Keflavik Savings Bank

Consolidated Financial Statements

2008

Keflavik Savings Bank
Tjarnargata 12
230 Reykjanesbær
Iceland
Idno. 610269-3389

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Independent Auditor's Report

To the Board of Directors and owners of Keflavik Savings Bank

We have audited the accompanying consolidated financial statements of Keflavik Savings Bank and its subsidiaries, which comprise the consolidated balance sheet as at December 31, 2008, 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 European Union. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, 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 ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, 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 policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion
In our opinion, the consolidated financial statements give a true and fair view of the financial position of Keflavik Savings Bank and its subsidiaries as of December 31, 2008, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Without further qualifying our opinion, we draw attention to note 43 in the Consolidated Financial Statements. It states that at year end 2008 the equity ratio of the consolidation of Keflavik Savings Bank is below the legal limit of 8% as it is defined by article no. 84 of laws no. 161/2002. Management has been working on improvements that have to do with matching assets against liabilities in foreign currencies. Keflavik savings bank has received an commitment of subordinated loan and has also applied for State involvement in accordance with emergency laws no. 125/2008. If management action on improvements will not be efficient and the state involvement will be denied, there is uncertenty regarding the Keflavik Savings Bank's ability to continue as a going consern.

Kópavogi, 31 March 2009.

Deloitte hf.

Páll Steingrímsson
State Authorized Public Accountant

Palina Arnadottir
State Authorized Public Accountant

Report by the Board of Directors and Managing Director

The net loss of the consolidation for the year 2008 amounted to ISK 17.041.969 thousand, compared to ISK 1.889.784 thousand for previous year. As to the balance sheet at Desember 31 2008, total assets amounted to ISK 98.012.076 thousand and total equity ISK 5.409.453 thousand. The equity ratio pursuant to the provisions of Article 84 of the Act on Financial Institution was 7,06% at year-end 2008, compared to 22,18% at year-end 2007.

At year-end the owners in Keflavik Savings Bank numbered 1.659, compared to 1.626 at the beginning of the year and the year-end capital stock amounted ISK 16.471 million.

As regards to the disposal of earnings and the assessment of major assets items, reference is made to the Financial Statements.

It is clear that at the end of 2008 the Keflavik Savings Bank had suffered from the effects of the financial crisis currently ravaging the world, and the Bank's equity ratio, as defined in Article 84 of Act No. 161/2002 on financial undertakings, had fallen to 7.06%, which is below the statutory requirement of 8%. The Financial Supervisory Authority has been informed of the situation, as required by law. The Board of Directors of the Bank has been working on improvements, and among other things efforts have been in progress on adjusting the Bank's foreign exchange balance, as with the issue of Government Regulation 1130 of 15 December 2008 trading in derivative contracts setting the ISK against foreign currency was prohibited. The consequence of the new legislation was an imbalance in the Bank's foreign exchange position. Measures to improve the equity ratio have included transfers of the Bank's lendings between currencies, with considerable progress made, which directly impacts the Bank's equity ratio. The Bank has requested negotiations with the Central Bank and State Government on forward contracts to balance its foreign exchange position and is now awaiting a response. If the Bank succeeds in fully balancing its currency position, this would improve the equity ratio total by about 3.12%. The Bank has also received assurances of a subordinated loan in the amount of ISK 350 million, which would further strengthen the equity ratio and improving it by 0.38% and bringing it to 10.56%. The Board of Directors of the Bank has also applied for support from the State Treasury under Emergency Act No. 25/2008; the Act provides for a 20% contribution based on the equity position of year-end 2007, which corresponds to ISK 5.092 million; if the application is successful, this would raise the Bank's equity ratio by 5.5%. Over the last months, the Board of Directors has focused primarily on maintaining the Bank's operations, keeping control of the Bank and concentrating on the Bank's community responsibilities, while at the same time protecting the interests of guarantee capital holders. Reference is made to Note 43 as regards the Bank's future prospects.

It is the opinion of the Board of Directors and the Managing Director that these Consolidated Financial Statements present all the information's necessary to show the positions of the Keflavik Savings Bank at year-end, the operation results for the year and the financial developments during the year.

The Board of Directors and Managing Director herby confirm the consolidated Financial Statements of Keflavik Savings Bank for the year 2008 with their signatures.

Keflavik, 31 March 2009.

Board of Directors

Þorsteinn Erlingsson
Chairman

Heimir Agústsson

Managing Director

Geirmundur Kristinsson

Björgvin Sigurjónsson

Birgir Þór Runólfsson

Kristján G. Gunnarsson

Income Statement for the year 2008

	Notes	Consolidated 2008	2007*
Interest revenues		12.996.031	5.062.160
Interest expenses		(12.443.370)	(4.553.589)
Net interest income	6	552.661	508.572
Fee and commission income		580.429	505.063
Fee and commission expenses		(144.281)	(90.126)
Net fee and commission income	7	436.148	414.937
Dividend income	8	242.327	312.339
Net gains/(losses) on financial assets and liabilities held for trading	9	(3.763.108)	1.635.197
Net gains on financial assets designated at fair value through profit and loss	10	(9.249.831)	3.243.737
Realised gains on financial assets available for sale		(94.216)	(5.792)
Net exchange differences		6.478.671	(186.472)
Share of the profit or loss of associated and joint ventures	21	(4.599.591)	(2.080.240)
Other operating income	11	93.458	62.035
Net income		(9.903.481)	3.904.312
Salaries and salary-related expenses	12	(933.982)	(680.693)
Other operating expenses		(1.410.107)	(794.058)
Depreciation on fixed assets	25	(52.426)	(31.636)
Impairment on financial assets	14	(6.764.208)	(164.052)
(Loss) /profit before tax		(19.064.203)	2.233.872
Tax revenue	15	2.022.234	(344.088)
(Loss) / profit for the period		(17.041.969)	1.889.784

* Year end results for 2007 shown for comparison in this consolidated report are solely for Keflavik savings bank prior to the merger with Hunathing og stranda savings bank and Vestfirdinga savings bank

Amounts in ISK thousands

Balance Sheet at 31 December 2008

Assets	Notes	Consolidated 31.12.2008	31.12.2007
Cash and cash balances with financial institution	16	1.206.188	4.873.617
Receivables from financial instituitions	17	195.208	946.250
Loans and receivables	18	84.479.458	62.369.485
Financial assets held for trading	19	4.633.301	7.562.486
Financial assets designated at fair value through profit or loss	20	2.270.621	11.821.029
Financial assets available for sale	21	354.059	514.162
Investments in associates and joint ventures	22	495.909	1.937.561
Intangible assets	24	155.000	175.000
Tangible assets	25	3.217.222	2.981.613
Non-current assets classified as held for sale	26	509.970	398.284
Tax asset	33	304.664	0
Other assets	27	190.475	449.963
Total assets		98.012.076	94.029.451
Liabilities			
Amounts owed to credit institutions	28	10.520.074	3.155.638
Deposits	29	54.693.415	38.912.232
Borrowings	30	22.227.781	18.209.222
Subordinated loans	31	2.696.962	2.434.232
Pensions obligations	32	354.551	1.960.708
Tax liabilities	33	113	1.710.867
Other liabilities	34	2.109.728	2.185.542
Total liabilities		92.602.623	68.568.440
Equity	35		
Capital stock		16.471.329	13.571.894
Fair value reserve		(69.357)	3.511
Retained earnings		(10.915.807)	11.792.273
Total equity majority of owners		5.486.164	25.367.678
Minority interest		(76.711)	93.333
Total equity		5.409.453	25.461.011
Total liabilities and equity		98.012.076	94.029.451

Amounts in ISK thousands

Statement of changes in equity

Changes in equity 2008	Stock Capital	Retained earnings	Other equity	Attributable to equity holders of the parent	Minority interest	Total equity
Equity 01.01.2008	13.571.894	11.738.564	57.220	25.367.678	93.333	25.461.011
Stock capital corrected january 1	118.594			118.594		118.594
Depreciation of reserve		330	(330)	0		0
Adjusted pension obligation		1.980	(1.980)	0		0
Adjusted investement in an associate		(36.747)		(36.747)	(6.755)	(43.502)
Adjustments of merger as to IFRS		(219.517)		(219.517)		(219.517)
Revaluation of financial assets		(771)	(72.869)	(73.639)		(73.639)
Profit for the year		(16.878.680)		(16.878.680)	(163.289)	(17.041.969)
Dividends paid		(2.791.525)		(2.791.525)		(2.791.525)
Special revaluation of capital	198.649	(198.649)		0		0
Revaluation of capital	2.582.192	(2.582.192)		0		0
Balance at 31.12.2008	16.471.329	(10.967.206)	(17.958)	5.486.164	(76.711)	5.409.453

Changes in equity 2007	Stock Capital	Retained earnings	Other equity	Attributable to equity holders of the parent	Minority interest	Total equity
Balance at 31.12.2006	2.156.060	7.485.893	54.120	9.696.073	101.508	9.797.581
Effect of adopting IFRS	(32.760)			(32.760)		(32.760)
Equity 01.01.2007 as to IFRS	2.123.300	7.485.893	54.120	9.663.314	101.508	9.764.822
Paid in capital	7.028.647			7.028.647		7.028.647
Merge with Vestfjarda Savings Bank	2.038.860	2.000.665		4.039.525		4.039.525
Merge w Hunathing & Stranda Savings Bank	1.973.464	2.190.986		4.164.450		4.164.450
Adjusted pension obligation		(815.328)		(815.328)		(815.328)
Adjustment due to deferred tax		146.759		146.759		146.759
Adjusted investement in an associate		(15.171)		(15.171)	270	(14.901)
Depreciation of reserve		411	(411)	0		0
Fair value adjustments			3.511	3.511		3.511
Profit for the year		1.898.229		1.898.229	(8.445)	1.889.784
Dividends paid		(746.258)		(746.258)		(746.258)
Revaluation of capital	407.623	(407.623)		0		0
Balance at 31.12.2007	13.571.894	11.738.564	57.220	25.367.678	93.333	25.461.011

According to the Savings bank's Articles of Association, total stock capital amounted to ISK 6.4 billion. At year-end 2008 own stock capital amounted to ISK 22,4 million. Each share amounts to ISK 1.

Financial Statements for the year 2008 6 Amounts in ISK thousands

Cash Flow Statement for the year 2008

	Notes	Consolidated 2008	2007
Operating activities			
Net profit		(17.041.969)	1.889.784
Operating activities without cash-flow effects:			
Tax		(2.022.234)	344.088
Indexation of subordinated loans		262.730	125.793
Depreciation		52.426	21.265
Impairment		6.725.819	164.052
Profits from associated companies		4.599.591	2.051.891
Market changes in financial assets designed through profit & loss		8.424.098	(3.231.757)
Exchange rate changes and profit on sales of assets		1.317.474	
		2.317.936	1.365.116
Changes in operating assets and liabilities:			
(Increase) decrease in loans and receivables		(28.496.106)	(18.698.559)
(Increase) decrease in receivable from financial institution		751.042	(498.810)
(Increase) decrease in financial assets held for trading		2.552.259	2.042.161
(Increase) decrease in assets classified as held for sale		(111.686)	(97.768)
(Increase) decrease in other assets		110.838	(243.732)
Increase (decrease) in debt with credit institutions		7.364.436	1.857.220
Increase (decrease) in deposits		15.781.183	10.143.031
Increase (decrease) in debt certificates		3.409.229	3.190.133
Increase (decrease) in other liabilities		(66.605)	(511.777)
Increase (decrease) in pensions liabilities		(1.606.157)	94.590
Cash flow from operating activities		2.006.370	(1.358.394)
Investing activities			
Cash payment to acquire tangible assets		(178.708)	815.844
Cash payment to acquire intangible assets		0	0
Cash payment for investment in financial assets available to sale		(29.618)	(506.964)
Cash inflow from the financial assets held for sale		1.000	127.637
Cash payment for the investment in associates and joint ventures		(3.150.414)	(2.465.708)
Cash inflow from tangible assets		(10.187)	(2.297.708)
		(3.367.928)	(4.326.899)
Financing activities			
Cash proceeds from the issuance of subordinated liabilities			
Dividends paid		(2.791.525)	(746.258)
New stock capital		118.594	6.996.218
		(2.672.931)	6.249.960
Increase (decrease) in cash		(4.034.489)	564.667
Cash from merge		367.060	3.117.012
Cash at beginning of year		4.873.617	1.191.938
Cash at year-end		1.206.188	4.873.617

Amounts in ISK thousands

Notes

1. General information

Keflavik Savings Bank is a company incorporated and domiciled in Iceland. The address of the Savings Bank's registered office is Tjarnargata 12, Reykjanesbae. The Consolidated Financial Statement for the year 2008 comprise Keflavik Savings Bank (the parent company) and its subsidiaries (together referred to as "the Savings Bank"). List of subsidiaries are in note 23.

The Saving Bank offers integrated financial services to companies, investors and individuals.

2. Statement of compliance with IFRS

2.1 Standards and interpretations effective in the current period

The financial statements are presented in accordance with the new and revised standards (IFRS / IAS) and new interpretations (IFRIC), applicable in the year 2008. These standards and interpretations are:

IAS 39 (revised) - *Financial Instruments: Recognition and Measurement*

IFRIC 11, *IFRS 2 - Group and treasury share transactions*

IFRIC 12 - *Service concession arrangements*

IFRIC 14 - *IAS 19 The limit on a defined benefit asset, minimum funding requirements and their interaction.*

The adoption of the new and revised standard and interpretations has not led to changes in the accounting policies.

2.2 Standards and interpretations in issue not yet adopted

Following is an overview of new or revised standards and interpretations that are not yet effective:

IFRS 2 (revised 2008) - *Share-based Payment* (effective for accounting periods beginning on or after 1 January 2009);

IFRS 3 (revised 2008) - *Business Combinations* (effective for accounting periods beginning on or after 1 July 2009);

IFRS 8 - *Operating Segments* (effective for accounting periods beginning on or after 1 January 2009);

IAS 1 (revised 2008) - *Presentation of Financial Statements* (effective for accounting periods beginning on or after 1 January 2009);

IAS 23 (revised 2008) - *Borrowing Costs* (effective for accounting periods beginning on or after 1 January 2009);

IAS 27 (revised 2008) - *Consolidated and Separate Financial Statements*;

IAS 39 (revised 2008) - *Financial Instruments: Recognition and Measurement* (effective for accounting periods beginning on or after 1 July 2009)

Minor changes to various standards as a result of the IASB's annual improvement process (2008). Most changes take effect for periods beginning 1 July 2009 or later.

IFRIC 13 - *Customer Loyalty Programs* (effective for accounting periods beginning on or after 1 July 2008);

IFRIC 15 - *Agreements for the Construction of Real Estate* (effective for accounting periods beginning on or after 1 January 2009);

IFRIC 16 - *Hedges of a Net Investment in a Foreign Operation* (effective for accounting periods beginning on or after 1 October 2008);

IFRIC 17 - *Non-cash Assets to Owners* (effective for accounting periods beginning on or after 1 July 2009);

2. Statement of compliance with IFRS (continued)

Revised IAS 1 will have the impact that all items of income and expense (including those recognised outside of profit or loss) must be presented either in a single statement as a statement of comprehensive income; or in two statements as a seperate income statement and a statement of comprehensive income.

Revised IAS 23 eliminates the previously available option to expense all borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. All other borrowing costs shall be expensed.

Revised IFRS 3 states that all acquisition-related costs are to be recognised as period expenses. Implementation may also result in a change in accounting for the recognition of goodwill related to the minority share of the acquired companies, step acquisitons and partial disposal of shares in subsidiaries.

It is the management´s assessment that in general, the adoption of those new and revised standards and interpretations will have no material impact on the financial statements, except for the additional disclosure requirements for operating segments according to IFRS 8.

IFRS 8 is the only one of the above new or revised standards and interpretations that has been approved by the EU.

3. Significant accounting policies

The Consolidated Financial Statement are prepared on the historical cost basis except for the following assets and liabilities that are stated at their fair value: financial assets and liabilities held for trading, derivative financial instruments and financial assets and liabilities designated at fair value through profit and loss.

Non-current assets classified as held for sale are valued at lower of cost or fair value less estimated sale cost, except where IFRS 5 required different basis for their valuation.

The Consolidated Financial Statement for the year 2008 are prepared and presented in Icelandic Krona (ISK), which is the Savings Bank's functional currency. Except as indicated, financial information presented has been rounded to the nearest ISK thousand.

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 amount 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.

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 effects 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 Consolidated Financial Statements is provided in note 4.

The accounting policies set out below have been applied consistently to all periods and all companies within the consolidation presented in this Consolidated Financial Statements. They have also been used for the preparation of the opening IFRS Balance Sheet at 1 January 2006 for the purpose of adopting IFRS.

3. Significant accounting policies (continued)

3.1 Basis of consolidation

The Consolidated Financial Statements of the Savings Bank include the Financial Statements of the parent and its subsidiaries which are controlled by the parent at the Balance Sheet date.

The purpose of the consolidation is to show only revenue, expenses, assets and liabilities of the consolidation to 3rd party and therefore internal transactions are eliminated in the Consolidated Financial Statements. Corrections are made, if necessary, to subsidiaries accounting policies in accordance with the consolidation accounting policies.

a) Subsidiaries
Subsidiaries are entities controlled by the Savings Bank. Control exists when the Savings 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 Savings Bank holds more than 50% of the voting power of the subsidiary. In assessing control, potential voting rights that are currently exercisable or convertible are taken into account. The Financial Statements of subsidiaries are included in 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 Savings 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 combination 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 Savings Bank's share of the net identifiable 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.

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

The Consolidated Financial Statements include the Savings Bank's share of the total recognised income and expenses of associates on an equity accounted investors, from the date that significant influence commences until the date that significant influence ceases. When the Savings Bank's share of losses exceeds its interest in an equity accounted associate, the Bank's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Savings 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.

c) Transactions eliminated on consolidation
Intragroup balances, unrealised income and expenses arising form intragroup transactions, are eliminated in preparing 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.

Notes

3. Significant accounting policies (continued)

3.2 Mergers

The purchase method of accounting is used in the consolidation and if the ownership in subsidiaries are less than 100% minority interest in equity and profit are recognised. If the minority interest is immaterial it is not presented separately within the Consolidated Financial Statements.

When new sibsidiaries are bought their assets and liabilities are remeasured at fair value at the date of transaction. If the acquisition price exceeds net value of assets the remaining balance is entered as goodwill.

The operating outcome of subsidiaries bought or sold over the financial year are included in the consolidated statements from the date of purchase or to the date of sale depending on which applies.

3.3 Foreign currency

Transactions in foreign currencies are translated to the respective functional currencies at exchange rate at the dates of transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the exchange rate at that date. Foreign exchange differences resulting from retranslation are recognised in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are retranslated 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 retranslated to the functional currency at the exchange rate at the date that the fair value was determined.

3.4 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.

Derivatives are recognised at fair value. Fair value changes are recognised in the Income Statement. 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.

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 Income Statement. 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 3.9.

3.5 Loans and receivables

Loans and receivables are non-derivative financial instruments with fixed or determinable payments that are not quoted in an active market and that the Savings Bank does not intend to sell immediately or in the near term. Loans and receivables include loans provided by the Savings Bank to credit institutions and its customers, participation in loans from other lenders and purchased loans.

Loans and receivables are recognised when cash is advanced to borrowers.

Loans and receivables are initially measured at fair value plus incremental direct transaction cost, and subsequently measured at their amortised cost using the effective interest method. Accrued interest is included in the carrying amount of the loans.

3. Significant accounting policies (continued)

3.6 Financial assets held for trading

Financial assets held for trading are financial instruments acquired principally for the purpose of generating profits from short-term price fluctuations from a dealer's margin.

Financial assets held for trading consist of bonds, shares and derivatives with positive fair value that are not designated as hedging instrument or are not effective hedging instruments.

Financial assets held for trading 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 these assets are recognised in the Income Statement and included in the line item *Net (loss) gain on financial assets and liabilities held for trading*. Interest and dividend income on these assets are included in *interest income* and *dividend income* line items in the Consolidated Income Statement.

3.7 Financial assets designated at fair value through profit and loss

The Savings Bank classifies certain financial assets upon their initial recognition as financial assets held at fair value with fair value changes recognised in the Income Statement as *Net income of financial assets designated at fair value through profit and loss*. This is the case when such classification result in more relevant information because:
a) the designation eliminates or significantly reduces an accounting mismatch which would otherwise arise
b) financial assets and/or financial liabilities are controlled and measured at fair value as to risk management and investment plan of the Savings Banks and information to key managements are reported internally on a fair value basis.

Interest and dividend income that arises from these assets are included in *Net interest income* and *Dividends income*, respectively. Interest income on debt instruments is recognised on an accrual basis.

3.8 Financial assets available-for-sale

Financial assets available-for-sale consist of unlisted equity instruments held for long time investment purposes.

Financial assets available-for-sale are recognised at fair value. Unrealised gains or losses on available-for-sale investments are recognised in equity, net of income taxes, until such investments are disposed of or until they are determined to be impaired. On disposal of an available-for-sale investment, the accumulated unrealised gain or loss included in equity is transferred to the Income Statement and recognised as *Realised gain on financial assets available-for-sale*. Gains and losses on disposal are determined using the average cost method.

Dividend income on available-for-sale financial assets is included in Dividends income in the Income Statement. Exchange rate difference arising on equity instruments are recognised in equity.

3.9 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 Savings Bank calibrates the valuation technique and test 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.

3. Significant accounting policies (continued)

3.9 Determination of fair value (continued)

Best proof of fair value at beginning is the acquisition price, which reflect the fair value of the assets, except if it is possible to confirm the fair value of the assets by comparing to other contracts and recently market transactions of the same assets without adopting or redo or is based on estimated method where all bias include only information from active market. When such supporting documents are available, the Saving Bank post profit or loss at original entering of the assets.

3.10 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 Savings Bank commits to purchase or sell the assets, except for loans and receivables 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 Saving Bank has transferred substantially all risks and reward of ownership.

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

3.11 Offsetting financial assets and financial liabilities

Financial assets and liabilities are setoff and the net amount reported in the Balance Sheet when, and only when, the Savings Bank has a legal right to offset the recognised amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

3.12 Leases

The Saving Bank classifies leases based on the extent of the transfer of risks and rewards incidental to ownership of leased assets. A lease is classified as a finance lease if the lessor transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if the lessor does not transfer substantially all the risks and rewards incidental to ownership.

a) Finance leases
The Saving Bank's receivables from leases classified as finance leases are presented in the Balance Sheet within loans and advances. Finance leases are initially recognised at an amount equal to the net investment in the lease and subsequent lease payments are applied against the gross investment in the lease to reduce both the principal and the unearned finance income.

The Saving Bank recognises its finance income as interest income based on a pattern reflecting a constant periodic rate of return on the Saving Bank's net investment in the finance lease. The interest rate implicit in the lease is defined in such a way that the initial direct costs are included automatically in the finance lease receivable and therefore the initial direct costs are recognised over the lease term.

b) Operating leases
Lease payments under operating leases where the Saving Bank is the lessee are recognised as an expense on a straight-line basis over the lease term. Property and equipment which the Bank leases to third party under operating leases are classified in the Balance Sheet as investment property or property and equipment.

3. Significant accounting policies (continued)

3.13 Intangible assets

a) Goodwill
All business combinations after 1 January 2006 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 2006, goodwill represents the difference between the cost of the acquisition and the net fair value of the net identifiable assets, liabilities and contingent liabilities of the acquire.

Goodwill is measured at cost less any accumulated impairment losses. Goodwill is connected to cash generated units and is not amortised, but is systematically tested for impairment at each reporting date. As to associates, the carrying amount of goodwill is included in carrying amount of the investment in associates.

3.14 Property and equipment

a) Owned assets
Items of property and equipment are measured at cost less accumulated depreciation and impairment losses in accordance with IAS 16.

When parts on an item of property and equipment have different useful lives, they are accounted for as separate items of property and equipment.

b) Subsequent costs
The cost of replacing part of an item of property and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Saving Bank and its cost can be measured reliably. The decision whether subsequent costs is added to an item of property and equipment is based on whether an item has been changed partly or in full or the nature of the subsequent costs is part of a new item. 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. Land is not depreciated. The estimated useful lives are as follows:

Real estate	25-50 years
Machinery and equipment	7-15 years
Vehicles	4 years

The residual value is reassessed annually, except it is immaterial.

3.15 Assets held for sale

Immediately before classification as held for sale, the measurement of the qualifying assets and all assets and liabilities in a disposal group is brought up-to-date in accordance with applicable IFRS. Then, on initial classification as held for sale, non-current assets and disposal groups are recognised at the lower of carrying amount and fair value less cost to sell. Impairment losses on initial classification as held for sale are included in the Income Statement.

Increase in fair value less cost to sell at subsequent reporting dates are entered in the Income Statement and as increase to the book value of the non-current assets and disposal groups, but can not exceed the prior impairment losses to the non-current assets and disposal groups held for sale, that have been recognised in the Income Statement.

Non-current assets and disposal groups held for sale are mainly mortgages foreclosed.

3. Significant accounting policies (continued)

3.16 Borrowings

The Savings Bank's borrowings consist of issued bonds and loans from credit institutions. Borrowings 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.

3.17 Subordinated loans

Subordinated loans are bonds issued by the Savings Bank with subordinated terms. Subordinated loans have the characteristics of equity in being subordinated to other liabilities of the Savings Bank. In the calculation of equity ratio, these bonds are included in equity, as shown in note 31. On one hand, there are bonds with no maturity date that the Savings Bank may not retire until 2011 and then only with approval of the Financial Supervisory Authority. These bonds qualify as Tier I capital. On the other hand there are bonds with maturity dates over the next 11 years. The loans are entered as liabilities with accrued interest and indexation at period-end.

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.

3.18 Pension liabilities

The liability recognised in the balance sheet in respect of defined benefit pension obligation is the present value of the obligation at the balance sheet date. The defined benefit obligation is calculated annually by independent actuaries. The discount rate used for the pension liability is 2%.

3.19 Provisions

Provisions are recognised in the Balance Sheet when the Saving Bank has a present obligation (legal or constructive) as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

3.20 Other assets and liabilities

Other assets and liabilities are measured at cost.

3.21 Capital

a) Primary capital
When primary capital is repurchased, the amount of the consideration paid, including directly attributable costs, is recognised as a change in capital. Revaluation of primary capital increases primary capital.

b) Dividends on primary capital
Dividends on primary capital are recognised in capital in the period in which they are approved by the Savings Bank's primary capital holders.

c) Retained earnings
Profit for the period is recognised in retained earnings. Dividends paid and revaluation of primary capital decreases retained earnings.

3.22 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 deposit with other credit institutions.

3. Significant accounting policies (continued)

3.23 Income and expenses

a) Interest income and expenses
Interest income and expenses are recognised in the Consolidated Income Statement as it accrues, taking into account the effective yield of the assets or and 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 Savings Bank estimates the cash flows considering all contractual terms of the financial instrument, but it 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 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
The Savings Bank provides various services to its clients and earns income there from, such as income from transactions on behalf of third parties, commission from customer for equity and bond transactions and other services. Fees and commission income are recognised in the Income Statement as the service is provided. Fees that are performance-linked are recognised when the performance criteria are fulfilled.

c) Dividend income
Dividend income is recognised in the Consolidated Income Statement on the date that the dividend is declared.

d) Net gains (losses) on financial assets and liabilities held for trading

Net gains (losses) on financial assets and liabilities held for trading consist of profit / (loss) on sales and changes in fair value of those assets and liabilities.

e) Net gain on financial assets designated at fair value through profit and loss

Net gains (losses) on financial assets designated at fair value through profit and loss consist of profit / (loss) on sales and changes in fair value of those assets.

f) Operating expenses

Operating expenses consist of salaries and related expenses, depreciation and amortisation of tangible and intangible assets and other expenses such as housing-, marketing- and computer expenses.

3. Significant accounting policies (continued)

3.24 Impairment

The carrying amount of the Savings Bank's assets, other than deferred tax assets and trading assets and financial assets designated at fair value through profit and loss, 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 receivable*
The Saving Bank recognises losses for impaired loans and receivable promptly where there is objective evidence that impairment of a loan and receivable has occurred. If there is objective evidence that an impairment loss has been incurred on loans and receivables, their carrying amount is reduced through the use of an allowance account to the present value of expected future cash flows, discounted at their original effective interest rate.

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 profit and loss account.

The Saving Bank's management first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant. Loans and receivables that are not impaired individually become a part of a portfolio which is assessed for impairment. Collective assessment based on a portfolio assumes that loans and receivables have similar credit risk characteristics. Objective evidence of impairment of a group of loans and receivables exists if objective data indicates a decrease in expected future cash flows from a portfolio of loans and the decrease can be measured reliably but cannot be identified with the individual loans in the portfolio.

Two methods are used to calculate impairment losses, one based on an assessment of individual loans and receivable and the other based on a collective assessment. Losses expected as a result of future events, no matter how likely, are not recognised.
Objective evidence of impairment includes information about the following events and conditions:

(i) significant financial difficulty of the borrower;
(ii) a breach of contract, such as a default on instalments or on interest or principal payments;
(iii) the Savings Bank granting to the borrower, for economic or legal reasons related 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 date indicating that there is a measurable decrease in the estimated future cash flows from a group of loans and receivable, 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 receivable
Impairment losses on individually assessed loans and receivable are determined by an evaluation of the exposures on a case-by case basis. The Savings Bank assesses at each balance sheet date whether there is any objective evidence that individual loan and receivable are impaired. This procedure is applied to all loans and receivable that are considered individually significant. In making the assessment, the following factors are considered:

3. Significant accounting policies (continued)

3.24 Impairment (continued)

- the Saving 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 mitigates) and likelyhood of successful repossession; and
- the likely deduction of any cost involved in recovery on amounts outstanding.

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

Collectively assessed loans and receivable
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 reporting 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;
- 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.

The estimated period between a loss occurring and its identification is determined for each identified portfolio.

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 Saving Bank to minimise any differences between loss estimates and actual loss.

Loans and receivable 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.

3. Significant accounting policies (continued)

3.24 Impairment (continued)

Assets acquired in exchange for loans
Non-current 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 cost 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 cost to sell, to the extent that this does not exceed the cumulative impairment loss, is recognised in the Income Statement.

b) Impairment of goodwill
The Saving Bank assesses whether there is any indication of impairment of goodwill on annual basis and the goodwill is written down of impairment if relevant. Gains and losses on disposal of subsidiaries include any unamortised balance of goodwill relating to the subsidiary disposed of.

c) Impairment of financial assets available-for-sale
The Savings Bank determines that available-for-sale equity instruments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgement. In making this judgement, the Savings Bank evaluates among other factors, the normal volatility in share price. In addition, impairment may be appropriate when there is evidence of deterioration in the financial strength of the investor, industry and sector performance, changes in technology, and operational and financing cash flows. The amount of impairment loss is recognised in the Income Statement.

d) Calculation of recoverable amount
The recoverable amount of the Savings Bank's investments in loans and receivables is calculated as the present value of estimated future cash flows. The discount rate used for fixed rate loans and receivables is the effective interest rate computed at initial recognition while for variable rate loans and receivables is the current effective interest rate.

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.

e) 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 a debt instrument classified as available-for-sale is reversed through the Income Statement while an impairment loss in respect of an investment in an equity instrument classified as available-for-sale is not reversed through Income Statement.
An impairment loss in respect of goodwill is not reversed.
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

3. Significant accounting policies (continued)

3.25 Income tax

Income tax on the profit or loss for the period comprises current and deferred tax. Income tax is recognised in the Consolidated 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 or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

The deferred income tax asset / 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 the one hand, and the Consolidated Financial Statement on the other hand. This difference is due to the fact that tax assessments are based on premises that differ from those governing the financial statements. Deferred tax liability is recognised for all time differences but deferred tax assets is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. A calculated tax asset is offset against income tax liability only if they are due to tax assessment from the same tax authorities.

Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

4. Critical accounting estimates and judgements in applying accounting policies

The Saving Bank makes estimates and assumptions that affect the reported amounts of assets and liabilities. 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 receivables
The Saving Bank reviews its loan portfolios to asses impairment regularly. In determining whether an impairment loss should be recorded in the Income Statement, the Saving 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 and receivables before the decrease can be identified with an individual loan or receivable in that portfolio. This evidence may include observable data indicating that there have been changes in the payment status of borrowers in a group or economic conditions. Management use 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.

5. Segment information

A segment is an differentiable part of the Saving Bank's operation which either provides service (operating segment) or provides service in certain area (geographical segment), who is dependent of other kind of risk and gain than other segments. The Savings Bank has defined two different operating segments, private banking and investments. Private banking contains normal banking service to individuals and companies while investments contains trading of financial assets, investments for the Saving Bank and financial control. All of the Saving Bank's service is provided in Iceland.

Notes

5. Segment information (continued)

Year 2008	Private banking	Investments	Total
Net interest income	3.545.270	(2.992.609)	552.661
Net fee and commission income	400.251	35.897	436.148
Net gains on financial assets	160.047	(13.024.875)	(12.864.828)
Other income	6.518.785	(4.546.247)	1.972.538
Total income	10.624.353	(20.527.834)	(9.903.481)
Operating expenses	(2.318.169)	(78.346)	(2.396.515)
Impairment	(6.764.208)	0	(6.764.208)
Total expenses	(9.082.377)	(78.346)	(9.160.723)
Profit before taxes	1.541.976	(20.606.180)	(19.064.204)
Income tax	(172.312)	2.194.546	2.022.234
Profit for the ye	1.369.664	(18.411.634)	(17.041.970)

Segment assets	Private banking	Investments	Total
Cash, receivables and loans	84.627.237	1.253.618	85.880.855
Other financial assets	976.217	6.777.674	7.753.891
Other assets	4.377.331	0	4.377.331
Total assets	89.980.784	8.031.292	98.012.076
Segment liabilities			
Debts, deposits, borrowings and subordinated loans	71.491.087	18.647.145	90.138.232
Other liabilities	2.464.392	0	2.464.392
Total liabilities	73.955.478	18.647.145	92.602.623
Equity	16.025.306	(10.615.853)	5.409.453
Total liabilities and equity	89.980.784	8.031.292	98.012.076

* Year end results for 2007 shown for comparison in this consolidated report are solely for Keflavik savings bank prior to the merger with Hunathing og Stranda savings bank and Vestfirdinga savings bank

Amounts in ISK thousands

Notes

5. Segment information (continued)

Year 2007	Private banking	Investments	Total
Net interest income	1.253.343	(744.772)	508.572
Net fee and commission income	414.937		414.937
Net gains on financial assets	3.050.165	1.822.977	4.873.142
Other income	(2.009.297)	116.958	(1.892.339)
Total income	2.709.148	1.195.164	3.904.312
Operating expenses	(1.424.653)	(81.734)	(1.506.387)
Impairment	(164.052)	0	(164.052)
Total expenses	(1.588.705)	(81.734)	(1.670.439)
Profit before taxes	1.120.443	1.113.430	2.233.872
Income tax	(422.425)	78.336	(344.088)
Profit for the year	698.018	1.191.766	1.889.784

Segment assets	Private banking	Investments	Total
Cash, receivables and loans	67.490.906	698.446	68.189.352
Other financial assets	13.277.135	8.558.103	21.835.238
Other assets	1.411.003	2.593.857	4.004.860
Total assets	82.179.044	11.850.407	94.029.451
Segment liabilities			
Debts, deposits, borrowings and subordinated loans	61.074.822	723.581	62.711.323
Other liabilities	4.959.480	897.636	5.857.116
Total liabilities	66.034.302	1.621.217	68.568.440
Equity	25.367.678	93.333	25.461.011
Total liabilities and equity	91.401.980	1.714.550	94.029.451

Geographical segments is defined by the directors of Keflavik Savings Banks as one segment. All of the Savings Bank's operation is located in Iceland so the financial statements is not divided into geographical segments.

* Year end results for 2007 shown for comparison in this consolidated report are solely for Keflavik savings bank prior to the merger with Hunathing og Stranda savings bank and Vestfirdinga savings bank

Amounts in ISK thousands

6. Net interest income

Interest income and expenses is specified as follow:	2008	2007*
Interest income from cash and balances with central banks	2.537.288	2.156.674
Loans and receivables	10.458.743	2.905.486
Interest income	12.996.031	5.062.160
Borrowings	1.500.400	396.736
Deposits	7.614.286	2.291.891
Securities	3.176.003	1.699.788
Other interest expenses	152.680	165.174
Interest expenses	12.443.370	4.553.589
Net interest income	552.661	508.572

7. Net fee and commission income

Fee and commission income and expenses is specified as follow:	2008	2007*
Securities brokerage and advisory	35.897	157.190
Loans	103.317	99.953
Guarantees	16.702	8.027
Other fee and commission income	424.513	239.892
Fee and commission income	580.429	505.063
Inter-bank charges	78.318	60.622
Other fee and commission expenses	65.963	29.504
Fee and commission expenses	144.281	90.126
Net fee and commission income	436.148	414.937

8. Dividend income

Dividend income is specified as follows:	2008	2007*
Dividend income on trading assets	17.675	260.938
Dividend income on assets at fair value through profit and loss	217.772	50.617
Dividend income on available-for-sale financial assets	6.880	783
Dividend income	242.327	312.339

* Year end results for 2007 shown for comparison in this consolidated report are solely for Keflavik savings bank prior to the merger with Hunathing og Stranda savings bank and Vestfirdinga savings bank

Amounts in ISK thousands

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9. Net gains on financial assets and financial liabilities held for trading

Net gains on financial assets and financial liabilities held for trading are specified as follows:

	2008	2007*
Shares and related derivatives	(4.081.215)	1.161.064
Bonds and related derivatives	318.107	474.133
Net gains on financial assets and financial liabilities held for trading	(3.763.108)	1.635.197

10. Net gains on financial assets designated at fair value through profit and loss

Net gains on financial assets designated at fair value through profit and loss are specified as follows:

	2008	2007*
Shares	(9.249.831)	3.243.737

11. Other operating income

Other operating income is specified as follows:	2008	2007*
Rent	37.042	37.500
Other income	56.416	24.535
Other operating income	93.458	62.035

12. Personnel

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

	2008	2007*
Average number of full time equivalent positions during the year	142,3	99,5
Full time equivalent positions at year-end	127,6	101,0
Of which banking positions	124,6	98,0

Salaries and related expenses:

	2008	2007*
Salaries	819.146	520.692
Contribution to pension obligation	0	10.502
Salary related expenses	114.836	149.499
	933.982	680.693

* Year end results for 2007 shown for comparison in this consolidated report are solely for Keflavik savings bank prior to the merger with Hunathing og Stranda savings bank and Vestfirdinga savings bank

Amounts in ISK thousands

12. Personnel (continued)

Salary to the Savings Bank managers were as follows:

	Salary and compensation	Capital shares at year-end
Managing director		
Geirmundur Kristinsson	31.583	0
Board of directors		
Þorsteinn Erlingsson, chairman of the board	2.880	1.088
Kristján G. Gunnarsson, vice-chairman	1.440	1.451
Birgir Þór Runólfsson	1.320	0
Björgvin Sigurjónsson	1.986	1.666
Hersteinn Heimir Ágústsson	2.748	9.640
Árni Björgvinsson, alternate	120	41
Garðar Vilhjálmsson, alternate	120	1.088
Margrét Ágústsdóttir, alternate	240	23.642
Managers (6)	72.707	3.402
Former members of the board of directors		
Guðjón Stefánsson	360	442
	115.504	42.460

13. Auditors fee

Fee to auditors was as follows:

	2008	2007*
Audit of financial statements	17.716	5.107
Review of interim financial statements	6.904	3.500
Other services	17.000	10.277
Total fee to auditors	41.620	18.884
Fee to others than the Parent Company's auditors, included in the above total	12.344	0

Included in the auditors fee is the audit of the annual and interim financial statements as well as other tasks that management has assigned the auditors as a normal part of their duties. Other services contains accounting services, tax advisory and advisory with mergers.

14. Impairment

Impairment losses recognised in profit and loss were as follows:

	2008	2007*
Loans and receivables	6.706.332	163.716
Impairment on assets held available for sale	37.876	337
Impairment on intangible assets	20.000	0
Impairment on assets	6.764.208	164.052

* Year end results for 2007 shown for comparison in this consolidated report are solely for Keflavik savings bank prior to the merger with Hunathing og stranda savings bank and Vestfirdinga savings bank

Amounts in ISK thousands

15. Effective income tax rate

The corporate income tax rate in Iceland is 15% and 2.022 million ISK will be stated as revenue in the income statement. In the year 2009 no income tax will be paid because of negative taxable income.

Legislation changing tax rates from 18% to 15% was confirmed in May 2008 and is effective from January 1st 2008. The effect of lowering the tax rate on deferred tax liability at the beginning of the year is 305 million kronur and the change is charged to the income statement.

Other changes were made on tax laws that allow reduction in taxable income equal to the profit on sale of stocks and registered derivaties on stocks. Reduction is only allowed if tax loss for previous years and the current year have been equalized. The change is valid for income for the year 2008 or later. The effect upon the accounting of the Company is that stock ownership and listed derivative agreements on stocks no longer affect tax liabilites on the balance sheet. Due to that the tax liability of the Company has decreased by 1.501 millions of krona at January 1 2008.

as follows:

	2008	2007*
Profit before tax	(19.064.203)	2.233.872
15% income tax calculated on the profit of the year	(2.859.630)	402.097
Adjustment for new tax ration	(304.773)	0
Dividends received, exempt from tax	(242.327)	(312.339)
Tax effect of changes due to subsidiaries	0	374.711
Adjustment for stocks	997.476	0
Other changes	387.020	(120.381)
Income tax according to Income statement	(2.022.234)	344.088
Effective tax rate	10,6%	15,4%

16. Cash and cash balances with financial institution

Cash and cash balances with financial institution were as follows:

	31.12.2008	31.12.2007
Cash	300.661	346.330
Cash balances with financial institutions other than required reserves	905.528	4.527.287
	1.206.188	4.873.617

17. Receivables from financial institutions

Receivables from financial institutions were as follows:

	31.12.2008	31.12.2007
Required reserves at Central bank	195.208	446.250
Receivables	0	500.000
	195.208	946.250

* Year end results for 2007 shown for comparison in this consolidated report are solely for Keflavik savings bank prior to the merger with Hunathing og stranda savings bank and Vestfirdinga savings bank

18. Loans and receivables

Loans and receivables are specified as follows:

	31.12.2008	31.12.2007
Overdrafts	9.276.621	10.604.864
Produce loans and operating loans	3.963.572	2.021.089
Bills of exchange	108.034	152.407
Loans to customers in ISK	34.204.333	29.277.344
Loans to customers in foreign currency	36.688.629	20.146.029
Other	238.270	167.753
	84.479.458	62.369.485

Loan and receivables are specified by borrowers as follows:

	31.12.2008	31.12.2007
Central government and state-owned enterprises	0,98%	0,62%
Townships and municipalities	1,42%	0,64%
Business Sectors:		
Agriculture	0,08%	0,44%
Fishing industries	7,83%	5,98%
Commerce	13,56%	9,30%
Financial institutions	1,51%	1,08%
Industry and contractors	7,58%	7,78%
Transportation	0,67%	0,83%
Service	13,94%	16,99%
Other	4,09%	2,45%
Individuals and residential premises	48,34%	53,90%
	100%	100%

Changes in allowance for losses on loans and receivables are specified as follows:

	Specific provision	Collective assessment	Total 31.12.2008	Total 31.12.2007
Balance at beginning of year	494.360	607.876	1.102.236	646.053
Changes due to IFRS	0	0	0	40.648
Balance at beginning of year as to IFRS	494.360	607.876	1.102.236	686.702
Transferred into the group	0	0	0	417.279
Impairment on loans & receivables during the year	6.589.834	116.498	6.706.332	163.716
Loans and receivables written off	(883.078)	0	(883.078)	(183.298)
Amounts recovered during the year	6.524	0	6.524	17.837
Allowance account at year-end	6.207.640	724.373	6.932.013	1.102.236

Amounts in ISK thousands

19. Financial assets held for trading

Financial assets held for trading is specified as follows:

	31.12.2008	31.12.2007
Bonds issued by public bodies	3.463.986	917.965
Bonds issued by others	186.767	437.716
Shares	850.277	6.085.511
Derivatives	132.271	121.294
Financial assets held for trading	4.633.301	7.562.486

20. Financial assets designated at fair value through profit and loss

Financial assets designated at fair value through profit and loss is specified as follows:

	31.12.2008	31.12.2007
Shares	2.270.621	11.821.029

21. Financial assets available-for-sale

Financial assets available-for-sale are specified as follows:

	31.12.2008	31.12.2007
Shares	354.059	514.162

22. Investments in associates

Investment in associates are specified as follows:

	31.12.2008	31.12.2007
Investment in associates at the beginning of the year	1.937.561	1.686.464
Adjustments for prior year	158.884	0
Additions	2.999.055	2.465.708
Sold during the period	0	(688.376)
Profit share	(4.599.591)	(2.080.240)
Investment in associates at year-end	0	554.005
	495.909	1.937.561

Investment in associates are specified as follows:

Associates	Operation	Address	Ownership 2008	Ownership 2007
Reiknistofa bankanna	Computer service	Reykjavík	3,18%	3,18%
Teris	Computer service	Kópavogur	15,56%	15,56%
Kista fjárfestingafélag ehf	Holding company	Reykjavík	34,25%	34,25%
FSP Holding ehf	Holding company	Reykjavík	25,39%	25,39%
SP eignir ehf	Holding company	Reykjavík	50,00%	50,00%
SPR ehf	Advisory	Reykjavík	50,00%	50,00%
Protinus ehf	Holding company	Reykjavík	50,00%	50,00%

Amounts in ISK thousands

22. Investments in associates (continued)

Total financial information of associates is as follows:

	31.12.2008	31.12.2007
Total assets	4.198.117	12.737.468
Total liabilities	(1.137.431)	(4.372.489)
Equity	3.060.686	8.364.979
Keflavik Savings Bank share in associates equity	362.183	1.686.464

	31.12.2008	31.12.2007
Total revenue for the year	4.877.632	4.056.020
Total loss for the year	13.099	528.644
Keflavik Savings Bank share in associates loss	(5.449.267)	140.125

Reiknistofa bankanna and Teris are not independent tax entities, therefor are they treated as an associate even though the Savings Bank owns less than 20% of their shares. After the merger of Vestfjarda Savings Bank and Hunathings & Stranda Savings Bank with Keflavik Savings Bank at year-end the Savings Bank became holder of more than 50% of shares in some comapanies. Those companies have been treated as associates but if the Savings Bank holds the majority of the voting power they will be treated as subsidiaries in 2008.

23. Investment in subsidiaries

The parent's interest in its subsidiaries are as follows:

	Address	Ownership	Voting power	Operation
Sparisjóðurinn í Keflavík hf.	Keflavík	100,00%	100,00%	Holding
Eyrareldi ehf.	Ísafjörður	100,00%	100,00%	Holding
Þrælsfell ehf.	Hvammstangi	100,00%	100,00%	Holding
Víkur ehf.	Keflavík	100,00%	100,00%	Holding
Tjarnargata 12 ehf.	Keflavík	64,90%	64,90%	Holding
Nikel ehf.	Keflavík	55,00%	55,00%	Holding
Miðland ehf.	Keflavík	55,00%	55,00%	Holding

24. Intangible assets

Intangibles are specified as follows:

	Goodwill
Balance at 1.1.2007	175.000
Impairment	0
Balance at 1.1.2008	175.000
Impairment	(20.000)
Balance at 31.12.2008	155.000

Amounts in ISK thousands

Notes

25. Property and equipment

2008	Real estate	Fixtures, equipment and vehicles	Total
Cost or valuation			
At beginning of year	3.055.810	257.098	3.312.907
Additions	215.331	105.571	320.902
Disposals	(28.110)	(15.297)	(43.407)
At end of year	3.243.030	347.372	3.590.403
Accumulated depreciation			
At beginning of year	193.558	137.736	331.294
Impairment	28.121	24.306	52.426
Disposals	(5.654)	(4.887)	(10.540)
At end of year	216.025	157.155	373.181
Carrying Amount			
Book value at beginning of year	2.862.252	119.361	2.981.613
Book value at end of year	3.027.005	190.217	3.217.222
Depreciation rates	2-4%	6-25%	

2007	Real estate	Fixtures, equipment and vehicles	Total
Cost or valuation			
At beginning of year	1.291.770	134.181	1.425.951
Additions through merger	413.387	94.361	507.749
Additions	1.350.652	28.555	1.379.208
At end of year	3.055.810	257.098	3.312.907
Accumulated depreciation			
At beginning of year	116.330	67.594	183.924
Additions through merger	61.235	54.498	115.734
Impairment	15.993	15.644	31.637
At end of year	193.558	137.736	331.294
Carrying Amount			
Book value at beginning of year	1.175.440	66.587	1.242.027
Book value at end of year	2.862.252	119.361	2.981.613
Depreciation rates	2-4%	6-25%	

Official estimates of property at year end	31.12.2008	31.12.2007
Assessment value	649.799	979.642
Fire insurance valuation	1.678.248	2.455.888

Amounts in ISK thousands

26. Assets held for sale

Assets held for sale are specified as follows:

	31.12.2008	31.12.2007
Assets acquired in exchange for loans	509.970	398.284

Those assets have been obtained through forclosing of mortgages. They are temporary assets and are shown on the consolidated balance sheet after impairments have been deducted.

27. Other assets

Other assets are specified as follows:

	31.12.2008	31.12.2007
Sundry assets	158.482	407.935
Accrued income	31.993	42.028
	190.475	449.963

28. Amounts owed to credit institutions

Amounts owed to credit institutions are specified as follows:

	31.12.2008	31.12.2007
Amounts owed to credit institutions	10.520.074	3.155.638

29. Deposits

Deposits are specified as follows:

	31.12.2008	31.12.2007
Demand deposits	38.736.015	28.411.706
Time deposits	12.889.684	8.940.096
Specific deposits	3.067.716	1.560.430
	54.693.415	38.912.232

30. Borrowings

Borrowing are specified as follows:

	31.12.2008	31.12.2007
Issued bonds	5.869.016	885.165
Issued bills exchange	0	33.246
Money market loans	2.605.415	2.756.279
Exchange rate borrowings	13.753.350	14.534.532
	22.227.781	18.209.222

Amounts in ISK thousands

31. Subordinated loans

Subordinated loans are specified as follows:

	Currency	Interest	Maturity date	Book value
Loans which qualify as Tier I capital:				
Listed on the Iceland Stock Exchange..........................	ISK	10,0%	None	363.166
Total Tier I				363.166
Loans which qualify as Tier II capital:				
Listed on the Iceland Stock Exchange..........................	ISK	7,5%	2010	17.713
Listed on the Iceland Stock Exchange..........................	ISK	4,8%	2014	344.623
Listed on the Iceland Stock Exchange..........................	ISK	5,5%	2014	114.531
Listed on the Iceland Stock Exchange..........................	ISK	6,3%	2014	86.100
Listed on the Iceland Stock Exchange..........................	ISK	5,3%	2015	1.060.235
Listed on the Iceland Stock Exchange..........................	ISK	6,5%	2015	225.419
Listed on the Iceland Stock Exchange..........................	ISK	6,5%	2015	172.380
Listed on the Iceland Stock Exchange..........................	ISK	7,0%	2018	312.795
Total Tier II				2.333.796
Total subordinated loans				2.696.962

32. Pension obligations

The Savings Bank guarantees the index adjustment of pension payments to employees. This is taken into account in the preparation of the Consolidated Financial Statement, and a provision has been formed for pension obligations which is credited to the Balance Sheet. Calculation of the commitment was based on the projection that real return in excess of pay hikes will amount to 2-3%. In the beginning of 2008 an agreement was signed between the savings bank and The Pension fund of Reykjanesbaer. In accordance of the agreement the savings bank paid in full all accrued pension obligations by that pension fund. The agreement applied from January 1st 2007 when the amount vas 1.282.839 thousand ISK. In this financial report this is treated as a pension obligation of the Savings bank and has been extrapolated to the year end 2008 taking not of the consumer price index and a 5% interest rate.

The change in the obligation for the period is specified as follows:

	31.12.2008	31.12.2007
Pension liability at end of previous year..	1.960.708	962.700
Changes in valuation of pension liability..	0	738.097
Pension liability as at beginning of year as to IFRS..	1.960.708	1.700.797
Payment to Pension fund of Reykjanesbaer..	(1.612.890)	0
Acquisition through business combinations..	0	88.090
Provision during the year..	23.509	186.396
Paid during the year..	(16.776)	(14.575)
Pension liability at year-end..	354.551	1.960.708

33. Tax liabilities

Tax in the Balance Sheet:

	Assets	Liabilities
Deferred tax asset..	304.664	0
Income tax payable (from a subsidiary)..		113
	304.664	113

Amounts in ISK thousands

33. Tax liabilities (continued)

Changes in the deferred tax asset and liabilities during the year are as follows:

	Assets	Liabilities
Tax liabilities at 1.1.2007		1.519.999
Addition through business combinations		(22.323)
Corrections due to associate at beginning of the year		15.171
Calculated income tax for the year 2007		343.984
Corrections due to subsidiary at beginning of the year		(146.069)
Tax liabilities at year end	0	1.710.762
Tax liability transfered to tax asset	(1.710.762)	(1.710.762)
Adjustment for a subsidiary	(6.921)	
Calculatied income tax for 2008	2.022.347	
Calculated tax liabilities 31.12.2008	304.664	0

The Saving Bank´s deferred tax liabilities are attributable to the following Balance Sheet item:

	Asset
Property and equipment	(99.799)
Taxable loss from subsidiary	404.462
Deferred tax liabilities at year-end	304.664

34. Other liabilities

	31.12.2008	31.12.2007
Accruals	181.162	282.918
Deferred income	554.240	472.485
Other liabilities	1.374.325	1.430.139
Other liabilities	2.109.728	2.185.542

35. Equity

Equity at year-end amounted to ISK 5.409 million, or about 5,52% of total assets. The Savings Bank's capital adequacy ratio (CAD), calculated as to Article 84 of the Financial Institution is 7,06% but the minimum ratio is 8%.

In the year 2008 Keflavik Savings Bank calculated the CAD ratio in accordance with a new rule Basel II. The major changes are that the total required capital is the total of weighted risk factors, such as credit risk, stock risk, exchange risk, interest rate risk and operation risk that the operation includes.

Amounts in ISK thousands

Notes

35. Equity (continued)

The ratio is calculated as follows, all amounts in ISK thousands:

	31.12.2008	31.12.2007
Equity as to Balance sheet	5.409.453	25.461.011
Subordinated loans Tier I	363.166	312.108
Subordinated loans Tier II	2.316.083	2.049.258
Goodwill	(155.000)	(175.000)
Investments in financial institutions deducted from equity	(504.041)	(12.000.878)
Equity base total	7.429.661	15.646.499
Required equity for credit risk	4.939.193	4.444.914
Required equity for market risk	2.642.622	507.656
Required equity for operation risk	837.215	690.479
Required equity total	8.419.030	5.643.049
Capital adequacy ratio	7,06%	22,18%

36. Related party transactions

The Savings Bank has defined its relationship with it's subsidiaries, board of directors of the parent company, managing director and other managers of the Savings Bank, other managers of it's largest subsidiaries and immediate family of these parties. This description is in accordance with IFRS. Loans to and from those related parties at year-end is as follows:

	2008	2007
Loans to the managing director and other managers	73.208	71.443
Loan to the board of directors and companies tied to them	3.024.485	1.980.440
Loans to associates and subsidiaries and people/companies tied to them	2.992.879	2.721.603
Loans from associates and subsidiaries and people/companies tied to them	(985.450)	(912.920)

No unusual transactions were made with related parties during the year 2008. Business with related parties are made on an arms-length basis. Information about salary and compensation to managers and board of directors are given in note number 12.

37. Operating lease agreements

At year-end the Savings Bank was committed with a few undismissable operating lease agreements. Large real estate operating lease agreements contains major renewal clause and options on index of lease price. These lease agreements do not contain conditional lease payments or buying options.

38. Asset management

Assets managed by the savings bank are:

	31.12.2008	31.12.2007
Assets managed	2.297.067	2.136.245

39. Collateralised assets

Assets have been collateralised for the following liabilities and contingencies:

	31.12.2008	31.12.2007
Repurchase agreement with Central bank	4.062.674	0

40. Off Balance Sheet information

The Savings Bank has granted its customers guarantees, overdraft permissions and loan commitments. Exercised overdraft rights are entered into the accounts of the Savings Bank, and unexercised rights and guarantees are specified as follows in ISK thousands:

	31.12.2008	31.12.2007
Guarantees issued to clients	1.285.026	5.678.299
Unexercised overdraft rights	2.342.218	2.978.060
Forwards contracts:		
Assets in foreign currencies	0	76.011
Assets in ISK	13.332.202	8.633.354
Liabilities in foreign currencies	13.199.931	8.684.631
Interest rate swap in ISK asset	0	225.750
Interest rate swap in ISK liability	0	225.986

41. Maturity date of financial assets and liabilities

Financial assets and liabilities are specified as follows based on maturity 31.12.2008:

31.12.2008	Claims due	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Cash and cash balances	0	1.206.188	0	0	0	1.206.188
Receivables financial inst.	0	195.208	0	0	0	195.208
Loans and receivables	1.456.061	9.346.113	11.938.742	25.108.991	36.609.272	84.459.179
Trading	0	960.800	0	168.410	3.504.091	4.633.301
Other assets at FVTPL	0	2.270.621	0	0	0	2.270.621
	1.456.061	13.978.930	11.938.742	25.277.401	40.113.363	92.764.497
Owed to credit inst.	0	10.520.074	0	0	0	10.520.074
Deposits	38.736.056	1.935.917	1.199.648	9.915.897	2.905.897	54.693.415
Borrowings	0	0	3.912.677	15.164.340	3.150.764	22.227.781
Subordinated loans	0	0	0	17.713	2.679.249	2.696.962
	38.736.056	12.455.991	5.112.325	25.097.950	8.735.910	90.138.232
Financial assets - liabilities	(37.279.995)	1.522.939	6.826.417	179.451	31.377.453	2.626.265

41. Maturity date of financial assets and liabilities (continued)

31.12.2007

	Claims due	1-3 months	3-12 months	1-5 years	Over 5 years	Total
Cash and cash balances	0	2.444.565	0	0	0	2.444.565
Receivables financial inst.	0	18.658	0	0	0	18.658
Loans and receivables	1.668.269	9.961.255	7.823.514	22.709.834	29.850.596	72.013.468
Trading	0	3.283.389	0	151.004	1.203.465	4.637.858
Other assets at FVTPL	0	6.369.156	0	0	0	6.369.156
	1.668.269	22.077.023	7.823.514	22.860.838	31.054.061	85.483.705
Owed to credit inst.	0	6.650.403	0	0	0	6.650.403
Deposits	34.686.433	1.847.084	1.287.338	4.571.699	2.501.587	44.894.141
Borrowings	11.524	20.931	0	15.611.730	5.739.730	21.383.915
Subordinated loans	0	0	0	16.441	2.535.282	2.551.723
	34.697.957	8.518.418	1.287.338	20.199.870	10.776.599	75.480.182
Financial assets - liabilities	(33.029.688)	13.558.605	6.536.176	2.660.968	20.277.462	10.003.523

42. Risk analysis

Risk management

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 the main task of the Savings Bank. It is the policy of the board of directors of Keflavik Savings Bank that the various risks that the Savings Bank faces in its business are to be constantly monitored and managed. It is the policy of the board of directors that the various risks that the Savings Bank faces in its business such as credit risk, liquidity risk and market risk are constantly monitored.

The process of risk management

Keflavik Savings bank operates a centralized risk management department which monitors risk and report's on various risk both to the board of directors and to the authorities. Decision making is in accordance with resolutions made by the board of directors which has given power to the various committees of the Savings Bank to issue and define acceptable levels of risk for day-to-day operations, as well as the willingness of the Savings Bank to incur risk weighed against the expected rewards. Information regarding risks is regularly reported to the management and board of directors.

Monitoring and controlling liquidity risk

Liquidity risk is the risk of loss arising from the Savings Bank inability to meet its liabilities as they become due. The Svaings 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 Savings Bank must always have sufficient liquidity to meet both foreseeable as well as unexpected payment obligations. The Savings Bank has in place a set of liquidity and funding policies that are intended to maintain flexibility. This includes lines of credit, overdraft facilities and highly liquid securities, such as Treasury bills and bonds.

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 assigns weights to each asset class as a conservative measure of liquidity.

The Savings Bank breakdown by contractual maturity of financial assets and liabilities, at 31 December 2008.

Amounts in ISK thousands

42. Risk analysis (continued)

Monitoring and controlling market risk

The Savings Bank policy is to monitor its market risk closely and to make sure that limits set by the Board of directors are not exceeded. Market risk is managed by exposure limits and with limits on risk measures.

Derivatives

The Savings 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. The Savings Bank use 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

The Savings Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest-earning assets and interest-bearing liabilities mature or reprice at different times or in different amounts. In the case of floating rate assets and liabilities the Savings 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. It is the Savings 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 and to maximize the net interest income.

Sensitivity analysis

The table below shows the influence a 50 and 100 points increase in interest rates on net interest bearing assets and liabilities would have on financial performance and equity on reporting date. The analysis includes those assets that bear fluctuating interest rates and all other variables are held constant. The analysis consideres the influence on taxation and therefor reflects the influence on the income statement and equity.

The influence on the financial performance and equity remainst the same since revaluation doesn't under any circumstances involve a transaction directly through equity. A positive numer stands for an increase in profits and equity. Lowering the interest rate would have had the same effect, just reversed.

Assets	31.12.2008	31.12.2007
Cash and cash balances in financial institutions	1.206.188	4.873.617
Receivables from financial institutions	195.208	946.250
Loans and receivables	87.372.323	62.369.485
Financial assets held for trading	4.684.145	7.562.486
	93.457.864	75.751.838

Liabilities	31.12.2008	31.12.2007
Amounts owed to credit institutions	10.520.074	3.155.638
Deposits	55.548.661	38.912.232
Borrowings	22.227.781	18.209.222
Subordinated loans	2.696.962	2.434.232
	90.993.478	62.711.323
Interest bearing assets over liabilities	2.464.387	13.040.515

Sensitivity analysis (continued)

	31.12.2008		31.12.2007	
	50 pkt	100 pkt	50 pkt	100 pkt
Effect on financial performance and equity	12.322	24.644	65.203	130.405

Amounts in ISK thousands

42. Risk analysis (continued)

Price risk

Price risk is the risk of market price changes. The Savings Bank's shareholdings and bond holdings are most sensitive to such changes.

The savings bank invests mostly in listed companies but also has invested in some entities that are not. Investments in stock are listed at fair value through the income statement, as financial assets held for trading or assets held for sale.

	31.12.2008	31.12.2007
Financial assets held for trading	850.277	6.085.511
Stocks at fair value through income statement	2.270.621	11.821.029
Assets held for sale	354.059	514.162

The effect of 5% and 10% increase in market value on financial performance and equity is shown below. Income tax is not taken into consideration. 5% or 10% decrease would have a reversed effect.

	31.12.2008		31.12.2007	
	50 pkt	100 pkt	50 pkt	100 pkt
Effect on financial performance and equity	173.748	347.496	921.035	130.405

Currency risk

Currency risk is the risk of loss due to adverse movements in foreign exchange rates. Net exposures per currency are monitored centrally in the Savings Bank.

These are the currencys that have the most impact on the Savings Bank assets and liabilities:

Mynt	Árslokamiðgengi		Meðalgengi		Ársflökt
	2008	2007	2008	2007	2007
EUR	169,72	91,75	130,74	92,41	98,58%
GBP	176,25	124,95	150,60	131,76	90,17%
JPY	1,34	0,56	0,95	0,58	94,41%
CHF	114,07	55,38	84,73	56,65	95,61%
DKK	22,78	12,30	17,54	12,39	98,52%
USD	121,13	62,71	91,92	66,75	88,60%

Breakdown of assets and liabilities by currency in ISK thousands:

Currency risk 31.12 2008

	Assets	Debts	Net book value
EUR	8.659.835	(26.535.336)	(17.875.501)
GBP	816.636	(83.970)	732.666
JPY	17.793.314	(860)	17.792.454
CHF	13.414.154	(14.192)	13.399.962
DKK	189.806	(26.480)	163.326
USD	960.510	(304.373)	656.137
Other	320.857	(32.632)	288.225
	42.155.112	(26.997.843)	15.157.269

42. Risk analysis (continued)

Currency risk (continued)

Currency risk 31.12 2007

	Assets	Debts	Net book value
EUR	10.888.532	(10.832.918)	55.614
GBP	658.563	(552.560)	106.003
JPY	9.977.547	(9.997.180)	(19.633)
CHF	6.509.291	(6.497.440)	11.851
DKK	337.875	(83.685)	254.190
USD	816.524	(764.336)	52.188
Other	261.377	(99.022)	162.355
	29.449.710	(28.827.141)	622.569

The effect of 5% and 10% increase of the value of foreign currency agains the Krona on financial performance and equity is shown below. Income tax is not taken into consideration. 5% or 10% decrease would have a reversed effect.

Impact on financial performance and equity	31.12.2008		31.12.2007	
	5%	10%	5%	10%
EUR	(893.775)	(1.787.550)	2.781	5.561
GBP	36.633	73.267	5.300	10.600
JPY	889.623	1.779.245	(982)	(1.963)
CHF	669.998	1.339.996	593	1.185
DKK	8.166	16.333	12.710	25.419
USD	32.807	65.614	2.609	5.219
Other	14.411	28.823	8.118	16.236

Operational risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Savings Bank's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behavior. Operational risks arise from all of the Savings Bank's operations and are faced by all business entities. The Savings Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Savings Bank's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity. The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management within each business unit.

Credit risk

Credit risk derives from lending activities. The amounts of credit risk in this regard are reflected in the book value of assets in the balance sheet. Counterparty risk attaches to various other financial assets, such as derivative contracts and market bonds. The current counterparty risk is reflected in the book value of these assets in the balance sheet. The Bank is also exposed to counterparty risk relating to items off the balance sheet, such as undrawn overdrafts and lines of credit.

The Board of Directors of the Keflavik Savings Bank establishes general rules on lending and lines of credit and decides the Bank's lending policy. The Board of Directors supervises the Bank's lending activities and establishes credit limits on the recommendation of the Managing Director. The Board of Directors deals with any lending that exceeds the authority of the Managing Director.

A separate supporting division, Risk Management and Credit Control, supervises all aspects of lending, granting of credit, collateral, composition of the loan portfolio and collection.
Internal Audit is responsible for exercising control and providing advice in the course of lending processes in line with its rules of procedure.

Amounts in ISK thousands

42. Risk analysis (continued)

Credit risk (continued)

The Head of Risk Management and Credit Control and the Head of Internal Audit will notify the Board of Directors of the Keflavik Savings Bank if the conduct of lending is not in compliance with the Bank's credit policy or lending rules.

The Managing Director, acting for the Board of Directors, is responsible for compliance with the Bank's rules on risk management. The Managing Director will ensure that proper measures are taken to analyse, assess and measure risk factors in the day-to-day operation of the Bank. Day-to-day supervision of risk management is the responsibility of the Head of Risk Management and Credit Control. Risk Management and Credit Control in the Keflavik Savings Bank cuts across all the Bank's business activities at any time and thereby extends to all aspects of the Bank's business operations. The principal role of Risk Management and Credit Control is to analyse the Bank's risk at any time, monitor and assess risk factors and establish specific criteria for individual risk factors. At the same time, the division will monitor and manage the risks facing the Bank that could have a significant impact on its performance and ensure that appropriate prudential measures are taken at any time. Risk Management and Credit Control will also issue warnings and provide advice when an exposure is approaching established limits and ensure that appropriate measures are taken.

The objective of the Keflavik Savings Bank's risk management is to aim for acceptable results for the Bank at any time with regard to the underlying risk of the Bank's operations and ensure that the Bank's aggregate risk always remains within defined limits.

Notwithstanding the fact that the Bank takes systematic measures to reduce the risks taken at any time, changes can occur in domestic and foreign financial markets, the Bank's competitive environment or its operations which can have a negative impact on its results.

The Bank's loan portfolio is diversified among debtors, sectors and regions. The loan portfolio is managed with a view to ensuring that no single debtor or group of financially linked debtors accounts for a larger proportion of the loan portfolio than the Bank's rules concerning risk will permit.

43. Going concern

As explained in note no. 35 the Keflavik Savings Bank's equity ratio (CAD) is 7,06%, as it is definition in article 84 of law no. 161/2002. In article no. 86 of the same law it is stated that the ratio should not be lower than 8% at any time. The management of the entity should inform The Financial Supervisory Authority immediately if they have reason to suspect that the required limit will not be reached. If the equity ratio is discovered to be lower than stated in the article 84 at preparing the management accounts the management will have to assemble a meeting of shareholders to decide on appropriate action and supply the Financial Supervisory Authority with an explanatory report there of. The Financial Supervisory Authority is entitled to allowing the entity up to six months period to reach the limit stated in article 84, with option to extend that period by six more months after that.

At the year end the Keflavik Savings Bank's equity ratio (CAD) has gone below the required 8% ratio and the management has already reacted to that problem, e.g. by sending a report to the Financial Supervisory Authority explaining what action will be taken in attempt to improve the equity ratio. An effort has been made to adjust the Bank's foreign exchange balance, as with the issue of Government Regulation 1130 of 15 December 2008 trading in derivative contracts setting the ISK against foreign currency was prohibited. The consequence of the new legislation was an imbalance in the Bank's foreign exchange position.

43. Going concern (continued)

The actions taken to improve the CAD have focused on converting loans to customers between foreign currencies. Some progress has already been made which in return affects the equity ratio directly. Those actions will affect the equity ratio by 0,92% which means that the Savings bank would reach CAD of 7,98%. The Savings Bank has also rceived an assurance for a subordinated loan of 350 million ISK which would enhance the equity ratio. Those actions will affect the equity ratio by 0,38% which means that the Savings Bank would reach CAD of 8,36%. The Savings Bank has also applied for State involvement in accordance with emergency laws no. 125/2008 from October 2008. The equity ratio would improve by further 5,47% if state involvement is approved, and reach 13,83%.

Highly unusual and extraordinary circumstances have occurred on the Icelandic financial market as they are descibed in act no.125/2008 on the Authority for Treasury Disbursement due to Unusual Financial Market Circumstances etc. and the current uncertainty regarding continuing operations of Icelandic Financial Institution. Keflavik Savings Bank has applied for State involvement in accordance with above act. The application has not been finalised within the State and therefor it is unforseeable how the situation will affect the Savings bank and its future operations.

44. Events after reporting date

After the reporting date resoloution committees have been assigned authority over Straumur – Burdaras investment bank, SPRON savings bank and Sparisjodabankinn (before Icebank). Its influence on the income statement and balance sheet of Keflavik Savings Bank are minimal since impairment of those assets had already been accounted for at year end. VBS Investment Bank and Saga Capital received state involvement in March which in return might lead to other valuation of those assets. The savings Bank holds approximately 16,3% share in VBS Investment Bank.

45. Approval of the consolidated financial statements

The Consolidated Financial Statements were approved by the board of directors and authorised for issue on March 31st 2009.