

Icebank hf.
Consolidated Financial Statements
for the year 2007

ISK

Icebank hf.
Raudarárstíg 27
105 Reykjavík

Reg. no. 681086-1379

Contents

	Page		Page
Endorsement and Signatures of the Board of Directors and the CEO	3	Consolidated Statement of Changes in Equity	7
Independent Auditor's Report	4	Consolidated Statement of Cash Flows	8
Consolidated Income Statement	5	Notes to the Consolidated Financial Statements	9
Consolidated Balance Sheet	6	Appendix I - Un-audited Information	34

Endorsement and Signatures of the Board of Directors and the CEO

The Financial Statements include the Consolidated Financial Statements of Icebank hf. and its subsidiary. The Annual Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU.

Profit of the year, according to the Income Statement, amounted to ISK 1,616 million for the year 1 January to 31 December 2007. Capital, according to the Balance Sheet, amounted to ISK 13,361 million at the end of the year. The equity ratio of the Bank, calculated according to the Act on Financial Undertakings, was 11.0%. This ratio may not be lower than 8.0%. The Board of Directors does not propose payment of dividend for the year 2007. Allocation of profit and changes in equity are further explained in the notes to the Financial Statements.

During the year 2007 the average number of employees of the Bank was 87. Salaries amounted to ISK 665 million. The Bank also paid salary related expenses amounting to ISK 144 million.

The share capital at year-end 2007 amounted to ISK 1,127 million but during the year, the Bank purchased Treasury shares of nominal value ISK 13.5 million. The Bank also issued a non-taxable stock dividend amounting to ISK 449 million. Shareholders at year-end were 34 compared to 21 at the beginning of the year. One shareholder owned more than 10% of the Bank's outstanding capital stock at year-end 2007, Sparisjóðurinn í Keflavík which owned 15.4%.

Statement by the Board of Directors and the CEO

According to our best knowledge it is our opinion that the annual consolidated financial statements give a true and fair view of the consolidated financial performance of the Bank for the financial year 2007, its assets, liabilities and consolidated financial position as at 31 December 2007 and its consolidated cash flows for the financial year 2007.

Further, in our opinion the consolidated financial statements and the Endorsement of the Board of Directors and the CEO gives a fair view of the development and performance of the Bank's operations and its position and describes the principal risks and uncertainties faced by the Bank.

The Board of Directors and the CEO have today discussed the annual consolidated financial statements of Icebank hf. for the year 2007 and confirm them by means of their signatures. The Board of Directors and the CEO recommend that the consolidated financial statements be approved at the annual general meeting of Icebank hf.

Reykjavík, 5 February 2008

Board of Directors

Geirmundur Kristinsson
Chairman

Grímur Sæmundsen

Fridrik Fridriksson

Gísli Kjartansson

Steinþór Jónsson

CEO:

Agnar Hansson

Independent Auditor's Report

To the Board of Directors and Shareholders of Icebank hf.

Introduction

We have audited the accompanying consolidated financial statements of Icebank hf. and its subsidiary (the "Bank"), which comprise the consolidated balance sheet as at December 31, 2007, and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the EU. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of 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 the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers 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 principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

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

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the financial position of Icebank hf. as at December 31, 2007, and of its financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Reykjavík, 5 February 2008

Sigurður Jónsson

Ólafur Már Ólafsson

KPMG hf.

Consolidated Income Statement

for the year 2007

	Notes	2007	2006
Interest income		14,585,648	5,234,622
Interest expense		(12,244,265)	(3,980,813)
Net interest income.....	32	2,341,383	1,253,809
Fee and commission income		259,410	209,497
Fee and commission expense		(152,513)	(73,361)
Net fee and commission income	33	106,897	136,136
Dividend income	34	394,718	302,788
Net loss on trading assets and liabilities	35	(750,660)	(391,925)
Net gain on financial assets designated at fair value	36	759,991	6,224,154
Net foreign exchange difference		436,184	221,265
Other operating revenue	37	49,275	74,184
Other net operating income.....		889,508	6,430,466
Net operating income.....		3,337,788	7,820,411
Salaries and related expenses	39	(808,782)	(575,234)
Administrative expenses		(615,207)	(408,325)
Depreciation	57	(11,770)	(12,366)
Impairment on loans and advances	52	(181,579)	15,096
		(1,617,338)	(980,829)
Profit before income tax		1,720,450	6,839,582
Income tax expense	41	(104,347)	(1,177,957)
Profit for the year.....		1,616,103	5,661,625
Earnings per share			
Basic and diluted earnings per share	42	1.6	8.5

Notes numbered 1-83 are an integral part of these financial statements

Consolidated Balance Sheet

as at 31 December 2007

	Notes	2007	2006
Assets			
Cash and balances with the Central Bank	44	4,423,799	7,292,521
Loans and advances	45-52	97,197,831	61,520,424
Trading assets	53	136,354,791	8,869,689
Financial assets designated at fair value	55	12,972,251	8,804,996
Property and equipment	57	331,920	342,836
Intangible assets	56	1,062,370	0
Other assets	58	168,881	94,793
Total Assets		<u>252,511,843</u>	<u>86,925,259</u>
Liabilities			
Deposits from credit institutions and the Central Bank	59	117,388,327	12,705,456
Other deposits	60	10,954,690	4,130,836
Borrowings	61-62	104,753,243	53,257,960
Subordinated loans	63	2,409,624	2,430,339
Trading liabilities	64	841,373	6,965
Current tax liability	65	233,170	87,560
Deferred tax liability	66	1,877,399	2,006,222
Other liabilities	67	692,844	293,279
Total Liabilities		<u>239,150,670</u>	<u>74,918,617</u>
Equity			
Share capital		1,127,049	691,270
Reserves		182,573	879,924
Retained earnings		12,051,551	10,435,448
Total Equity	68-69	<u>13,361,173</u>	<u>12,006,642</u>
Total Liabilities and Equity		<u>252,511,843</u>	<u>86,925,259</u>

Notes numbered 1-83 are an integral part of these financial statements

Consolidated Statement of Changes in Equity

for the year 2007

	Share capital	Reserves	Retained earnings	Total
Changes in equity in 2006				
Equity 1 January 2006	609,944	351,306	4,773,823	5,735,073
Profit for the year	0	0	5,661,625	5,661,625
Paid-in capital	81,326	528,618	0	609,944
Equity 31 December 2006	<u>691,270</u>	<u>879,924</u>	<u>10,435,448</u>	<u>12,006,642</u>
Changes in equity in 2007				
Equity 1 January 2007	691,270	879,924	10,435,448	12,006,642
Profit for the year	0	0	1,616,103	1,616,103
Purchased treasury shares	(13,547)	(248,025)	0	(261,572)
Stock dividend issued	449,326	(449,326)	0	0
Equity 31 December 2007	<u>1,127,049</u>	<u>182,573</u>	<u>12,051,551</u>	<u>13,361,173</u>

Notes numbered 1-83 are an integral part of these financial statements

Consolidated Statement of Cash Flows

for the year 2007

	Notes	2007	2006
Operating activities:			
Profit for the year.....		1,616,103	5,661,625
Adjustments for:			
Impairment on loans and advances.....	52	181,579	(15,096)
Depreciation of property and equipment.....	57	11,770	12,366
Net interest income.....	32	(2,341,383)	(1,253,809)
Income tax expense.....	41	104,347	1,177,957
		(427,584)	5,583,043
Loans and advances, changes.....		(35,858,986)	(15,949,844)
Trading assets, changes.....		(133,353,690)	(3,746,139)
Financial assets designated at fair value, changes.....		1,706,847	(4,585,796)
Other assets, changes.....		(74,088)	(49,778)
Deposit from credit institutions and the Central Bank.....		104,682,871	(969,695)
Other deposits.....		8,077,749	56,936
Trading liabilities, changes.....		834,408	(10,380)
Other liabilities, changes.....		291,424	96,069
		(54,121,049)	(19,575,584)
Interest received.....		13,076,995	5,027,552
Interest paid.....		(11,989,507)	(3,865,181)
Income tax paid.....		(87,556)	0
Net cash used in operating activities		(53,121,117)	(17,426,690)
Investing activities:			
Purchase of property and equipment.....		(854)	(25,208)
Payments for acquisition of subsidiary (less cash acquired).....	56	(959,747)	0
Cash used in investing activities		(960,601)	(42,036)
Financing activities:			
Borrowings, change.....		51,495,283	13,430,095
Subordinated loans.....		(20,715)	1,303,946
Purchased and sold treasury shares.....		(261,572)	609,944
Cash from financing activities		51,212,996	14,374,290
Decrease in cash and cash equivalents.....		(2,868,722)	(3,094,436)
Cash and cash equivalents at beginning of the year.....		7,292,521	10,386,957
Cash and cash equivalents at year-end.....	44	4,423,799	7,292,521

Notes numbered 1-83 are an integral part of these financial statements

Notes to the Consolidated Financial Statements

General information

1. Reporting entity

Icebank hf. is a company domiciled in Iceland. The address of the Bank is Rauðarárstígur 27 in Reykjavík. The Consolidated Financial Statements for the year 2007 comprise of Icebank and its subsidiary (together referred as "the Bank"). Icebank is a commercial bank, focusing on wholesale transactions with domestic and foreign financial institutions, especially with Icelandic savings banks and businesses.

2. Basis of preparation

a) *Statement of compliance*

The Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

The Consolidated Financial Statements were approved by the Board of Directors and the CEO of Icebank hf. on 5 February

b) *Basis of measurement*

The Consolidated Financial Statements are prepared on the historical cost basis except that trading assets and liabilities and financial instruments designated at fair value are measured at fair value.

c) *Functional and presentation currency*

These Consolidated Financial Statements are prepared and presented in Icelandic króna (ISK), which is the Bank's functional currency. Except as indicated, financial information presented has been rounded to the nearest ISK thousand.

d) *Use of estimates and judgements*

The preparation of the Consolidated Financial Statements in conformity with IFRS requires management to make judgements, estimates and assumptions, which affect the application of accounting policies and the reported amounts of assets and liabilities as well as income and expenses. The estimates and underlying assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying amounts of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Information about areas of estimation uncertainty and judgements made by management in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements is provided in note 31.

Summary of significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these Consolidated Financial Statements.

3. Basis of consolidation

a) *Subsidiaries*

Subsidiaries are entities controlled by the Bank. Control exists when the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Control usually exists when the Bank holds more than 50% of the voting power of the subsidiary. In assessing control, potential voting rights that are currently exercisable or convertible, if any, are taken into account. The Financial Statements of subsidiaries are included in the Consolidated Financial Statements from the date that control commences until the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Bank. The cost of an acquisition is measured as the fair value, at the date of exchange, of the assets given, liabilities incurred or assumed and equity instruments issued, plus cost directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Bank's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Notes, contd.:

3. Contd.:

b) *Transactions eliminated on consolidation*

Intragroup balances, unrealised gains and losses or income and expenses arising from intragroup transactions, are eliminated in the Consolidated Financial Statements. Unrealised gains arising from transactions with associates and jointly controlled entities are eliminated to the extent of the Bank's interest in the entity. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

4. **Interest income and expense**

Interest income and expense are recognised in the income statement on an accrual basis using the effective interest method. Interest income and expense includes the amortisation of any discount or premium or other differences between the initial carrying amount of a financial instrument and its maturity amount, calculated using the effective interest method.

The effective interest rate is the rate that exactly discounts estimated future cash flows through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Bank estimates the cash flows considering all contractual terms of the financial instrument, but it does not consider future credit losses.

Once a financial asset or a group of similar financial assets has been written down as a result of impairment loss, interest income is recognised at the rate of interest used for the purpose of calculating the impairment loss. Interest income on financial assets which have been written down as a result of impairment is calculated based on their net carrying amount.

Interest income and expense presented in the income statement include:

- interest on financial assets and liabilities at amortised cost on an effective interest rate basis
- interest on trading assets and liabilities and on financial assets designated at fair value on an accrual basis

Interest income and expense on all trading assets and liabilities are considered to be incidental to the Bank's trading operations and are presented together with all other changes in the fair value of trading assets and liabilities in net trading income.

5. **Fee and commission income and expense**

The Bank provides various services to its clients and earns income there from, such as income from transactions on behalf of third parties, commission from customers for equity and bond transactions and other services. Fees and commission income are recognised in the income statement as the services are provided. Fees that are performance-linked are recognised when the performance criteria are fulfilled.

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

6. **Other net operating income**

Other net operating income comprises net gains (losses) from trading assets and liabilities and financial assets designated at fair value, including fair value changes, dividends and foreign exchange differences. Dividend income is recognised in the income statement on the date that the dividend is declared.

7. **Foreign currency**

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated to Icelandic krónas at the foreign exchange rate ruling at the reporting date. 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. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated to Icelandic krónas at foreign exchange rates ruling at the dates the fair value was determined. Foreign exchange differences resulting from translation to Icelandic kronas is recognised in the income statement.

Notes, contd.:

8. Impairment

The carrying amount of the Bank's assets, other than trading assets and financial assets designated at fair value, is reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. An impairment is recognised in the income statement whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount.

a) *Impairment on loans and advances*

The bank recognises impairment losses when there is objective evidence that loans and advances are impaired, whether individually or on a portfolio basis.

Two methods are used to calculate impairment losses, one based on an assessment of individual loans and advances and the other based on a collective assessment. Losses expected as a result of future events, no matter how likely, are not recognised.

- (i) significant financial difficulty of the borrower;
- (ii) a breach of contract, such as a default on installments or on interest or principal payments;
- (iii) the Bank granting to the borrower, for economic or legal reasons relating to the borrower's financial difficulty, a refinancing concession, that the lender would not otherwise consider;
- (iv) it becomes probable that the borrower will enter bankruptcy or undergo other financial reorganisation;
- (v) the disappearance of an active market for that financial asset because of financial difficulties; or
- (vi) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of loans, even if the decrease cannot yet be identified with the individual financial assets in the group, including:
 - adverse changes in the payment status of borrowers in the group; or
 - general national or local economic conditions connected with the assets in the group.

Individually assessed loans and advances

Impairment losses on individually assessed loans and advances are determined by an evaluation of the exposures on a case-by-case basis. The Bank assesses at each balance sheet date whether there is any objective evidence that individual loans are impaired. This procedure is applied to all loans and advances that are considered individually significant. In making the assessment, the following factors are considered:

- the Bank's aggregate exposure to the customer;
- the amount and timing of expected receipts and recoveries;
- the likely dividend available on liquidation or bankruptcy;
- the complexity of determining the aggregate amount and ranking of all creditor claims and the extent to which legal and insurance uncertainties are evident;
- the realisable value of security (or other credit mitigants) and likelihood of successful repossession; and
- the likely deduction of any costs involved in recovery of amounts outstanding.

Impairment loss is calculated by comparing the carrying amount of individual loans and advances with the present value of their expected future cash flows, discounted at their original effective interest rate. In the case of loans at variable interest rates, the discount rate used is their current effective interest rate. The carrying amount of impaired loans and advances is reduced through the use of an allowance account.

Collectively assessed loans and advances

Where loans and advances have been individually assessed and no evidence of loss has been identified, these loans are grouped together on the basis of similar credit risk characteristics for the purpose of calculating a collective impairment loss. This loss covers loans that are impaired at the balance sheet date but which will not be individually identified as such until some time in the future.

The collective impairment loss is determined after taking into account:

- future cash flows in a group of loans evaluated for impairment are estimated on the basis of the contractual cash flows of the assets;
- historical loss experience in portfolios of similar risk characteristics (for example, by industry sector, loan grade or product);
- the estimated period between a loss occurring and that loss being identified and evidenced by the establishment of an allowance against the loss on an individual loan;
- management's experienced judgement as to whether the current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience.

Notes, contd.:

8. Contd.:

Estimates of changes in future cash flows for groups of assets are consistent with changes in observable data from period to period, for example changes in property prices, payment status, or other factors indicative of changes in the probability of losses on the group and their magnitude. The methodology and assumptions used for estimating future cash flows are reviewed regularly by the Bank to minimise any differences between loss estimates and actual losses.

Loan write-offs

Loans are written off, partially or in full, when there is no realistic prospect of recovery.

Reversals of impairment

If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is recognised as revenue in the income statement.

b) *Calculation of recoverable amount*

The recoverable amount of the Bank's investments in financial assets carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate.

The recoverable amount of other assets is the greater of their fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

9. **Income tax expense**

Income tax expense comprises current tax and deferred tax. Income tax expense is recognised in the income statement, except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the period, using tax rates enacted at the Balance Sheet date, and any adjustment to tax payable in respect of previous years.

The deferred income tax liability has been calculated and recognised in the balance sheet. The calculation is based on the difference between balance sheet items as presented in the tax return on one hand, and in the Consolidated Financial Statements on the other, taking into consideration tax losses carried forward. This difference is due to the fact that the tax assessment is based on premises that differ from those governing the financial statements, mostly due to temporary differences arising from the recognition of revenues and expenses in the tax returns and in the Financial Statements.

10. **Cash and cash equivalents**

Cash and cash equivalents in the Statement of Cash Flows consist of cash, demand deposits with the Central Bank and demand deposits with other credit institutions.

11. **Loans and advances**

Loans and advances are non-derivative financial instruments with fixed or determinable payments that are not quoted in an active market, other than those that the Bank designates upon initial recognition as at fair value. Loans and advances include loans provided by the Bank to its customers, participation in loans from other lenders and purchased loans that are not quoted in an active market and which the Bank has no intention of selling immediately or in the near future.

Loans and advances are initially recognised at fair value, which is the cash advanced, plus any transaction costs. Subsequently, they are measured at amortised cost using the effective interest method. Accrued interest is included in the carrying amount of the loans and advances.

12. **Trading assets**

Trading assets are financial assets acquired principally for the purpose of generating profits from short-term price fluctuations or from dealer's margin. Trading assets consist of bonds, shares and derivatives with positive fair value.

Notes, contd.:

12. Contd.:

Trading assets are measured at fair value. Realised and unrealised gains and losses on these assets are recognised in the income statement and included in the line item Net (loss) gain on trading assets and liabilities. Interest and dividend income on these assets are included in interest income and dividend income line items in the income statement.

13. Derivatives

A derivative is a financial instrument or other contract within the scope of IAS 39, the value of which changes in response to a change in an underlying variable (such as share, commodity or bond prices, an index value or an exchange or interest rate), which requires no initial net investment or initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors and which is settled at a future date.

The Bank uses derivatives for trading purposes and to hedge its financial risk exposure.

Derivatives are recognised at fair value. Fair value changes are recognised in the income statement as interest and other gains and losses. Interest income is recognised on an accrual basis. Derivatives with positive fair values are recognised as trading assets and derivatives with negative fair values are recognised as trading liabilities (see notes 53 and 54).

Derivatives embedded in other contracts are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contracts and when the contracts are not carried at fair value through profit and loss.

The fair value of derivatives is determined in accordance with the accounting policy presented in note 15.

14. Financial assets designated at fair value

The Bank designates certain financial assets upon their initial recognition as financial assets at fair value when doing so results in more relevant information, including information provided internally to key management personnel. Fair value changes are recognised in the income statement.

15. Determination of fair value

The determination of fair value of financial assets and financial liabilities that are quoted in an active market is based on quoted prices. For all other financial instruments fair value is determined by using valuation techniques. A market is considered active if quoted prices are readily and regularly available and those prices represent actual and regularly occurring market transactions on an arm's length basis.

Valuation techniques include recent arm's length transactions between knowledgeable, willing parties, if available, reference to the current fair value of other instruments that are substantially the same, the discounted cash flow analysis and option pricing models. Valuation techniques incorporate all factors that market participants would consider in setting a price and are consistent with accepted methodologies for pricing financial instruments. Periodically, the Bank calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument, without modification or repackaging, or based on any available observable market data.

For more complex instruments, the Group uses proprietary models, which usually are developed from recognised valuation models. Some or all of the inputs into these models may not be market observable, and are derived from market prices or rates or are estimated based on assumptions. When entering into a transaction, the financial instrument is recognised initially at the transaction price, which is the best indicator of fair value, although the value obtained from the valuation model may differ from the transaction price. This initial difference, usually an increase, in fair value indicated by valuation techniques is recognised in income depending upon the individual facts and circumstances of each transaction and not later than when the market data becomes observable.

The value produced by a model or other valuation technique is adjusted to allow for a number of factors as appropriate, because valuation techniques cannot appropriately reflect all factors market participants take into account when entering into a transaction. Valuation adjustments are recorded to allow for model risks, bid-ask spreads, liquidity risks, as well as other factors. Management believes that these valuation adjustments are necessary and appropriate to fairly state financial instruments carried at fair value on the balance sheet.

Notes, contd.:

16. 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 recognised and the maturity amount, minus any reduction for impairment.

17. Recognition and derecognition of financial assets and financial liabilities

Purchases and sales of financial assets are recognised using trade date accounting, i.e. they are recognised on the date on which the Bank commits to purchase or sell the asset, except for loans and advances, which are recognised when cash is advanced to the borrowers. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all risks and rewards of ownership.

Financial liabilities are recognised when the Bank becomes a party to the contractual provisions of the liability instrument. Financial liabilities are derecognised when the obligation of the Bank is discharged or cancelled or expires.

The Bank enters into transactions whereby it transfers assets recognised on its balance sheet, but retains either all risks and rewards of the transferred assets or a portion of them. If all or substantially all risks and rewards are retained, then the transferred assets are not derecognised from the balance sheet. Transfers of assets with retention of all or substantially all risks and rewards include, for example, securities lending and repurchase transactions.

The rights and obligations retained in the transfer are recognised separately as assets and liabilities as appropriate. In transfers where control over the asset is retained, the Group continues to recognise 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 Group retains rights to service a transferred financial asset for a fee. The transferred asset is derecognised in its entirety if it meets the derecognition criteria. An asset or liability is recognised for the servicing rights, depending on whether the servicing fee is more than adequate to cover servicing expenses (asset) or is less than adequate for performing the servicing (liability).

18. Offsetting financial assets and financial liabilities

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis.

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

19. Repurchase agreements

Repurchase agreements involve the sale of securities subject to the simultaneous agreement to repurchase the same securities at a certain later date and at an agreed price. Reverse repurchase agreements involves the purchase of securities subject to the simultaneous agreement to resell the same securities at a certain later date and at an agreed price. The cash received initially along with the accrued interest are recognised as deposits from credit institutions and the Central Bank. The cash paid initially along with the accrued interest are recognised as loans to credit institutions. Accrued interest is recognized as interest revenue and expense over the life of each agreement.

In the case of repurchase agreements, the control of the securities remains with the Bank throughout the entire term of the agreements and the securities continue to be presented in the balance sheet as financial assets designated at fair value.

20. Investments in associates

Associates are those entities in which the Bank has significant influence over the financial and operating policy decisions but not control over those policies. Significant influence generally exists when the Bank holds between 20% and 50% of the voting power, including potential voting rights, if any. Investments in associates are initially recognised at cost.

Notes, contd.:

20. Contd.:

The Consolidated Financial Statements include the Bank's share of the total recognised gains and losses of associates on an equity accounted basis, from the date the significant influence commences until the date it ceases. When the Bank's share of loss exceeds its interest in an associate, the Bank's carrying amount is reduced to zero and recognition of further losses is discontinued except to the extent that the Bank has incurred legal or constructive obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the investor resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

21. Intangible assets

a) Goodwill

All business combinations after 1 January 2004 are accounted for by applying the purchase method. Goodwill has been recognised on the acquisition of subsidiaries and associates. In respect of business acquisitions that have occurred since 1 January 2004, goodwill represents the difference between the cost of the acquisition and the fair value of the net identifiable assets acquired.

22. Property and equipment

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

The Bank recognises in the carrying amount of an item of property and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Bank and the cost of the item can be measured reliably. All other costs are expensed in the income statement when incurred.

Depreciation is recognised in the income statement on a straight-line basis over the estimated useful lives of each component of an item of property and equipment. The estimated useful lives are as follows:

Property	20-50 years
Machinery and equipment	3-5 years

As long as the residual value is not immaterial, it is reassessed annually.

23. Deposits

Deposits are measured initially at fair value and subsequently at amortised cost.

24. Borrowings and subordinated loans

The Bank's borrowings consist of issued bonds and loans from credit institutions. Subordinated loans are bonds issued by the Bank with subordinated terms. Subordinated loans have the characteristics of equity in being subordinated to other liabilities of the Bank. In the calculation of equity ratio, these bonds are included in equity, as shown in note 69.

Borrowings and subordinated loans are initially recognised at fair value less attributable transaction costs. Subsequently, they are measured at amortised cost using the effective interest method. Accrued interest is included in their carrying amount.

25. Trading liabilities

Trading liabilities consist of derivatives with negative fair values, as shown in note 13.

26. Financial guarantees

Financial guarantees are contracts that require the Bank to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument.

Financial guarantee liabilities are initially recognised at their fair value, and initial fair value is amortised over the life of the financial guarantee. The guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment, when a payment under the guarantee has become probable. Financial guarantees are included within other liabilities.

Notes, contd.:

27. Employee benefits

Obligations for contributions to defined contribution pension plans are recognised as an expense in profit or loss when they are due.

28. Other assets and other liabilities

Other assets and other liabilities are measured at cost.

29. Equity

a) Share capital

The consideration paid to shareholders for the acquisition of own shares are deducted from equity, including transaction costs.

b) Reserves

The value of paid-in capital which exceeds nominal value is recognised in reserves. In accordance with the Financial Statement Act, part of profit for previous years has been transferred to statutory reserve.

c) Dividends

Dividends on shares are recognised as a decrease in equity in the period in which they are approved by the Bank's shareholders.

30. New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2007, and have not been applied in preparing these Consolidated Financial Statements:

IFRS 8 Operating Segments introduces the "management approach" to segment reporting. IFRS 8, which becomes mandatory for the Bank's 2009 financial statements, will require the disclosure of segment information based on internal reports in order to assess each segment's performance and to allocate resources to them. IFRS 8 is effective from 1 January 2009.

Revised IAS 23 Borrowing Costs removes the option to expense borrowing costs and requires that an entity capitalise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. If endorsed by the EU, the revised IAS 23 will become mandatory for the Bank's 2009 financial statements and will constitute a change in accounting policy for the Bank. In accordance with the transitional provisions the Bank will apply the revised IAS 23 to qualifying assets for which capitalisation of borrowing costs commences on or after the effective date.

IFRIC 11 IFRS 2 – Group and Treasury Share Transactions requires a share-based payment arrangement in which an entity receives goods or services as consideration for its own equity instruments to be accounted for as an equity-settled share-based payment transaction, regardless of how the equity instruments are obtained. IFRIC 11 will become mandatory for the Bank's 2008 financial statements, with retrospective application required. It is not expected to have any impact on the consolidated financial statements.

IFRIC 12 Service Concession Arrangements provides guidance on certain recognition and measurement issues that arise in accounting for public-to-private service concession arrangements. IFRIC 12, which becomes mandatory for the Bank's 2008 financial statements if endorsed by the EU, is not expected to have any effect on the consolidated financial statements.

IFRIC 13 Customer Loyalty Programmes addresses the accounting by entities that operate, or otherwise participate in, customer loyalty programmes for their customers. It relates to customer loyalty programmes under which the customer can redeem credits for awards such as free or discounted goods or services. IFRIC 13, which becomes mandatory for the Bank's 2009 financial statements if endorsed by the EU, is not expected to have any impact on the consolidated financial statements.

IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction clarifies when refunds or reductions in future contributions in relation to defined benefit assets should be regarded as available and provides guidance on the impact of minimum funding requirements (MFR) on such assets. It also addresses when a MFR might give rise to a liability. IFRIC 14 will become mandatory for the Bank's 2008 financial statements if endorsed by the EU, with retrospective application required. The Bank has not yet determined the potential effect of the interpretation on the consolidated financial statements.

Notes, contd.:

31. Critical accounting estimates and judgements in applying accounting policies

Management makes a judgements, estimates and assumptions, which can affect various items in the balance sheet. The estimates and underlying assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying amounts of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

a) *Impairment losses on loans and advances*

The Bank reviews its loan portfolios to assess impairment at least on a three months basis. In determining whether an impairment loss should be recorded in the income statement, the Bank makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio. This evidence may include observable data indicating that there have been changes in the payment status of borrowers in a bank or economic conditions. Management uses estimates based on historical loss experience for assets with similar credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

b) *Fair value of financial instruments*

The fair value of financial instruments that are not quoted in active markets are determined by using valuation techniques which are reviewed regularly by qualified independent personnel. All models that are used must be approved and calibrated to ensure that outputs reflect actual data.

Notes, contd.:

Notes to the Income Statement

Net interest income

32. Interest income and expense are specified as follows:

	Interest income	Interest expense	Net interest income
2007			
Cash and deposits from credit institutions and the Central Bank	6,646,099	10,158,788	(3,512,689)
Loans and deposits	6,500,218	328,240	6,171,978
Borrowings		1,557,613	(1,557,613)
Subordinated loans	2,242	197,532	(195,290)
Trading assets and liabilities	1,437,089	2,092	1,434,997
	<u>14,585,648</u>	<u>12,244,265</u>	<u>2,341,383</u>
	Interest income	Interest expense	Net interest income
2006			
Cash and deposits from credit institutions and the Central Bank	2,302,175	2,502,433	(200,258)
Loans and deposits	2,110,480	225,764	1,884,716
Borrowings		1,028,807	(1,028,807)
Subordinated loans	4,901	180,805	(175,904)
Trading assets and liabilities	817,066	43,004	774,062
	<u>5,234,622</u>	<u>3,980,813</u>	<u>1,253,809</u>

Net fee and commission income

33. Fee and commission income and expense are specified as follows:

	2007	2006
Securities commission	54,664	27,138
Payment service commission	20,425	14,321
Other commission income	184,321	168,038
Total fee and commission income	<u>259,410</u>	<u>209,497</u>
Securities commission	43,422	5,655
Other commission expense	109,091	67,706
Total fee and commission expense	<u>152,513</u>	<u>73,361</u>
Net fee and commission income	<u>106,897</u>	<u>136,136</u>

Dividend income

34. Dividend income is specified as follows:

Dividend income on financial assets designated at fair value	374,803	300,294
Dividend income on trading assets	19,915	2,494
Total dividend income	<u>394,718</u>	<u>302,788</u>

Net (loss) gain on trading assets and liabilities

35. Net (loss) gain on trading assets and liabilities is specified as follows:

Shares and related derivatives	(1,219,683)	(391,925)
Bonds and related derivatives	469,023	0
Net (loss) gain on trading assets and liabilities	<u>(750,660)</u>	<u>(391,925)</u>

Notes, contd.:

Net gain on financial assets designated at fair value

36. Net gain on financial assets designated at fair value is specified as follows:	2007	2006
Shares	593,900	6,224,154
Bonds	166,091	0
Net gain on financial assets designated at fair value	759,991	6,224,154

Other operating revenue

37. Other operating revenue is specified as follows:

Gain on disposals of assets	21,891	30,458
Other	27,384	43,726
Other operating revenue	49,275	74,184

Personnel

38. The Bank's total number of employees is as follows:

Average number of full time equivalent positions during the year	87	67
Full time equivalent positions at year-end	102	71

39. Salaries and related expenses are specified as follows:

Salaries	664,775	471,772
Salary related expenses	144,007	103,462
Salaries and related expenses	808,782	575,234

Employment terms of Directors

	Salaries and benefits	Share held at year-end
CEO:		
Agnar Hansson	26,101	21,208
Board of Directors:		
Geirmundur Kristinsson, Chairman	3,240	0
Grímur Sæmundsen, Vice-Chairman	95	108,357
Fridrik Fridriksson	2,085	0
Gísli Kjartansson	89	0
Steinþór Jónsson	81	108,357
Angantýr V. Jónasson , Reserve Director	75	0
Helga Gudjónsdóttir, Reserve Director	75	0
Ólafur Elísson, Reserve Director	308	0
Managing Director (2)	21,719	12,119
Former CEO:		
Finnur Sveinbjörnsson	45,526	30,297
Former Board of Directors:		
Gudmundur Hauksson	1,764	0
Magnús Ægir Magnússon	1,764	0
Ragnar Zophonías Gudjónsson	1,764	0

Included among the holdings of the aforementioned persons are holdings of their spouses, dependent children, and companies owned by them, if any.

Notes, contd.:

Auditor's fee

40. Auditor's fee is specified as follows:	2007	2006
Audit of the Financial Statements	5,280	4,391
Review of the Interim Financial Statements	5,642	2,992
Other service	7,610	3,287
Auditor's fee	18,532	10,670

Income tax expense

41. Income tax expense recognised in the income statement is specified as follows:

Current tax	233,170	87,560
Deferred tax, change	(128,823)	1,090,397
Total income tax expense	104,347	1,177,957

Reconciliation of effective tax rate:	2007	2006
Profit before income tax	1,720,450	6,839,582
18% income tax calculated on the profit for the year	18.0% 309,681	18.0% 1,231,125
Dividends received, exempt from tax	(4.1%) (71,049)	(0.8%) (54,502)
Deferral of tax liability against acquisitions in a subsidiary and other changes	(7.8%) (134,285)	0.0% 1,334
	6.1% 104,347	17.2% 1,177,957

Earnings per share

42. Earnings per share are specified as follows:	2007	2006
Profit for the year	1,616,103	5,661,625
Equity according to Financial Statements at the beginning of the period	691,270	609,944
Effects of increase/sale of share during the period	351,073	55,347
Weighted average of outstanding shares for the period	1,042,343	665,291
Basic and diluted earnings per share	1.6	8.5

Earnings per share

Earnings per share are calculated by dividing the profit for the year attributable to equity holders of the Bank by the weighted average number of ordinary shares outstanding during the period.

Notes, contd.:

Notes to the Balance Sheet

Financial assets and liabilities

43. Classification of each class of financial assets and liabilities, and their fair values:

According to IAS 39 Financial instruments: recognition and measurement, financial assets and liabilities are divided into specific categories. The classification effects how the relevant financial instrument is evaluated. Those categories to which the Fund's financial assets and liabilities pertain and their basis of measurement are specified as follows:

- Trading assets and liabilities - are recognized at fair value through profit and loss.
- Financial assets and liabilities designated at fair value - are recognized at fair value through profit and loss.
- Loans and advances - are recognized at the amortized cost.
- Other financial liabilities - are recognized at the amortized cost.

The following table shows to which group financial assets and financial liabilities pertain and their fair value:

31 December 2007	Trading	Designated at fair value	Amortised cost	Total carrying amount	Fair value
Cash and Central Bank balances			4,423,799	4,423,799	4,423,799
Loans and advances			97,197,831	97,197,831	96,362,657
Trading assets	136,354,791			136,354,791	136,354,791
Financial assets designated at fair value		12,972,251		12,972,251	12,972,251
	<u>136,354,791</u>	<u>12,972,251</u>	<u>101,621,630</u>	<u>250,948,672</u>	<u>250,113,498</u>
Deposits from credit institutions and the Central Bank			117,388,327	117,388,327	117,388,327
Other deposits			10,954,690	10,954,690	10,954,690
Borrowings			104,753,243	104,753,243	102,826,849
Subordinated loans			2,409,624	2,409,624	2,425,843
Trading liabilities	841,373			841,373	841,373
	<u>841,373</u>	<u>0</u>	<u>235,505,884</u>	<u>236,347,257</u>	<u>234,437,082</u>
31 December 2006					
Cash and Central Bank balances			7,292,521	7,292,521	7,292,521
Loans and advances			61,520,424	61,520,424	61,102,295
Trading assets	8,869,689			8,869,689	8,869,689
Financial assets designated at fair value		8,804,996		8,804,996	8,804,996
	<u>8,869,689</u>	<u>8,804,996</u>	<u>68,812,945</u>	<u>86,487,630</u>	<u>86,069,501</u>
Deposits from credit institutions and the Central Bank			12,705,456	12,705,456	12,705,456
Other deposits			4,130,836	4,130,836	4,130,836
Borrowings			53,257,960	53,257,960	53,895,171
Subordinated loans			2,430,339	2,430,339	2,525,658
Trading liabilities	6,965			6,965	6,965
	<u>6,965</u>	<u>0</u>	<u>72,524,591</u>	<u>72,531,556</u>	<u>73,264,086</u>

Cash and balances with the Central Bank

44. Cash and balances with the Central Bank are specified as follows:

	2007	2006
Cash and balances with the Central Bank	4,423,799	5,515,484
Other cash equivalents	0	1,777,037
Cash and balances with the Central Bank	<u>4,423,799</u>	<u>7,292,521</u>

Notes, contd.:

Loans and advances

45. Loans and advances are specified as follows:	2007	2006
Loans to credit institutions	48,887,750	30,270,492
Loans to customers	48,850,162	31,608,748
Provision for impairment	(540,081)	(358,816)
Loans and advances	97,197,831	61,520,424

Loans to credit institutions

46. Loans to credit institutions specified by types of loans:

Bank accounts	1,746,515	178,293
Money market loans	10,859,752	8,639,411
Repurchase agreements	7,195,471	13,425
Other loans	29,086,012	21,439,363
Loans to credit institutions	48,887,750	30,270,492

47. Loans to credit institutions specified by maturity:

Up to 3 months	21,148,108	9,267,655
Over 3 months and up to a year	13,020,338	9,470,845
Over 1 year and up to 5 years	11,552,549	8,070,267
Over 5 years	3,166,755	3,461,725
Loans to credit institutions	48,887,750	30,270,492

Loans to customers

48. Loans to customers, net of impairment, specified by types of loans:

Overdrafts	2,071,179	2,424,290
Bonds and loan agreements	25,069,898	12,243,724
Other loans	21,169,004	16,581,918
Loans to customers	48,310,081	31,249,932

49. Loans to customers specified by sectors:

Municipalities	0.0%	0.1%
Business enterprises:		
Agriculture and Fishing	2.6%	6.4%
Industry	14.1%	21.1%
Commerce	5.7%	8.4%
Service	71.3%	48.0%
Other	6.3%	16.0%
Loans to customers	100.0%	100.0%

50. Loans to customers specified by maturity:

On demand	13,566	76,746
Up to 3 months	16,325,797	7,097,036
Over 3 months and up to a year	8,123,428	2,861,849
Over 1 year and up to 5 years	19,811,118	16,170,604
Over 5 years	4,036,172	5,043,697
Loans to customers	48,310,081	31,249,932

Notes, contd.:

51. Impaired loans to customers specified by types of loans:

	2007			2006		
	Gross amount	Impairment	Net amount	Gross amount	Impairment	Net amount
Bonds:						
Individuals	85,426	60,880	24,546	61,494	43,020	18,474
Corporate customers	382,783	199,552	183,231	511,415	165,251	346,164
	<u>468,209</u>	<u>260,432</u>	<u>207,777</u>	<u>572,909</u>	<u>208,271</u>	<u>364,638</u>

Provision for impairment of loans and advances

52. Changes in the provision for impairment of loans and advances are specified as follows:

	2007	2006
Provision for individually impaired loans and advances		
Balance at the beginning of the year	208,271	284,602
Impairment for the year	52,475	796
Write-offs	(8,939)	(77,422)
Recoveries of loans previously written off	8,625	295
Provision for individually impaired loans and advances	<u>260,432</u>	<u>208,271</u>
Provision for collectively impaired loans and advances		
Balance at the beginning of the year	150,545	166,437
Impairment for the year	129,104	(15,892)
Provision for collectively impaired loans and advances	<u>279,649</u>	<u>150,545</u>
Provision for impairment of loans and advances, total	<u>540,081</u>	<u>358,816</u>

Included within interest income is ISK 5.8 million. (2006: ISK 9.5 million) with respect of interest income accrued on impaired financial assets and ISK 1.0 million (2006: ISK 0.6 million) with respect to the unwind of the impairment provision discount.

Non-performing loans are classified as aggregated exposures of customers for which the Bank has made specific provisions in part or in full. Non-performing loans amounted to ISK 207.8 million (2006: ISK 350.3 million) at year end 2007, 0.43% of total loans to customers (2006: 1.12%)

Trading assets

53. Trading assets are specified as follows:

Bonds	125,400,970	4,904,111
Shares	3,332,271	1,165,553
Derivatives	7,621,550	2,800,025
Trading assets	<u>136,354,791</u>	<u>8,869,689</u>

Notes, contd.:

Derivatives

54. Derivatives, remaining maturity of principal and book value are specified as follows:

2007	Principal			Total	Assets	Liabilities
	Up to 3 months	Over 3 months and up to a year	Over 1 year			
OTC currency and interest rate derivatives:						
Forward currency agreements	4,731,160	146,144,910	0	150,876,070	959,357	173,635
Interest rate agreements	30,015,750	36,562,080	16,116,738	82,694,568	43,336	0
	<u>34,746,910</u>	<u>182,706,990</u>	<u>16,116,738</u>	<u>233,570,638</u>	<u>1,002,693</u>	<u>173,635</u>
OTC equity derivatives:						
Forward equity agreements	11,267,669	144,686	0	11,412,355	2,965,692	0
	<u>11,267,669</u>	<u>144,686</u>	<u>0</u>	<u>11,412,355</u>	<u>2,965,692</u>	<u>0</u>
Total	<u>46,014,579</u>	<u>182,851,676</u>	<u>16,116,738</u>	<u>244,982,993</u>	<u>3,968,385</u>	<u>173,635</u>

2006	Principal			Total	Assets	Liabilities
	Up to 3 months	Over 3 months and up to a year	Over 1 year			
OTC currency and interest rate derivatives:						
Forward						
Currency agreements	50,189,052	2,936,471	0	53,125,523	595,937	538,255
Interest rate agreements	8,000,000	4,000,000	5,186,660	17,186,660	106,786	98,946
	<u>58,189,052</u>	<u>6,936,471</u>	<u>5,186,660</u>	<u>70,312,183</u>	<u>702,723</u>	<u>637,201</u>
OTC equity derivatives:						
Forward equity agreements	230,865	2,654,486	0	2,885,351	457,626	323,213
	<u>230,865</u>	<u>2,654,486</u>	<u>0</u>	<u>2,885,351</u>	<u>457,626</u>	<u>323,213</u>
Total	<u>58,419,917</u>	<u>9,590,957</u>	<u>5,186,660</u>	<u>73,197,534</u>	<u>1,160,349</u>	<u>960,414</u>

Financial assets designated at fair value

55. Financial assets designated at fair value are specified as follows:

	2007	2006
Securities	6,268,830	261,528
Shares	6,703,421	8,543,468
Financial assets designated at fair value	<u>12,972,251</u>	<u>8,804,996</u>

Notes, contd.:

Acquisition of subsidiary

56. Acquisition of subsidiary

In end of October 2007 the Bank acquired all of the shares in Behrens Fyrirtækjaráðgjöf ehf. The acquisition price was paid with cash. The company became part of the Bank at year-end 2007. If the acquisition had occurred on January 1, 2007 the consolidated profit would have been ISK 94 million higher.

	Pre-acquisition carrying amount	Recognised values
Cash	40,253	40,253
Loans and advances	246,921	246,921
Financial assets designated at fair value	6,940	6,940
Other assets	2,024	2,024
Other deposits	(252,649)	(252,649)
Other liabilities	(105,859)	(105,859)
Net identifiable assets and liabilities	(62,370)	(62,370)
Intangible assets on acquisition		1,062,370
Consideration paid, satisfied in cash		1,000,000

Property and equipment

57. Property and equipment are specified as follows:

	Property	Machinery and equipment	Total 2007	Total 2006
Balance 1 January.....	434,634	17,326	451,960	426,752
Additions during the period.....	0	854	854	25,208
Gross carrying amount at the end of the period.....	434,634	18,180	452,814	451,960
Previously depreciated	99,492	9,632	109,124	96,758
Depreciated during the period.....	9,115	2,655	11,770	12,366
Total depreciation at the end of the period	108,607	12,287	120,894	109,124
Carrying amount at the end of the period.....	326,027	5,893	331,920	342,836
Depreciation ratios	2-4%	20-25%		

Other assets

58. Other assets are specified as follows:

	2007	2006
Sundry assets	15,201	68,675
Prepaid expenses and accrued income	153,680	26,118
Other assets	168,881	94,793

Notes, contd.:

Deposits from credit institutions and the Central Bank

59. Deposits from credit institutions and the Central Bank mature as follows:	2007	2006
Up to 3 months	115,875,044	12,705,456
Over 3 months and up to 1 year	1,513,283	0
Deposits from credit institutions and the Central Bank.....	117,388,327	12,705,456

Other deposits

60. Other deposits mature as follows:		
Up to 3 months	10,954,690	4,122,008
Over 1 year and up to 5 years	0	8,828
Other deposits	10,954,690	4,130,836

Borrowings

61. Borrowings are specified as follows:		
Bonds issued	5,259,682	4,999,757
Bills issued	16,164,756	1,045,475
Loans from credit institutions	83,328,805	47,212,728
Borrowings	104,753,243	53,257,960

62. Borrowings mature as follows:		
Up to 3 months	40,465,463	12,667,291
Over 3 months and up to a year	23,111,582	3,399,093
Over 1 year and up to 5 years	36,166,516	32,191,819
Over 5 years	5,009,682	4,999,757
Borrowings	104,753,243	53,257,960

Subordinated loans

63. Subordinated loans are specified as follows:				2007	2006
	Currency	Interest	Maturity date	Book value	Book value
Loans that qualify as Tier II capital:					
Issued in 2006	ISK	5.0%	2016	1,020,046	1,017,842
Issued in 2005	EUR	5.2%	2015	1,389,578	1,412,497
Subordinated loans				2,409,624	2,430,339

Trading liabilities

64. Trading liabilities are specified as follows:		
Derivatives with credit institutions	841,373	6,965
Trading liabilities	841,373	6,965

Notes, contd.:

Deferred income tax liability

65. Deferred income tax liability is specified as follows:	2007	2006
Deferred income tax liability at the end of previous year	2,006,222	915,825
Calculated income tax for the year	104,347	1,177,957
Income tax for the year to be paid next year	(233,170)	(87,560)
Deferred income tax liability at the end of the year	1,877,399	2,006,222

66. Deferred income tax liability is attributable to the following items:

Shares in other companies	1,808,771	1,993,421
Property and equipment	13,127	12,801
Other assets and liabilities	55,501	0
Deferred income tax liability at the end of the year	1,877,399	2,006,222

Other liabilities

67. Other liabilities are specified as follows:

Sundry liabilities	92,241	58,281
Unpaid expenses	591,259	224,349
Accrued expenses and deferred income	9,344	10,649
Other liabilities	692,844	293,279

Capital

68. The Bank's share capital according to its Articles of Association is ISK 1,141 million. The Bank holds treasury shares with nominal value of ISK 13.5 million which are deducted from equity. Outstanding shares at year-end amounts to ISK 1,127 million and are all paid for. One vote is attached to each share of one ISK in the Parent Company.

69. Equity at the end of the period amounted to ISK 13,361 million. Equity ratio, calculated in accordance to Article 84 of the Act on Financial Undertakings, was 11.0%. According to law the ratio may not be lower than 8.0%.

The ratio is calculated as follows:

	2007		2006	
	Book value	Weighted value	Book value	Weighted value
Risk base:				
Assets recorded in the Accounts	252,511,843	80,122,422	86,925,259	56,628,605
Assets deducted from capital		(4,994,967)		(5,209,492)
Guarantees and other items not included in the Balance Sheet		12,796,389		2,876,259
		<u>87,923,844</u>		<u>54,295,372</u>
Capital:				
Tier I capital:				
Equity		13,361,173		12,006,642
Intangible assets		(1,062,370)		
Tier II capital:				
Subordinated loans		2,409,624		2,430,339
Investment in credit institutions		(4,994,967)		(5,209,492)
		<u>9,713,460</u>		<u>9,227,489</u>
Equity ratio		11.0%		17.0%
Thereof Tier I ratio		15.2%		22.1%

Notes, contd.:

Off-balance sheet information

70. The bank has granted its customers guarantees. These items are specified as follows:

	2007	2006
Guarantees	13,788,282	4,502,023
Unused overdrafts	70,711	57,521

71. At 31 December 2007, the Bank was obligated under operating leases for cars and IT-equipment. The duration of the contracts is at most three years.

Pledged assets

72. Assets have been pledged as security in respect of the following liabilities:

	2007	2006
Liabilities		
Repurchase agreements with the Central Bank	104,571,973	3,624,643
Assets		
Repurchase agreements with credit institutions	7,195,471	13,425

Related parties

73. The Bank has a related party relationship with its associates, the Board of Directors, the Managing Directors of the Bank, close family members of individuals referred to herein, and entities with significant influence as the largest capital holders of the Bank, which are Sparisjóðurinn í Keflavík (15,4%) og Sparisjóður Mýrasýslu (8,8%). This definition is based on IAS 24. Information regarding related parties are as follows:

Balance 1 January 2007	3,158,162
New related parties	8,503,353
Former related parties	(314,471)
Other changes	3,130,841
Balance 31 December 2007	14,477,885

At year-end 2007, loans to related parties amounted to ISK 1,746 million (2006: ISK 22 million.). Terms of the loans are comparable to loans to other customers. Loans to business activities that above-mentioned related parties participate in are not included in the amounts above.

Transactions with related parties have been carried out on arm's length basis.

Icelandic savings banks are among the Bank's main customers but their transactions are not included in the aforementioned amounts.

Events after the Balance Sheet date

74. There have been no material post Balance Sheet events which would require disclosure or adjustment to the Financial Statements for the year 2007. On 5th February 2008 the Board of Directors discussed the Financial Statements and authorised for public appearance.

Risk Management Disclosure

75. The Bank faces various types of risks related to its business as a financial institution, which arise from its day to day operations. Management devotes a significant portion of its time to the management of these risks. The mainstays of effective risk management are the identification of significant risk, the quantification of the Bank's risk exposure, actions to limit risk and the constant monitoring of risk. The most significant of these risks are discussed below. The most important types of financial risk to which the Bank is exposed are credit risk, liquidity risk and market risk. Market risk includes currency risk, interest rate risk and equity price risk.

Notes, contd.:

75. Contd.:

Risk Policy

The assessment of risk, in particular the determination of its true price along with actions aimed at limiting the risk with sensible credit and investments in other assets, is one of the major tasks of banks and other financial institutions. Many risk factors can adversely affect the Bank. It is the policy of the Board of Directors that the various risks that the Bank faces in its business are to be constantly monitored and managed. For these purposes Icebank operates a centralised risk management department. In addition, Bank's internal auditor oversees the operations in order to ensure that its rules are implemented in accordance with resolutions made by the board of directors.

The Bank's risk management aims at identifying all significant risk factors related to its operation, implementing risk monitoring methods, making regular risk assessments, maintaining control and regulations in order to keep the relevant risk factors within defined limits and thereby reach an acceptable equilibrium between the minimisation of risk on the one hand and maximisation of the Bank's income on the other hand.

Managing Directors of single divisions are responsible towards the CEO of the Bank for the risk management relevant to their division, including enforcement of these rules in addition to other risk management rules and limits, which might be established.

The Manager of Risk Management carries out the task of risk management by the authority of the CEO of the Bank, including identifying the significant risk factors, assessing and measuring thereby the Bank's overall risk, maintaining rules and effective control, controlling that single sectors of the Bank do not exceed risk criterion and making evaluation on how undesirable risk may be reduced. Risk Management remits to the Bank's Board of Directors, the CEO and the Finance Committee information relating to significant risk factors, including risk limits so that the Bank's management is at each time aware of all significant risks and can react to them if necessary.

The Bank's Board of Directors establishes rules on the Bank's risk management and is responsible for the enforcement of those rules towards the shareholders. The CEO of the Bank is responsible for the Bank's risk management towards the Board of Directors. He establishes further risk management rules, defines risk criterion when needed in accordance with provisions of these rules and, having received the Finance Committee's opinion, controls the enforcement of the rules.

Bank Committees

The Bank's Finance Committee consists of the CEO, Managing Directors, the Manager of Risk Management and other employees in accordance with the CEO's decision. The Committee discusses in general the Bank's risk management, i.e. rules and limits on which risk management is based, risk management effectiveness and the Bank's standing in relation to risk limits. The Committee also discusses the Bank's financing and capital management.

The Bank's Loan Committee consists of the CEO of the Bank, Managing Directors, Manager of Risk Management and Credit Control and other employees in accordance with the CEO's decision. The Committee addresses the Bank's loans and advances either as a discussion to make a decision or for information.

The Bank's Committee on Security consists of the CEO of the Bank, Managing Director of Operations, Managing Director of Business Support, Manager of Risk Management and Credit Control and other employees in accordance with the CEO's decision. The Committee discusses in general the Bank's operating risk, such as the safety of IT systems, housing safety, transfer of valueables, work procedures and methods, training of employees, emergency procedures and insurance issues.

Credit risk

The Bank's primary exposure to credit risk arises through its loans and advances. The amount of credit exposure in this regard is represented by the carrying amounts of the assets on the Balance Sheet. The Bank is exposed to credit risk on various other financial assets, including derivative instruments used for hedging and debt investments, the current credit exposure in respect of these instruments is equal to the carrying amount of these assets in the Balance Sheet. In addition, the Bank is exposed to off balance sheet credit risk through commitments to extend credit and guarantees issued.

Notes, contd.:

75. Contd.:

Commitments and guarantees

The Bank often commits itself and ensures that funds are available to customers as required. Potential loss on these accounts is equal to the amount of the limits although they may only be partly used at any one time. In practice, the potential loss is less severe since many of these commitments can be recalled immediately by the Bank in case the clients do not meet credit standards. Guarantees carry the credit risk to the full amount similar as loans, since they represent irrevocable assurances that the Bank will make payments in the event that a customer cannot meet its obligations to third parties.

Derivatives trading

Derivative financial instruments used by the Bank include swaps, forwards, options and other similar types of contracts whose value changes in response to changes in interest rates, foreign exchange rates, security prices or price indices. Limits on the net open derivative positions on these types of contracts are strictly controlled by the Bank. These limits are generally client specific and may refer specifically to different categories of contracts. Generally, collateral is required to cover potential losses on a contract. Acceptable collateral for margin accounts is in the front of very liquid assets, e.g. cash or traded stocks. In case the net negative position of the contract falls below a certain level a call for added collateral is made. If extra collateral is not supplied the contract is closed.

Credit process and authority

All credit issues are handled by the Credit Committee, either by means of discussion and decision (more significant matters) or for informative purposes (minor matters). The risk management rules established by the Board of Directors set forth requirements that limit the CEO's and other employees' lending authorities. According to general credit rules established by the Bank's Board of Directors, the CEO's general lending authority is limited to 15% of the Bank's regulatory capital but thereafter the Board of Directors handles each individual matter. However, the CEO has the authority to exceed the 15% lending authority limit in case of a loan to financial institutions that is preapproved by the Board of Directors. The CEO of the Bank has delegated to specific counterparties the lending authority.

Credit risk strategy

In recent years, the Bank has emphasised maintaining a healthy loan portfolio and improving the quality of loans. The Bank has in that regard increased its participation in foreign syndicated loans and thereby increased the ratio of syndicated loans in the Bank's loan portfolio.

Credit risk monitoring

Credit risk is monitored within the department Risk Management and Credit Control. The department performs numerical analysis of the loan Credit risk is monitored within the department Risk Management and Credit Control. The department performs numerical analysis of the loan portfolio, e.g. estimates expected loss, concentrations within the loan portfolio and maps defaults in a systematic way. These findings are reported to management where possible risk concentrations toward counterparties, sectors etc. are highlighted. Risk Management and Credit Control focuses on distressed clients and in co-operation with the relevant profit center tries to minimise or prevent loss on behalf of the Bank by special monitoring of clients with deteriorating credit worthiness. The integrity of the credit process, i.e. in regard to data collection, limit compliance, application preparation, documentation and collateral registration and valuation is monitored centrally within the Bank.

Loan provisioning

An impairment on loans and advances is established if there is objective evidence that the Bank will be unable to collect all amounts due on a claim, i.e. a loan, commitment, guarantee etc., according to the original contractual terms or the equivalent value. An impairment is reported as a reduction of the carrying value of a claim on the balance sheet, whereas for an off-balance sheet item, such as a commitment, a provision for credit loss is reported in Other liabilities. Additions to the provisions for credit losses are made through impairment on loans. Provisions for credit losses are evaluated at a counterparty-specific level and collectively based on the following principles:

a) Counterparty-specific

A claim is considered impaired when there is an object evidence that it is probable that the Bank will not be able to collect all amounts due according to the original contractual terms or the equivalent value. Individual credit exposures are evaluated based upon the borrower's character, overall financial condition, resources and payment record; the prospects for support from any financially responsible guarantors; and, where applicable, the realisable value of any collateral.

Notes, contd.:

75. Contd.:

The estimated recoverable amount is the present value, using the loan's original effective interest rate, of expected future cash flows, which may result from restructuring or liquidation. Impairment is measured and allowances for credit losses are established for the difference between the carrying amount and the estimated recoverable amount. Upon impairment, the accrual of interest income based on the original terms of the claim is discontinued, but the increase of the present value of impaired claims due to the passage of time is reported as interest income.

All impaired claims are reviewed and analysed at least every three months. Any subsequent changes to the amounts and timing of the expected future cash flows compared to the prior estimates will result in a change in the allowances for credit losses and be charged or credited through impairment on loans.

An impairment is reversed only when the credit quality has improved such that there is reasonable assurance of timely collection of principal and interest in accordance with the original contractual terms of the claim agreement.

A write-off is made when all or part of a claim is deemed uncollectible or forgiven. Write-offs are charged against previously established provisions for credit losses or directly to credit loss expense and reduce the principal amount of a claim. Recoveries in part or in full of amounts previously written off are credited to credit loss expense.

b) Collectively

All loans for which no impairment is identified on a counterparty-specific level are grouped into homogeneous portfolios to collectively assess whether impairment exists within a portfolio. Provision from collective assessment of impairment are recognised as credit loss expense and result in an offset to the loan position. As the provision cannot be allocated to individual loans, interest is accrued on all loans according to contractual terms.

All loans for which no impairment is identified on a counterparty-specific level are grouped into economically homogeneous portfolios to collectively assess whether impairment exists within a portfolio. Provision from collective assessment of impairment are recognised as credit loss expense and result in an offset to the loan position. As the provision cannot be allocated to individual loans, interest is accrued on all loans according to contractual terms.

Monitoring and controlling liquidity risk

76. Liquidity risk is the risk of loss arising from the Bank's inability to meet its liabilities as they become due. The Bank monitors its liquidity through a maturity analysis of financial assets and liabilities in order to be able to serve and repay all maturing debts. The Bank must always have sufficient liquidity to meet both foreseeable as well as unexpected payment obligations. The Bank has in place a set of liquidity and funding policies that are intended to maintain flexibility.

Additionally, liquidity risk is monitored through a risk management report on liquidity ratio, which is filed with the Central Bank of Iceland every month. The liquidity ratio measures the ratio of the liquid asset base to liabilities. To determine the liquid asset base the Central Bank every month. The liquidity ratio measures the ratio of the liquid asset base to liabilities. To determine the liquid asset base the Central Bank assigns weights to each asset class as a conservative measure of liquidity.

Notes, contd.:

76. Contd.:

The breakdown by contractual maturity of financial assets and liabilities, at 31 December 2007.

	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Cash and Central Bank balances	4,423,799					4,423,799
Loans and advances	24,833,267	12,775,204	21,143,766	31,242,667	7,202,927	97,197,831
Trading assets	136,354,791					136,354,791
Financial assets design. at fair value .	12,972,251					12,972,251
Total financial assets	178,584,108	12,775,204	21,143,766	31,242,667	7,202,927	250,948,672
Deposits from credit inst.	114,809,239	1,066,805	1,512,283			117,388,327
Other deposits	10,954,690					10,954,690
Trading liabilities	841,373					841,373
Borrowings and subordinated loans ..	36,086,357	4,358,391	23,111,582	36,166,516	7,440,021	107,162,867
Total financial liabilities	162,691,659	5,425,196	24,623,865	36,166,516	7,440,021	236,347,257
Net financial assets and liabilities	15,892,449	7,350,008	(3,480,099)	(4,923,849)	(237,094)	14,601,415
Unused creditlines	3,294,000	0	0	0	0	3,294,000
Unused overdrafts	70,711	0	0	0	0	70,711

Monitoring and controlling market risk

77. The Bank's policy is to monitor its market risk closely and to make sure that limits set by the Finance Committee are not exceeded. Market risk is managed by exposure limits and with limits on risk measures, both monitored on a daily basis and reviewed weekly by the Finance Committee.

Price risk

78. Price risk is the risk of market price changes. The Bank's shareholding and bond holding are most sensitive to such changes. Price risk management is disassociated with exchange rate risk. Price risk is measured by means of exposure analysis and on 31 December, 2006 (99%, 10 days) amounted to ISK 1,015 million.

Derivatives

79. The Bank uses derivatives for trading purposes and to hedge its exposure to market price risk, foreign exchange and interest rate risk arising from operating, financing and investing activities.

Interest rate risk

80. The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets (including investments) and interest-bearing liabilities mature or reprice at different times or in different amounts. In the case of floating rate assets and liabilities the Bank is also exposed to basis risk, which is the difference in repricing characteristics of the various floating rate indices, such as the savings rate and LIBOR-rates and different types of interest. Bank's Treasury division manages the balance between interest-earning assets and interest-bearing liabilities. It is the Bank's policy to maintain the best balance between maturity on interest-earning assets and interest-bearing liabilities, fixed interest rate and floating interest rate. The Bank's Treasury division is authorized to expose the Bank to interest rate risk, within limits, which reflect the Bank's expectation.

Notes, contd.:

80. Contd.:

The following table lists interest rate sensitivity, that is the difference between interest bearing assets and liabilities, broken down by currency and duration. Carrying amounts bearing fixed interest are categorized by their time to maturity. Carrying amounts bearing floating interest are categorized by their repricing frequency.

	Up to 6 months	6-12 months	1-5 year	Over 5 years
CAD	(6,000)	0	0	0
CHF	(7,699,000)	764,000	1,872,000	0
DKK	(684,000)	47,000	0	0
EUR	6,361,000	(1,723,000)	1,851,000	0
GBP	(2,938,000)	495,000	879,000	0
ISK	(14,049,000)	(3,960,000)	15,086,000	4,606,000
JPY	(6,736,000)	1,219,000	1,760,000	0
NOK	(1,349,000)	0	0	0
SEK	(767,000)	8,000	75,000	0
UAH	156,000	0	0	0
USD	(19,454,000)	7,824,000	1,903,000	32,000
Total	(47,164,000)	4,674,000	23,427,000	4,638,000

81. The total amount of indexed assets of the Bank amounted to ISK 12,104 million at year end (2006: ISK 17,163 million), and the total amount of indexed liabilities amounted to ISK 5,287 million (2006: ISK 13,042 million).

Currency risk

82. Currency risk is the risk of loss due to adverse movements in foreign exchange rates. Net exposures per currency are monitored centrally in the Bank. The Bank aims at limiting currency risk and monitors its exposure in relation to the Bank's total capital.

As a general rule the Bank aims for equilibrium between assets and liabilities in foreign currencies. It may however be deviated from, provided that provisions of the Central Bank rules on foreign currency balance, are met. This implies that the open foreign currency balance of the Bank in single foreign currencies shall neither be positive nor negative by an amount corresponding to more than 20% of its capital according to a definition in those rules and according to the last disclosed financial statements. The Bank's total foreign currency balance shall neither be positive nor negative in excess of 30% of its regulatory capital according to the last disclosed financial statements.

If foreign currency balance exceeds the aforementioned limits, adjustment actions shall be taken. The balance must be within set limits within three business days.

83. Breakdown of assets and liabilities by currency:

The total amount of assets in foreign currencies in the Bank's Financial Statements is ISK 177,129 million (2006: ISK 96,564), and the total amount of liabilities is ISK 174,457 million (2006: ISK 96,162 million) respectively, at year-end. Included in these assets and liabilities are forward contracts and interest rate swaps.

	EUR	USD	JPY	CHF	Other currencies	Total
Assets	83,093,977	22,986,076	27,515,476	23,458,005	20,075,734	177,129,268
Liabilities	82,207,969	22,270,460	27,866,371	23,477,339	20,634,763	176,456,902
Net on-balance sheet position	886,007	715,616	(350,895)	(19,334)	(559,029)	672,366

Un-audited Information

Quarterly Statements

Summary of the Bank's results by quarters:

2007	Q4	Q3	Q2	Q1	Total
Net interest income	510,448	675,086	649,112	506,737	2,341,383
Other operating income	(3,258,150)	(241,443)	2,543,907	1,952,091	996,405
Operating cost	(569,743)	(299,650)	(313,197)	(253,169)	(1,435,759)
Impairment	(77,730)	(54,904)	(35,407)	(13,538)	(181,579)
Profit before income tax	(3,395,175)	79,089	2,844,415	2,192,121	1,720,450
Income tax	748,766	(14,237)	(445,193)	(393,683)	(104,347)
Profit for the period	(2,646,409)	64,852	2,399,222	1,798,438	1,616,103
2006	Q4	Q3	Q2	Q1	Total
Net interest income	149,861	500,709	362,246	240,993	1,253,809
Other operating income	(428,785)	5,107,502	1,358,510	529,375	6,566,602
Operating cost	(423,354)	(178,495)	(223,412)	(170,664)	(995,925)
Impairment	49,596	(22,500)	10,500	(22,500)	15,096
Profit before income tax	(652,682)	5,407,216	1,507,844	577,204	6,839,582
Income tax	118,901	(971,141)	(221,820)	(103,897)	(1,177,957)
Profit for the period	(533,781)	4,436,075	1,286,024	473,307	5,661,625