

**Icebank hf.**

**Interim Accounts  
1 January - 30 June 2006**

Icebank hf.  
Raudarárstíg 27  
105 Reykjavík

Reg. no. 681086-1379

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# Endorsement and Signatures of the Board of Directors and the Managing Director

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The Interim Account of Icebank hf. for the six months ended 30 June 2006 have been prepared in accordance with International Financial Reporting Standards (IFRS). These are the Bank's first Interim Accounts where IFRS has been applied. According to the Profit and Loss Account net earnings for the period 1 January to 30 June 2006 amounted to ISK 1,759 million. Equity according to the Balance Sheet at the end of the period amounted to ISK 8,104 million including shareholders' equity amounting to ISK 691 million. The Bank's equity ratio, calculated according to the Act on Financial Undertakings, was 14.5% for the Bank. This ratio may not be lower than 8.0%.

During the year, the Bank's equity was increased by nominal value of ISK 81 million and market value of ISK 610 million.

The changes in the Bank's shareholders' equity as of 1 January 2005 as a result of the implementation of IFRS is an increase amounting to ISK 89 million. Further information on the effects of adopting IFRS are in the notes to the Interim Accounts.

The Board of Directors and the Managing Director of Icebank hf. hereby confirm the Interim Accounts for the period from 1 January to 30 June 2006, by means of their signature.

Reykjavík, 15 August 2006

## **Board of Directors:**

Geirmundur Kristinsson  
chairman

Fridrik Fridriksson

Gudmundur Hauksson

Magnús Ægir Magnússon

Ragnar Z. Guðjónsson

## **Managing Director:**

Finnur Sveinbjörnsson

# Auditors' Report

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To the Board of Directors and shareholders of Icebank hf.

## **Introduction**

We have reviewed the accompanying Balance Sheet of Icebank hf. as of 30 June 2006 and the related Profit and Loss Account, Changes in Equity and Cash Flows for the six months period then ended. Management is responsible for the preparation and presentation of these interim account in accordance with International Financial Reporting Standard IAS 34, Interim Financial Reporting. Our responsibility is to express a conclusion on this interim account based on our review.

## **Scope of review**

We conducted our review in accordance with International Standard on Review Engagements 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity." A review of interim financial information consists of making inquiries, primarily to persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

We have also reviewed the changes that have been made to the balance sheet with the transition to International Financial Reporting Standards (IFRS), that were approved by the EU. As explained in the notes, figures might change during the year, mainly because the Annual Accounts will be made according to IFRS in force at year-end.

## **Conclusion**

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim accounts are not prepared, in all material respects, in accordance with IAS 34, Interim Financial Reporting.

Reykjavík, 15 August 2006.

Sigurður Jónsson

*KPMG Endurskoðun hf.*

# Profit and Loss Account

## for the Period from 1 January to 30 June 2006

	Notes	2006 1.1.-30.6.	2005 1.1.-30.6
Interest income .....		2,552,158	1,594,382
Interest expenses .....		(1,948,919)	(1,200,336)
<b>Net interest income</b> .....		<u>603,239</u>	<u>394,046</u>
Fee and commission income .....		111,856	94,197
Fee and commission expenses .....		(30,604)	(32,915)
<b>Net fee and commission income</b> .....		<u>81,252</u>	<u>61,282</u>
Dividend income .....	25	291,616	80,184
Net (loss) gain on financial assets and liabilities not at fair value .....	26	(10,352)	22,255
Net gain on financial assets at fair value .....	27	1,402,671	690,889
Net foreign exchange difference .....		104,372	86,962
Share of profit of associates .....		1,264	210
Other operating income .....		17,062	10,158
<b>Operating income</b> .....		<u>1,806,633</u>	<u>890,658</u>
Salaries and related expenses .....		219,723	167,737
Administration expenses .....		168,678	131,760
Depreciation and amortisation .....		5,675	25,367
Impairment on loans and advances .....		12,000	85,000
<b>Profit before income tax</b> .....		2,085,048	936,122
Income tax .....		(325,717)	(170,942)
<b>Net earnings</b> .....		<u><u>1,759,331</u></u>	<u><u>765,180</u></u>
<b>Earnings per share</b>			
Earnings per share .....	28	2.8	1.3

# Balance Sheet

## as at 30 June 2006

	Notes	30.6.2006	1.1.2006
<b>Assets</b>			
Cash and cash balances with Central bank .....		7,496,454	8,494,369
Loans .....	29	58,207,764	47,448,072
Trading assets .....	36	5,568,520	5,123,550
Financial assets at fair value .....	37	7,323,496	4,201,155
Investment in associates .....		25,213	24,619
Property and equipment .....	38	344,946	329,994
Other assets .....	39	126,247	45,015
		<u>79,092,640</u>	<u>65,666,774</u>
<b>Total Assets</b>			
<b>Liabilities</b>			
Credit institutions and Central Bank .....	40	14,015,196	13,675,151
Deposits .....	41	2,647,656	4,165,338
Borrowings .....	42	50,310,844	39,827,865
Subordinated loans .....	44	2,484,114	1,126,393
Trading liabilities .....		113,150	17,345
Tax liabilities .....		1,241,542	915,825
Other liabilities .....	45	175,787	203,784
		<u>70,988,289</u>	<u>59,931,701</u>
<b>Total Liabilities</b>			
<b>Equity</b>			
Share capital .....		691,270	609,944
Statutory reserves .....		879,924	351,306
Retained earnings .....		6,533,157	4,773,823
		<u>8,104,351</u>	<u>5,735,073</u>
<b>Total Equity</b>			
<b>Total Liabilities and Equity</b>			
		<u>79,092,640</u>	<u>65,666,774</u>
<b>Off Balance Sheet items</b>			
Obligations .....	48	4,539,178	3,835,215

## Statement of Changes in Equity

### for the period from 1 January to 30 June 2006

	Equity			Total
	Share capital	Statutory reserves	Retained earnings	
<b>Changes in equity in 2006</b>				
Equity 1 January 2006 .....	609,944	351,306	4,727,268	5,688,518
Changes due to implementation of IFRS .....	0	0	46,555	46,555
Equity 1 January 2006, adjusted .....	609,944	351,306	4,773,823	5,735,073
Net earnings according to the Profit and Loss Account .....	0	0	1,759,331	1,759,331
Paid-in capital .....	81,326	528,618	0	609,944
Equity 30 June 2006 .....	<u>691,270</u>	<u>879,924</u>	<u>6,533,154</u>	<u>8,104,348</u>
<b>Changes in equity in 2005</b>				
Equity 1 January 2005 .....	604,464	248,078	2,383,590	3,236,132
Changes due to implementation of IFRS .....	0	0	89,033	89,033
Equity 1 January 2005 .....	604,464	248,078	2,472,623	3,325,165
Net earnings according to the Profit and Loss Account .....	0	0	765,180	765,180
Equity 30 June 2005 .....	<u>604,464</u>	<u>248,078</u>	<u>3,237,803</u>	<u>4,090,345</u>

## Statement of Cash Flows

### for the Period from 1 January to 30 June 2006

	2006	2005
	1.1.-30.6.	1.1.-30.6.
Net cash provided by operating activities .....	559,389	1,025,528
Net cash flow used in investing activities .....	(12,106,234)	(1,967,118)
Net cash flow provided by financing activities .....	10,548,930	2,725,860
(Decrease) increase in cash and cash equivalents .....	(997,915)	1,784,270
Cash and cash equivalents at beginning of the year .....	8,494,369	5,209,298
<b>Cash and cash equivalents at end of the period .....</b>	<u>7,496,454</u>	<u>6,993,568</u>

# Notes to the Interim Accounts

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## Accounting Policies

### General information

Icebank hf. is a bank (referred to as "the Bank") domiciled at Raudarárstígur 27 in Reykjavík. The Condensed Interim Accounts for the six months ended 30 June 2006 have been prepared in Icelandic currency and amounts are presented in thousands of Icelandic krónur.

The Condensed Interim Accounts were authorised for issue by the Board of Directors of Icebank hf. on 15 August 2006.

### Summary of significant accounting policies

#### 1. Statement of compliance

The Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU. These are the Bank's first IFRS Interim Accounts and IFRS 1 First-time Adoption of International Financial Reporting Standards has been applied.

An explanation of how the transition to IFRS has affected the reported financial position and financial performance of the Bank is provided in note 51. This note includes reconciliations of capital and profit or loss for comparative periods reported under Icelandic Generally Accepted Accounting Principles (IS-GAAP), to those reported for those periods under IFRS.

The amendments made in 2005 to IAS 39, IAS 32 and IFRS 1 relating to the fair value option have been effective for annual periods beginning on or after 1 January 2006. The Bank has applied these amendments in the Annual Accounts for the year 2005, before their effective date. The application of the amendments coincides with the initial application of IAS 39 as explained in note 51.

#### 2. Basis of preparation

The Interim Accounts are prepared on the historical cost basis except the following assets and liabilities are measured at their fair value: derivative financial instruments, financial instruments held for trading and financial instruments designated at fair value through profit and loss.

The preparation of the Financial Statements in conformity with IFRS requires management to make judgements, estimates and assumptions. These judgements, estimates and assumptions affect the reported amounts of assets and liabilities as well as income and expenses recognised in the financial statements. The estimates and associated 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 values of assets and liabilities that are not readily apparent from other sources. Actual may differ from the estimates and the assumptions made.

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.

Judgements made by management in the application of IFRS that have significant effect on the Interim Accounts and estimates with a significant risk of material adjustment in the next year are discussed in note 24.

#### Implementation of International Financial Reporting Standards (IFRS)

The preparation of the Interim Accounts in accordance with IFRS resulted in changes to the accounting policies as compared with the most recent Annual Accounts prepared under IS-GAAP. The accounting policies set out below have been applied consistently to all periods presented in these Interim Accounts. They have also been applied in preparing an opening IFRS Balance Sheet at 1 January 2005 for the purposes of the transition to IFRS, as required by IFRS 1.

# Notes to the Interim Accounts

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## 3. Associates

Associates are those entities over which the Bank has significant influence, i.e. the power to participate in the financial and operating policy decisions of the associates but not control or joint 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. The Bank's investment in associates may include goodwill (net of any accumulated impairment loss) identified on acquisition (see note 22).

The Interim Accounts include the Bank's share of the total recognised gains and losses of associates on an equity accounted basis, from the date that significant influence commences until the date that significant influence 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.

## 4. Foreign currency

The Bank's functional currency is Icelandic krónas (ISK). 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 at the balance sheet date are translated to Icelandic krónas at the foreign exchange rate ruling at that 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 kronas at foreign exchange rates ruling at the dates the fair value was determined.

## 5. Financial instruments - 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 exposure to market price risk, foreign exchange and interest rate risk arising from operating, financing and investing activities.

Derivatives are recognised at fair value. Fair value changes are recognised in the income statement, except in the case of derivatives that are designated and are effective hedging instruments, whose fair value changes are recognised in accordance with the accounting policies in note 7. Fair values of derivatives are split into (i) interest income (see note 21 a), (ii) foreign exchange differences (see note 4) and other gains and losses. Interest income is recognised on accrual basis. Derivatives with positive fair values are recognised as trading assets and derivatives with negative fair values are recognised as trading liabilities (see note 16).

Derivatives embedded in host contracts are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit and loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the profit and loss account. They are presented in the balance sheet in the same line as the host contracts.

The fair value of derivatives is determined in accordance with the accounting policy presented in note 8.

## 6. Loans

Loans are non-derivative financial instruments with fixed or determinable payments that are not quoted in an active market, other than those that the Bank upon initial recognition designates as at fair value through profit or loss. 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 are initially reported at disbursement of the loan. They are initially recognised at fair value, which is the cash given to originate the loan, including any transaction costs, and are subsequently measured at amortised cost using the effective interest method. Accrued interest is included in the carrying amount of the loans.

# Notes to the Interim Accounts

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## 7. Financial assets measured at fair value through profit and loss

### a) *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.

### b) *Financial assets measured at fair value*

The Bank classifies certain financial assets upon their initial recognition as financial assets held at fair value with fair value changes recognised in the profit and loss account if doing so results in more relevant information because:

- it eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or
- financial assets and/or financial liabilities are managed and their performance is evaluated on a fair value basis, in accordance with the Bank's risk management or investment strategy, and information about it is provided internally on that basis to the

## 8. 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.

The best evidence of the fair value of a derivative 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 (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When such evidence exists, the Bank recognises profits on day one.

## 9. 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 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 specified in the contract is discharged or cancelled or expires.

## 10. 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, or realise the asset and settle the liability simultaneously.

## 11. Repurchase agreements

A repurchase agreement involves the sale of securities subject to the simultaneous agreement to repurchase the same securities at a certain later date and at an agreed price. In repurchase agreements, the cash received, including accrued interest is recognised in the Balance Sheet. The proceeds from the legal sale of these securities are reported as borrowings.

# Notes to the Interim Accounts

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The control of the securities remains with the Bank throughout the entire term of the transaction and the securities continue to be reported in the Bank's Balance Sheet as Financial assets measured at fair value, as appropriate. Interest incurred is recognized as interest expense over the life of each agreement.

## 12. Leases

### *Operating lease*

Lease payments under operating leases where the Bank is the lessee are recognised as an expense on a straight-line basis over the lease term.

## 13. Property and equipment

### a) *Owned assets*

Items of property and equipment are measured at cost less accumulated depreciation and impairment losses, according to the cost model in IAS 16.

Where parts of an item of property and equipment have different useful lives, those components are accounted for as separate items of property and equipment.

### b) *Subsequent costs*

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. The decision if subsequent costs is added to the acquisition cost of the property or equipment, is based on whether an identified component, or part of such component, has been replaced or not, or if the nature of the subsequent cost means a contribution of a new component. All other costs are recognised in the Profit and Loss Account as an expense as incurred.

### c) *Depreciation*

The depreciable amount of property and equipment is determined after deducting its residual value. Depreciation is charged to the Profit and Loss Account on a straight-line basis over the estimated useful lives of each part of an item of property and equipment.

Property and equipment .....	25 - 50 years
Machinery and equipment .....	4-5 years

Residual value is reassess annually.

## 14. Borrowings

Borrowings are financial liabilities of the Bank which consist of issued bonds and leases from credit institutions. They are initially recognised at fair value less attributable transaction costs. Subsequent to initial recognition, borrowings are measured at amortised cost using the effective interest method. Accrued interest is included in the carrying amount of the borrowings.

## 15. Subordinated loans

The Bank has borrowed funds by issuing bonds on subordinate terms. The bonds have the characteristics of equity in being subordinated to other liabilities of the Bank. In the calculation of equity ratio, the bonds are included in equity, as shown in note 46. Subordinated loans are entered among liabilities with interest, exchange rate differences and indexation.

## 16. Trading liabilities

Trading liabilities primarily consist of derivatives with negative fair values and delivery obligations for short sales of securities.

Trading liabilities are measured at fair value. Gains and losses realised on disposal or redemption and unrealised gains and losses from changes in the fair value of trading liabilities are reported as net gain on financial assets/liabilities measured at fair value. Interest expenses on trading liabilities are included in Interest expenses.

# Notes to the Interim Accounts

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## 17. Obligations

The liability is recognised in the balance sheet when the Bank is legally obligated due to past events and it is likely that the Bank will suffer the cost. If the effects are considerable the obligations are determined by discounting the future cash flow with the pre-tax ratio and with that method evaluate the risk that is connected to the obligation.

## 18. Other assets and other liabilities

Other assets and other liabilities are measured at cost.

## 19. Share capital

### a) *Treasury shares*

Acquired own shares and other equity instruments (treasury shares) are deducted from equity. No gain or loss is recognised in Profit and Loss Account on the purchase, sale, issue or cancellation of treasury shares. Consideration paid or received is recognised directly in equity. Incremental transaction costs of treasury share transaction are accounted for as a deduction from equity (net of any related income tax benefit).

### b) *Dividends*

Dividends on shares are recognised in equity in the period in which they are approved by the Bank's shareholders. Dividends for the year that are declared after the Balance Sheet date are dealt with in the subsequent events note.

## 20. Cash and cash equivalents

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

## 21. Income and Expense

### a) *Interest income and expense*

Interest income and expense are recognised in the Profit and Loss Account as it accrues, taking into account the effective yield of the asset or an applicable floating rate. Interest income and expense includes the amortisation of any discount or premium or other differences between the initial carrying amount of an interest bearing instrument and its amount at maturity calculated on an effective interest rate basis.

The effective interest rate method is a method of calculating the amortised cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts 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 cash flows, considering all contractual terms of the financial instrument, but does not consider future credit losses. The calculation generally includes all fees and amounts paid or received between parties to the contract that are an integral part of the effective interest rate, as well as transaction costs and all other premiums or discounts.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised at the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. Interest income on financial assets which have been written down as a result of impairment is calculated based on the net amount of the financial asset taking the write-down into consideration.

### b) *Fee and commission income*

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, commission from asset management and other services. Fees earned from services that are provided over a certain period of time are recognised as the services are provided. Fees earned from transaction-type services are recognised when the service has been completed. Fees that are performance-linked are recognised when the performance criteria are fulfilled.

### c) *Dividend income*

Dividend income is recognised in the Profit and Loss Account on the date that the dividend is declared. Income from equity investments and other non-fixed income investments is recognised as dividend income when it accrues.

# Notes to the Interim Accounts

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## 22. Impairment

The carrying amount of the Bank's assets, other than financial assets measured at fair value with changes recognised in the income statement 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, see note 22 c.

An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the Profit and Loss Account.

### a) *Impairment on loans and advances*

The Bank recognises losses for impaired loans promptly where there is objective evidence that impairment of a loan or portfolio of loans has occurred. This is done on a consistent basis in accordance with the Bank's guidelines.

There are two basic methods of calculating impairment losses, those calculated on individual loans and those losses assessed on a collective basis. Losses expected as a result of future events, no matter how likely, are not recognised.

Objective evidence of impairment includes observable data about the following loss events:

- (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 since the initial recognition of those assets, 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*

Impairment losses on individually assessed accounts 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 a loan is impaired. This procedure is applied to all accounts that are considered individually significant. In determining such impairment losses on individually assessed accounts, 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

### *Collectively assessed loans*

Where loans 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;
- future cash flows in a group of loans evaluated for impairment are estimated on the basis of the contractual cash flows; and
- 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 to the Interim Accounts

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Estimates of changes in future cash flows for groups of assets should be 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 Group to minimise any differences between loss estimates and actual losses.

## *Loan write-offs*

Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery of these amounts and, for collateralised loans, when the proceeds from the realisation of security have been received.

## *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 reversed. The amount of any reversal is recognised in the Profit and Loss Account.

## *Assets acquired in exchange for loans*

Non-financial assets acquired in exchange for loans in order to achieve an orderly realisation are recorded as assets held for sale and reported in the balance sheet. The asset acquired is recorded at the lower of its fair value less costs to sell and the carrying amount of the loan, net of impairment allowance amounts, at the date of exchange. No depreciation is provided in respect of assets held for sale. Any subsequent write-down of the acquired asset to fair value less costs to sell is recorded as an impairment loss and included in the income statement. Any subsequent increase in the fair value less costs to sell, to the extent this does not exceed the cumulative impairment loss, is recognised in the Profit and Loss Account. At the end of June the Bank held no such assets.

## c) *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 (i.e. the effective interest rate computed at initial recognition of these financial assets). However, the current stage of the effective interest rates is used in calculating the recoverable amount of loans and advances with variable interest rates.

The recoverable amount of other assets is the greater of their net selling price 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.

## d) *Reversals of impairment*

An impairment loss in respect of financial assets carried at amortised cost is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

An impairment loss in respect of an investment in an equity instrument classified as available-for-sale is not reversed through profit or loss. If the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the Profit and Loss Account the impairment loss shall be reversed, with the amount of the reversal recognised in the Profit and Loss Account.

In respect of other assets, 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 amortisation, if no impairment loss had been recognised.

# Notes to the Interim Accounts

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## 23. Income tax

Income tax on the profit or loss for the period comprises current and deferred tax. Income tax is recognised in the Profit and Loss Account 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 or substantially 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 entered 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 Annual Accounts on the other. This difference is due to the fact that tax assessments are based on premises that differ from those governing the Annual Accounts, mostly because revenues, especially from financial assets, are recognised earlier in the Annual Accounts than in the tax return.

## Critical accounting estimates and judgements in applying accounting policies

24. The Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

### a) *Impairment losses on loans and advances*

The Bank reviews its loan portfolios to assess impairment at least on a six 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 has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with 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 derivatives*

The fair value of financial instruments that are not quoted in active markets are determined by using valuation techniques. Where valuation techniques (for example models) are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created them. All models are certified before they are used, and models are calibrated to ensure that outputs reflect actual data and comparative market prices. To the extent practical, models use only observable data, however areas such as credit risk (both own and counterparty), volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect reported fair value of financial instruments.

# Notes to the Interim Accounts

## Dividend income

	1.1.-30.6. 2006	1.1.-30.6. 2005
25. Dividend income are specified as follows:		
Dividend income on trading assets .....	290,023	69,151
Dividend income on assets at fair value through profit and loss .....	1,593	11,033
<b>Total dividend income .....</b>	<b>291,616</b>	<b>80,184</b>

## Net gains on financial assets and financial liabilities held for trading

26. Net (loss) gain on financial assets and financial liabilities held for trading are specified as follows:		
Shares and related derivatives .....	53,297	90,899
Bonds and related derivatives .....	(63,649)	(68,644)
<b>Net (loss) gain on financial assets and financial liabilities held for trading .....</b>	<b>(10,352)</b>	<b>22,255</b>

## Net gains on financial assets designated at fair value through profit or loss

27. Net gain on assets designated at fair value through profit or loss		
Shares .....	1,402,671	690,889

## Earnings per share

	1.1.-30.6. 2006	1.1.-30.6. 2005
28. Earnings per share are specified as follows:		
Net earnings .....	1,759,331	765,180
Equity according to Interim Accounts at the beginning of the period .....	609,944	604,465
Effects of increase/sale of share during the period .....	29,368	1,827
Weighted average of outstanding shares for the period .....	639,312	606,292
Earnings per share .....	2.8	1.3

## Earnings per share

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

# Notes to the Interim Accounts

Loans			
29. Loans are specified as follows:		30.6.2006	1.1.2006
Loans to credit institutions .....		31,643,638	26,493,478
Loans to customers .....		27,002,628	21,405,633
Provision for losses .....		(438,502)	(451,039)
<b>Loans</b> .....		58,207,764	47,448,072
30. Loans to credit institutions specified by types of loans:			
Bank accounts .....		649,994	313,725
Money market loans .....		10,697,657	3,350,240
Repos .....		898,134	900,734
Other loans .....		19,397,853	21,928,779
<b>Loans to credit institutions</b> .....		31,643,638	26,493,478
31. Loans to credit institutions specified by maturity:			
Up to 3 months .....		10,226,938	9,380,502
Over 3 months and up to a year .....		9,757,204	6,384,256
Over 1 year and up to 5 years .....		8,291,821	7,686,475
Over 5 years .....		3,367,675	3,042,245
<b>Loans to credit institutions</b> .....		31,643,638	26,493,478
32. Loans to customers specified by types of loans:			
Overdrafts .....		1,104,585	170,417
Other loans .....		25,459,541	20,784,177
<b>Loans to customers</b> .....		26,564,126	20,954,594
33. Loans to customers specified by sectors:			
Municipalities .....		0.3%	0.3%
Business enterprises:			
Agriculture .....		0.2%	0.2%
Fishing .....		6.9%	9.6%
Industry .....		29.0%	15.4%
Commerce .....		16.0%	5.0%
Service .....		38.6%	43.9%
(Individuals) other .....		9.0%	25.6%
<b>Loans to customers</b> .....		100.0%	100.0%
34. Loans to customers specified by maturity:			
On demand .....		42,946	40,732
Up to 3 months .....		6,454,374	5,591,884
Over 3 months and up to a year .....		2,592,144	2,653,083
Over 1 year and up to 5 years .....		12,729,631	8,876,317
Over 5 years .....		4,745,031	3,792,578
<b>Loans to customers</b> .....		26,564,126	20,954,594

# Notes to the Interim Accounts

## Provision on loans and advances

35. Changes in the provision on loans and advances are specified as follows:	1.1.-30.6	1.1.-30.6.
	2006	2005
Balance at the beginning of the year .....	451,039	464,669
Impairment on loans and advances during the period .....	12,000	85,000
Write offs during the period .....	(24,537)	(110,744)
<b>Provision on loans and advances .....</b>	<b>438,502</b>	<b>438,925</b>

## Trading assets

36. Trading assets are specified as follows:	30.6.2006	1.1.2006
Market securities and other bonds with fixed income .....	4,330,326	3,650,136
Shares and other securities with variable income .....	1,238,194	1,473,414
<b>Trading assets .....</b>	<b>5,568,520</b>	<b>5,123,550</b>

## Financial assets at fair value

37. Financial assets at fair value are specified as follows:		
Securities .....	261,528	176,806
Shares .....	7,061,968	4,024,349
<b>Financial assets at fair value .....</b>	<b>7,323,496</b>	<b>4,201,155</b>

## Property and equipment

38. Property and equipment are specified as follows:

	Property and equipment	Machinery and equipm.	Total 30.6.2006	Total 31.12.2005
Balance 1 January.....	414,254	12,498	426,752	700,329
Additions during the period.....	17,186	3,441	20,627	0
Disposals during the period.....	0	0	0	(273,577)
Total value at the end of the period.....	431,440	15,939	447,379	426,752
Previously depreciated .....	90,504	6,254	96,758	312,942
Depreciated during the period.....	4,338	1,337	5,675	46,758
Disposals during the year .....	0	0	0	(262,942)
Total depreciation at the end of the period .....	94,842	7,591	102,433	96,758
Book value at the end of the period.....	336,598	8,348	344,946	329,994
Depreciation ratio .....	2-4%	20-25%		

# Notes to the Interim Accounts

<b>Other assets</b>	30.6.2006	1.1.2006
39. Other assets are specified as follows:		
Sundry assets .....	38,162	42,504
Prepaid expenses and accrued income .....	88,085	2,511
<b>Other assets</b> .....	126,247	45,015

## Deposits from credit institutions and the Central Bank

40. Deposits from credit institutions and the Central Bank mature as follows:		
Up to 3 months .....	14,015,196	13,675,151

## Other deposits

41. Other deposits mature as follows:		
Up to 3 months .....	2,579,452	4,165,338
Over 3 months and up to a year .....	0	0
Over 1 year and up to 5 years .....	68,204	0
<b>Other deposits</b> .....	2,647,656	4,165,338

## Borrowings

42. Borrowings are specified as follows:		
Bonds issued .....	6,293,065	8,049,567
Loans from credit institutions .....	44,017,779	31,778,298
<b>Borrowings</b> .....	50,310,844	39,827,865
43. Borrowings mature as follows:		
Up to 3 months .....	11,866,612	15,275,605
Over 3 months and up to a year .....	5,082,865	5,518,475
Over 1 year and up to 5 years .....	28,355,976	14,421,780
Over 5 years .....	5,005,391	4,612,005
<b>Borrowings</b> .....	50,310,844	39,827,865

# Notes to the Interim Accounts

**Subordinated loans** 30.6.2006 1.1.2006

44. Subordinated loans are specified as follows:

Tier II capital .....	2,484,114	1,126,393
<b>Subordinated loans</b> .....	<u>2,484,114</u>	<u>1,126,393</u>

## Other liabilities

45. Other liabilities are specified as follows:

Sundry liabilities .....	74,395	75,080
Accrued expenses and deferred income .....	101,392	128,704
<b>Other liabilities</b> .....	<u>175,787</u>	<u>203,784</u>

## Capital

46. During the year the Bank's capital was increased by ISK 81 million and the premium for the sold stock amounted to ISK 529 million. Equity at the end of the period amounted to ISK 8,104 million. Equity ratio, calculated in accordance to Article 84 of the Act on Financial Undertakings, was 14.5%. According to law the ratio may not go below 8.0%.

The ratio is calculated as follows:

	30.6.2006		31.12.2005	
	Book value	Weighted value	Book value	Weighted value
<b>Risk I:</b>				
Assets recorded in the Accounts .....	79,092,640	42,753,762	65,609,999	32,829,418
Assets deducted from capital .....		(4,698,263)		(2,713,809)
Guarantees and other items not included in the Balance Sheet .....		2,541,019		2,587,202
		<u>40,596,518</u>		<u>32,702,811</u>
<b>Capital:</b>				
<b>Tier I capital:</b>				
Equity .....		8,104,351		5,688,518
<b>Tier II capital:</b>				
Subordinated loans .....		2,484,113		1,126,393
Investment in credit institutions .....		(4,698,263)		(2,713,809)
		<u>5,890,201</u>		<u>4,101,102</u>
<b>Equity ratio</b> .....				
Thereof Tier I ratio .....		14.5%		12.5%

# Notes to the Interim Accounts

## Derivatives

47. Derivatives remaining maturity date of principal and book value are specified as follows:

	Principal			Total	Book value	
	Up to 3 months	Over 3 months and up to a year	Over 1 year		Assets	Liabilities
OTC currency and interest rate derivatives:						
Forward currency agreements .....	38,418,613	1,789,694	0	40,208,307	766,074	869,641
Ineterest rate agreements .....	0	1,000,000	280,030	1,280,030	28,463	38,045
	<u>38,418,613</u>	<u>2,789,694</u>	<u>280,030</u>	<u>41,488,337</u>	<u>794,537</u>	<u>907,686</u>
OTC equity derivatives:						
Forward equity agreements .....	187,465	1,833,353	0	2,020,818	83,585	46,861
	<u>187,465</u>	<u>1,833,353</u>	<u>0</u>	<u>2,020,818</u>	<u>83,585</u>	<u>46,861</u>
	<u>38,606,078</u>	<u>4,623,047</u>	<u>280,030</u>	<u>43,509,155</u>	<u>878,122</u>	<u>954,547</u>

## Obligations

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

		30.6.2006	1.1.2006
Guarantees .....		4,454,668	3,773,557
Unused overdrafts .....		84,510	61,658

## Related parties

49. The Bank has a related party relationship with its subsidiaries, 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 SPRON (24.5%), Sparisjóður Hafnarfjardar (14.7%), Sparisjóður vélstjóra (14.0%) and Sparisjóðurinn in Keflavík (11.6%). This definition is based on IAS 24. Information regarding related parties are as follows:

Loans to the managing director and management board members .....	0	0
Loans to members of the board and companies related to members of the board .....	0	0
Loans to associated companies .....	25,930	0

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

The Bank has entered into forward contracts with the Managing Director and the nominal value of the contracts amounts to ISK 102,225 thousand. At the end of the period the net balance of the contracts was negative to the amount of ISK 34,730 thousand.

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

50. There have been no material post Balance Sheet events which would require disclosure or adjustment to the 30 June 2006, Interim Accounts. On 15 August 2006 the Board of Directors reviewed the Interim Accounts and authorised them for publication.

# Notes to the Interim Accounts

## Changes to accounting policies in accordance with International Financial Reporting Standards (IFRS)

51. As discussed in note 1 on accounting policies, this is the first time the Bank has prepared its annual accounts in accordance with the International Financial Reporting Standards (IFRS).

The accounts for the operating year 2006 will be prepared in accordance with the accounting policies discussed in the notes on accounting policies. This also applies to comparative figures for 2005 and the opening balance sheet of 1 January 2005, as changes become effective as of that date, which is referred to as the transition date.

Amounts in the opening Balance Sheet of 1 January 2005 have been changed in accordance with IFRS, but were previously presented in accordance with legislation on annual accounts and Icelandic GAAP (Generally Accepted Accounting Principles). The following tables and notes show the effects the change from Icelandic GAAP (IS-GAAP) to IFRS has had on the financial position of the Bank, its financial results and cash flows. There are no significant changes to the cash flows summary according to IFRS compared with how it was previously under IS-GAAP.

<b>Changes in capital from IS-GAAP to IFRS:</b>	<b>Capital</b>
Capital according to IS-GAAP at 31 December 2005 .....	5,688,518
Capital according to IFRS at 1 January 2006 .....	5,735,073
<b>Change in capital from IS-GAAP to IFRS</b>	<u>46,555</u>
 <b>Adjustments at the beginning of the year 2005:</b>	
Loans .....	IAS 39 100,000
Net fee and commission income .....	IAS 39 8,577
Recalculation of tax liability .....	IAS 12 (19,544)
<b>Total transition to IFRS 1 January 2005</b>	<u>89,033</u>
 <b>Adjustments in 2005:</b>	
Net fee and commission income .....	(1,802)
Provision for losses .....	(50,000)
Recalculation of tax liabilities .....	9,324
<b>Total adjustments in 2005</b>	<u>(42,478)</u>
<b>Changes from previous GAAP to IFRS</b>	<u>46,555</u>

The total effect on capital of the transition to IFRS is an increase of ISK 89 million. The following describes the effects of these new accounting policies on the Bank's Balance Sheet and Profit and Loss Account.

### *Origination fees*

The main changes resulting from the introduction of the IFRS are as follows: origination fees will be accrued over the term of the loan instead of being recognised as income and interest expenses at the time of disbursement. As a result the Bank's interest income will decrease in the short term but the long term effects will be insignificant.

### *Impairment of loans and advances*

In accordance with IAS 39 the Bank has performed the impairment of loans. As a result the Bank's equity increased by ISK 41 million, when income tax has been taken into consideration.

According to IAS 39 the Bank is obligated to review all loans to ascertain whether there is objective evidence of impairment that affects the size of expected cash flows from the loan. The loan will then be written down to the present value of expected future cash flows.

# Notes to the Interim Accounts

## From IS-GAAP to IFRS

The following tables provide an overview of the effect of the transition to IFRS by valuation and presentation.

### Profit and Loss Account 2005, change from IS-GAAP to IFRS

		Change in valuation	Change in presentation		
<b>According to IS-GAAP</b>					<b>According to IFRS</b>
Net interest income.....	823,286			823,286	Net interest income
Fees, commissions and other service charges .....	207,823	(12,381)			
Fees, commissions and other service charges, paid .....	(87,174)	10,579		118,847	Net fee and commission income
Dividends from shares and other holdings .....	1,215		131	1,346	Dividend income
Trading gains.....	2,801,037		(1,528,965)	1,272,072	Net gain on financial assets / liabilities not at fair value
			1,402,671	1,402,671	Net gain on financial assets / liabilities at fair value
			126,294	126,294	Foreign exchange difference
			(131)	(131)	Share of profit of associates
Other operating income.....	28,330			28,330	Other operating income
Salaries and salary related expenses.....	(373,300)			(373,300)	Salaries and related expenses
Other administrative expenses.....	(288,269)			(288,269)	Administration expenses
and amortisation .....	(46,758)			(46,758)	Depreciation
Provision for losses.....	(91,578)	(50,000)		(141,578)	Impairment on loans
Income tax.....	(551,560)	9,324		(542,236)	Income tax
<b>Net earnings according to IS-GAAP</b>	<b>2,423,052</b>	<b>(42,478)</b>	<b>0</b>	<b>2,380,574</b>	<b>Net earnings according to IFRS</b>

# Notes to the Interim Accounts

## Balance Sheet, change from IS-GAAP to IFRS

IS-GAAP 31 December 2005		Change in valuation	Change in presentation		IFRS 1 January 2006
Cash and amounts due from credit institutions .....	34,987,847		( 26,493,478)	8,494,369	Cash and cash balances with Central Bank
Loans .....	20,897,819	56,775	26,493,478	47,448,072	Loans and advances
Bonds, shares and other securities .....	9,324,705		( 4,201,155)	5,123,550	Trading assets Financial assets designated at fair value
-	0		4,201,155	4,201,155	
Shares in associated companies.....	24,619			24,619	Investment in associates
Property and equipment.....	329,994			329,994	Property and equipment
Other assets.....	45,015			45,015	Other assets
<b>Total Assets</b>	<b>65,609,999</b>	<b>56,775</b>	<b>0</b>	<b>65,666,774</b>	<b>Total Assets</b>
Amounts owed to credit institutions .....	13,675,151			13,675,151	Deposits from credit institutions and Central Bank
Savings deposits.....	4,165,338			4,165,338	Other deposits
Borrowings .....	39,845,210		( 17,345)	39,827,865	Borrowings
Subordinated loans.....	1,126,393			1,126,393	Subordinated loans
-	0		17,345	17,345	Trading liabilities
Provision for deferred income-tax liability .....	905,605	10,220		915,825	Tax liabilities
Other liabilities.....	203,784	0		203,784	Other liabilities
Equity.....	5,688,518	46,555		5,735,073	Equity
<b>Total Liabilities and Equity</b>	<b>65,609,999</b>	<b>56,775</b>	<b>0</b>	<b>65,666,774</b>	<b>Total Liabilities and Equity</b>