated in the Central Bank Law of Iraq (Article 4, section 1.d), holds promissory notes in its off balance sheet amounting to IQD 1,685,025 million (2012: IQD 1,932,040 million), which represent the International Monetary Fund financing to Iraq for budget support and therefore for the use of the Ministry of Finance.

(32) Financial assets and liabilities

The table below sets out the carrying amounts and fair values of the Bank's financial assets and liabilities.

31 December 2013 *In millions of IQD*	**Held-to-maturity**	**Loans and receivables**	**Other amortised cost**	**Total carrying amount**	**Fair value**
Cash and balances with central banks	–	20,835,296	–	20,835,296	20,835,296
Balances with banks	–	14,059,312	–	14,059,312	14,059,312
Held to maturity investment securities	51,093,138	–	–	51,093,138	51,337,825
Due from Ministry of Finance	–	2,755,519	–	2,755,519	2,755,519
Foreign currencies investments at IMF	–	3,944,023	–	3,944,023	3,944,023
Other assets	–	420,666	–	420,666	420,666
	51,093,138	42,014,816	–	93,107,954	93,352,641
Currency issued	–	–	40,630,036	40,630,036	40,630,036
Treasury bills issued	–	–	943,166	943,166	943,166
Deposits of local and governmental banks	–	–	42,210,246	42,210,246	42,210,246
Due to foreign governments and banks	–	–	18,375	18,375	18,375
Due to International Monetary Fund	–	–	3,825,566	3,825,566	3,825,566
Balances due to governmental institutions	–	–	2,020,541	2,020,541	2,020,541
Other liabilities	–	–	44,862	44,862	44,862
	–	–	89,692,792	89,692,792	89,692,792

31 December 2012 *In millions of IQD*	**Held-to-maturity**	**Loans and receivables**	**Other amortised cost**	**Total carrying amount**	**Fair value**
Cash and balances with central banks	–	14,302,088	–	14,302,088	14,302,088
Balances with banks	–	10,469,338	–	10,469,338	10,469,338
Held to maturity investment securities	50,773,153	–	–	50,773,153	51,070,480
Due from Ministry of Finance	–	3,155,520	–	3,155,520	3,155,520
Foreign currencies investments at IMF	–	4,140,272	–	4,140,272	4,140,272
Other assets	–	421,854	–	421,854	421,854
	50,773,153	32,489,072	–	83,262,225	83,559,552
Currency issued	–	–	35,784,805	35,784,805	35,784,805
Treasury bills issued	–	–	745,471	745,471	745,471
Deposits of local and governmental banks	–	–	34,790,945	34,790,945	34,790,945
Due to foreign governments and banks	–	–	22,471	22,471	22,471
Due to International Monetary Fund	–	–	3,870,733	3,870,733	3,870,733
Balances due to governmental institutions	–	–	6,857,796	6,857,796	6,857,796
Other liabilities	–	–	36,762	36,762	36,762
	–	–	82,108,983	82,108,983	82,108,983

Glossary

CBI: Central Bank of Iraq

MOF: Ministry of Finance

IMF: International Monetary Fund

KRG: Kurdistan Regional Government

IQD: Iraqi Dinar

DFI: Development Fund for Iraq

SDR: Special Drawing Rights

MOU: Memorandum of Understanding