

Consolidated Financial Statements 2005



Landsbanki Íslands hf.

ISK

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Landsbanki
The National Bank of Iceland

Consolidated Financial Statements 2005

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ISK



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Consolidated Key Figures

Operations	2005	2004	2003	2002	2001
Interest revenues	66,437	34,252	21,871	21,813	27,909
Interest expenses	43,441	19,517	12,540	14,082	19,136
Net interest revenues	22,996	14,734	9,331	7,732	8,772
Fee and commission income	18,479	10,234	6,959	4,745	4,197
Fee and commission expenses	1,754	1,344	843	669	575
Net fee and commission income	16,726	8,891	6,116	4,076	3,622
Other operating revenues	21,257	9,842	3,535	2,109	(143)
Operating revenues	60,978	33,467	18,982	13,916	12,251
Salaries and related expenses	12,682	7,794	5,656	4,387	4,184
Administrative expenses	8,284	6,667	5,158	4,117	3,924
Operating expenses	20,967	14,460	10,815	8,505	8,108
Impairment on loans and advances and assets held for sale	6,197	4,485	4,656	2,863	2,298
Profit before impairment on goodwill and income tax	33,815	14,521	3,512	2,549	1,846
Impairment on goodwill	3,033	0	0	0	0
Income tax	5,764	1,798	457	475	(9)
Net profit	25,017	12,723	3,055	2,074	1,855
Attributable to:					
Shareholders of Landsbanki Íslands hf.	24,740	12,574	2,956	2,028	1,749
Minority interests	277	149	99	45	107
Balance Sheet					
Cash and cash balances with Central Bank	16,611	18,237	48,772	18,893	22,023
Loans and advances	1,071,513	614,274	326,400	214,787	199,083
Trading assets	218,894	64,730	63,744	36,337	39,939
Other assets	98,443	39,900	9,323	7,808	7,881
Total assets	1,405,460	737,141	448,239	277,824	268,926
Deposits	478,759	279,206	196,160	138,971	129,157
Funding	689,989	375,084	209,357	108,479	111,639
Subordinated loans	49,074	22,570	13,090	8,216	8,527
Other items	74,022	21,572	6,389	5,057	3,131
Equity	110,059	37,705	22,382	16,309	15,505
Minority interests	3,557	1,004	862	792	967
Total liabilities and equity	1,405,460	737,141	448,239	277,824	268,926
Key ratios	2005	2004	2003	2002	2001
Return on equity before impairment on goodwill and taxes	61.8%	57.2%	20.9%	17.0%	13.9%
Return on equity after taxes	45.8%	49.5%	17.6%	13.5%	13.1%
Tier 1 ratio	11.9%	7.8%	6.9%	7.7%	7.5%
Equity ratio	13.1%	10.4%	9.9%	10.6%	10.4%
Cost-income ratio	34.4%	43.2%	57.0%	61.1%	66.2%
Operating expenses as a ratio of average capital position	2.0%	2.5%	3.0%	3.1%	3.2%
Interest spread as a ratio of average capital position	2.2%	2.6%	2.6%	2.8%	3.5%
Ratio of provision to lending position at year-end	0.58%	0.73%	1.47%	1.33%	1.17%
Share price at year-end	25.30	12.10	5.80	3.65	3.39
Share price increase adjusted for dividend payments	110.7%	110.3%	61.6%	10.6%	0.1%
Number of positions at year-end	1,725	1,121	1,025	986	997

Consolidated Key Figures

Operations	2005	2005	2005	2005	2004	2004	2004	2004
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Interest revenues	21,073	18,594	14,309	12,461	10,879	8,172	8,534	6,668
Interest expenses	13,818	12,272	9,180	8,172	6,268	4,273	5,264	3,712
Net interest revenues	7,255	6,322	5,129	4,289	4,611	3,898	3,269	2,956
Fee and commission income	5,359	4,775	4,864	3,481	3,191	2,509	2,080	2,455
Fee and commission expenses	598	392	403	361	382	365	301	296
Net fee and commission income	4,761	4,383	4,461	3,120	2,809	2,144	1,779	2,159
Dividend income	191	161	616	105	11	1	98	343
Net gain on financial assets and liabilities held for trading	5,503	3,550	(163)	1,978	(41)	1,794	806	1,557
Net gain on financial assets designated at FV through P/L	1,205	1,167	1,003	2,490	(2,220)	4,693	200	2,245
Fair value adjustments in hedge accounting	(361)	232	(81)	216	0	0	0	0
Foreign exchange gain	92	359	(161)	97	122	111	59	72
Share of profit of associates	643	505	275	484	(79)	41	17	13
Net gain of disposal groups held for sale	63	270	817	0	0	0	0	0
Other operating revenues	7,337	6,243	2,307	5,370	(2,207)	6,639	1,179	4,231
Operating revenues	19,352	16,949	11,898	12,779	5,213	12,682	6,227	9,346
Salaries and related expenses	4,136	3,077	3,114	2,355	2,112	2,304	1,735	1,643
Administrative expenses	2,933	1,905	1,764	1,683	1,749	1,963	1,342	1,612
Operating expenses	7,069	4,982	4,879	4,037	3,862	4,267	3,076	3,255
Impairment on loans and advances and assets held for sale	1,805	1,687	1,359	1,345	1,223	1,293	978	991
Profit before impairment on goodwill and income tax	10,479	10,280	5,660	7,396	128	7,121	2,172	5,100
Impairment on goodwill	(259)	3,293	0	0	0	0	0	0
Income tax	1,929	1,882	602	1,351	(829)	1,333	361	934
Net profit	8,809	5,105	5,058	6,045	957	5,788	1,812	4,167
Attributable to:								
Shareholders of Landsbanki Íslands hf.	8,734	4,995	5,000	6,011	905	5,746	1,785	4,139
Minority interests	75	110	58	34	53	42	27	27
Balance Sheet	31.12.2005	30.9.2005	30.6.2005	31.3.2005	31.12.2004	30.9.2004	30.6.2004	31.3.2004
Cash and cash balances with Central Bank	16,611	8,134	8,211	14,136	18,237	84,977	53,260	57,461
Loans and advances	1,071,513	891,668	828,342	687,883	614,274	487,076	431,822	384,596
Trading assets	218,894	156,243	119,208	82,630	64,730	57,358	63,490	59,312
Other assets	98,443	86,212	66,311	65,993	39,900	9,002	9,920	9,639
Total assets	1,405,460	1,142,258	1,022,072	850,642	737,141	638,413	558,493	511,008
Deposits	478,759	413,988	355,410	298,063	279,206	277,172	240,095	211,689
Funding	689,989	531,417	521,870	417,947	375,084	287,944	262,663	245,105
Subordinated loans	49,074	47,224	49,394	49,327	22,570	23,416	14,897	15,333
Other items	74,022	48,804	34,378	30,241	21,572	11,027	7,685	7,697
Equity	110,059	98,749	58,954	53,988	37,705	37,916	32,256	30,314
Minority interests	3,557	2,076	2,066	1,076	1,004	939	897	870
Total liabilities and equity	1,405,460	1,142,258	1,022,072	850,642	737,141	638,413	558,493	511,008

Report of the Board of Directors and Group Managing Directors & CEOs

The Consolidated Financial Statements for the year 2005 comprise the Consolidated Financial Statements of the Landsbanki Íslands hf. and its subsidiaries. The Consolidated Financial Statements are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU. The effect on shareholder's equity as a result from adoption of IFRS is a decrease of ISK 311 million. Further disclosures of the effect of IFRS transition are in the notes.

In February Landsbanki made an offer for Teather & Greenwood Holdings plc and had bought a 100% share in the company in May. In August, a merger schedule was approved, merging part of Burðarás hf. with Landsbanki, and concluding in September. An agreement reached in September provides for the Bank's acquisition of holding companies owning 84% of Kepler Equities SA, and concluding in November. Landsbanki reached an agreement to acquire a 50% share of Merrion Capital Group Ltd. in Ireland. The transaction was completed in December.

In March 2005 the nominal share capital was increased by ISK 800 million. The share price in the Issue was 14.25. In September this year, the Bank issued additional shares of ISK 2,121 million nominal value, used to pay shareholders in Burðarás hf. for their holdings at a conversion rate of 19.00. Total issued nominal share capital is ISK 11,021 million at year-end 2005.

At year-end the Bank's shareholders numbered 29,675 as compared to 14,675 at the beginning of the year. Samson eignarhaldsfélag ehf. is the only shareholder with a stake over 10%, namely a 40.17% stake.

The Bank's after-tax profit in 2005 was ISK 25.017 million. The equity of the Landsbanki Group was ISK 110.059 million at year-end and the Group's capital ratio, calculated in accordance with the relevant Icelandic legislation, was 13.1%. As of 31 December 2005, the Bank's total assets were ISK 1.405.460 million.

At the Bank's AGM, the Board of Directors will move that shareholders be paid a dividend of 30%, equivalent to ISK 3.306 million and that the remaining profit be disposed of as indicated in the summary of changes in equity in the annual financial statement.

The Board of Directors and Chief Executive Officers hereby endorse the Consolidated Financial Statements of Landsbanki Íslands hf. for 2005.

Reykjavík, 27 January 2006

Board of Directors

Björgólfur Guðmundsson

Kjartan Gunnarsson

Andri Sveinsson

Guðbjörg Matthíasdóttir

Porgeir Baldursson

Group Managing Directors and Chief Executive Officers

Halldór J. Kristjánsson

Sigurjón Þ. Árnason

Auditor's Review Report

To the Shareholder and Board of Directors of Landsbanki Íslands hf.

We have audited the accompanying consolidated balance sheet of Landsbanki Íslands hf. (the bank) and its subsidiaries (the Group) as of 31 December 2005 and the related consolidated statements of income, cash flows and changes in shareholder's equity for the year then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on the financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance that the annual accounts are free of material misstatement. An audit includes, based on our assessment of materiality and risk, an analytical review and an examination, on a test basis, of evidence supporting the amounts and disclosures in the financial statements. The audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion the accompanying consolidated financial statements give a true and fair view of the financial position of the Group as of 31 December 2005 and of the results of its operations and its cash flows for the year then ended, in accordance with law and International Financial Reporting Standards as adopted by the EU.

Reykjavik, 27 January 2006

PricewaterhouseCoopers hf.

Hjalti Schiöth

Vignir Rafn Gíslason

Consolidated Income Statement for the year 2005

Notes	2005	2004
Interest revenues	66,437	34,252
Interest expenses	43,441	19,517
8 Net interest revenues	22,996	14,734
Fee and commission income	18,479	10,234
Fee and commission expense	1,754	1,344
9 Net fee and commission income	16,726	8,891
10,11 Dividend income	1,073	453
11 Net gain on financial assets and financial liabilities held for trading	10,868	4,116
11,12 Net gain on financial assets designated at fair value through profit and loss	5,866	4,918
11 Fair value adjustments in hedge accounting	6	0
11 Foreign exchange difference	387	364
11,22 Share of profit of associates	1,907	(8)
11 Net gain of disposal groups held for sale	1,150	0
Other operating revenues	21,257	9,842
Net operating revenues	60,978	33,467
13 Salaries and related expenses	12,682	7,794
Administrative expenses	8,284	6,667
Operating expenses	20,967	14,460
14 Impairment on loans and advances and assets held for sale	6,197	4,485
Profit before impairment on goodwill and income tax	33,815	14,521
24 Impairment on goodwill	3,033	0
15 Income tax	5,764	1,798
Net profit	25,017	12,723
Attributable to:		
Shareholders of Landsbanki Islands hf.	24,740	12,574
Minority interest	277	149
16 Earnings Per Share:		
Earnings Per Share	2.74	1.61
Diluted earnings per share	2.61	1.55

Consolidated Balance Sheet as at 31 December 2005

Notes	2005	1.1.2005	
Assets			
	Cash and cash balances with Central Bank	16,611	18,237
17	Loans and advances	1,071,513	614,274
18,19	Trading assets	218,894	64,730
20	Financial assets designated at fair value through profit and loss	34,483	12,817
21	Derivatives held for hedging	4,689	4,930
22	Investments in Associates	4,456	3,792
23	Property and equipment	4,260	4,146
24	Intangible assets	10,461	1,585
25	Non-current assets and disposal groups classified as held for sale	16,459	9,962
26	Other assets	23,636	2,668
	Total assets	1,405,460	737,141
Liabilities			
27	Deposits from credit institutions	144,596	61,236
28	Deposits from customers	334,163	217,970
29	Borrowing	689,989	375,084
30	Subordinated loans	49,074	22,570
19	Trading liabilities	26,504	8,077
21	Derivatives held for hedging	4,086	1,582
31	Tax liabilities	7,289	1,674
	Liabilities included in disposal groups classified as held for sale	4,475	4,204
	Unsettled payments	20,428	0
	Other liabilities	11,240	6,035
	Total liabilities	1,291,844	698,432
Equity			
	Share Capital	10,614	7,954
	Share Premium	52,277	7,557
	Reserves	1,790	(20)
	Retained earnings	45,377	22,214
		110,059	37,705
	Minority interest	3,557	1,004
32	Total equity	113,617	38,709
	Total liabilities and Equity	1,405,460	737,141

33-40 Other information

Consolidated Equity Statement

	Attributable to equity holders of the Company							
	Share capital	Share Premium		Reserves		Retained earnings	Minority Interest	Total
		Additionally paid in capital	Statutory Account	Translation	Fair value			
Equity 1 January 2004	7,500	4,355	268			10,259		22,382
Changes due to conversion to IFRS							862	862
Equity 1 January 2004 - adjusted	7,500	4,355	268	0	0	10,259	862	23,244
Capital increase	475	3,171						3,646
Dividends paid						(721)	0	(721)
Translation differences				(20)				(20)
Changes in minority interest							(7)	(7)
Net profit 2004						12,574	149	12,723
Equity 31 December 2004	7,975	7,526	268	(20)	0	22,112	1,004	38,865
Changes due to conversion to IFRS	(21)	(237)				103	0	(156)
Equity 1 January 2005	7,954	7,288	268	(20)	0	22,214	1,004	38,709
Capital increase	800	10,600						11,400
Merger with Burðarás	2,121	38,172						40,293
Purchases and sales of treasury shares	(260)	(4,052)						(4,312)
Dividends paid						(1,577)		(1,577)
Translation differences				(53)				(53)
Fair value adjustment of investment properties, included in disposal groups					1,864		870	2,734
Changes in minority interest							1,406	1,406
Net profit 2005						24,740	277	25,017
Equity 31 December 2005	10,614	52,009	268	(73)	1,864	45,377	3,557	113,617

Additional disclosures:

According to the Bank's Articles of Association, total share capital amounts to ISK 11.021 millions. At year- end 2005 own shares amounted to ISK 407 millions and share capital in the Balance sheet thus amounted to ISK 10.614 millions. One vote is attached to each share. The Board of Directors have proposed to the 2006 Annual General Meeting that a dividend of 30% of the share capital amounted.

The Board of Directors have proposed to the 2006 Annual General Meeting that a dividend of 30% of the share capital amounted.

Cash flow statement for the year 2005

	2005	2004
Net profit	24,740	12,574
Reconciliation of operating profit to net cash flow from operating activities:		
Provisions for credit losses	6,197	4,485
Changes in Tax liabilities	3,486	97
Depreciation og property and equipment	713	1,706
Translation differences in susidiaries	(53)	0
Change in other none cash items	(64,299)	(7,998)
Cash flows from operating profits before changes in operating assets and liabilities	(29,217)	10,864
- net decrease/(increase) in loans and advances	(4,678)	(39,203)
- net increase in loans and advances to customers	(415,215)	(255,249)
- net change in trading assets:		
- net change in trading bonds	(78,794)	20,668
- net increase in trading securities	(64,070)	(21,867)
- net increase in bought and sold derivatives	(3,985)	12,335
- net change in derivatives held for hedging - assetes/Liabilities	1,297	482
- net change in non current assets and disposal groups classified as held for sale	1,260	0
- net (increase)/decrease in other assets	(19,558)	195
- net increase in deposits from other banks	83,458	21,351
- net increase in amounts due to customers	113,478	67,568
- net increase in trading liabilities and other liabilities	42,450	3,255
Cash flow from operating activities	(373,575)	(179,601)
Purchase of property and equipment	(2,376)	(1,702)
Proceeds from sale of property and equipment	1,642	116
Financial assets designated at fair value through porfit and loss	(21,589)	(12,700)
Change in Intangible assets	(8,058)	150
Change in subsidiaries	(5,909)	(2,539)
Cash flow used by investing activities	(36,290)	(16,675)
Repayments and proceeds from borrowed funds and debt securitieschange in funding	339,613	185,901
Repayments and proceeds from subordinated loans	30,235	10,711
Dividends paid	(1,577)	(722)
Change in own stock	44,721	(914)
Increased share capital	2,661	4,560
Cash flow provided by financing activities	415,652	199,536
Increase in cash	5,787	3,261
Cash at beginning of year	25,630	22,369
Cash at year-end	31,417	25,630

1 General information

Landsbanki Íslands hf. (the Group) is a universal bank, providing retail, corporate and investment banking services. The Group operates subsidiaries in five countries and has 1,725 employees at year-end.

The Group's parent company is Landsbanki Íslands hf. (the Bank), which is a limited-liability company incorporated and domiciled in Iceland. The Bank was established in 1885 and remained state-owned until 1998 when the State decided to privatise the Bank through a public offering. Today, the Bank's shares are listed on the Main List of the Iceland Stock Exchange (ICEX).

These consolidated financial statements were approved for issue by the Board of Directors on 27 January 2006.

2 Summary of significant accounting policies

The principal accounting policies applied in preparing these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

2.1 Basis of preparation

The consolidated financial statements of Landsbanki Group 2005 have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU. They are covered by IFRS 1, International Financial Reporting Standards, First-time Adoption of IFRS, because they are the Group's first IFRS financial statements.

The accounting policies, as adopted by the EU, depart from full IFRS in the following areas, relating to the Group's operations:

Standards:

- IFRS 7: Financial Instruments: Disclosures

Amendments:

- Amendments to IAS 39 and IFRS 4: Financial guarantee Contracts
- Amendments to IAS 21: The effects of Changes in Foreign Exchange Rates

IFRS 7, Financial Instruments: Disclosures, and a complementary Amendment to IAS 1, Presentation of Financial Statements - Capital Disclosures (effective from 1 January 2007). IFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including sensitivity analysis to market risk. It replaces IAS 30, Disclosures in the Financial Statements of Banks and Similar Financial Institutions, and disclosure requirements in IAS 32, Financial Instruments: Disclosure and Presentation. It is applicable to all entities that report under IFRS. The amendment to IAS 1 introduces disclosures about the level of an entity's capital and how it manages capital. The Group assessed the impact of IFRS 7 and the amendment to IAS 1 and concluded that the main additional disclosures will be the sensitivity analysis to market risk and the capital disclosures required by the amendment of IAS 1.

The Group will apply IFRS 7 and the amendment to IAS 1 from annual periods beginning 1 January 2007.

IAS 39 (Amendment), Cash Flow Hedge Accounting of Forecast Intragroup Transactions (effective from 1 January 2006). The amendment allows the foreign currency risk of a highly probable forecast intragroup transaction to qualify as a hedged item in the consolidated financial statements, provided that: (a) the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction; and (b) the foreign currency risk will affect consolidated profit or loss. This amendment is not relevant to the Group's operations, as the Group does not have any intragroup transactions that would qualify as a hedged item in the consolidated financial statements as of 31 December 2005 and 2004.

IAS 39 (Amendment), The Fair Value Option (effective from 1 January 2006). This amendment changes the definition of financial instruments classified at fair value through profit or loss and restricts the ability to designate financial instruments as part of this category. The Group believes that this amendment should not have a significant impact on the classification of financial instruments, as the Group should be able to comply with the amended criteria for the designation of financial instruments at fair value through profit and loss. The Group will apply this amendment from annual periods beginning 1 January 2006.

IAS 21 (amendment) The Effects of Changes in Foreign Exchange Rates—Net Investment in a Foreign Operation. This amendment requires to define translation difference as defined to in IAS 21 to be reclassified to separate component of the equity. The group apply this amendment from annual period beginning 1 January 2006.

The accounting policies prescribed by IFRS and followed in preparing the consolidated financial statements have been consistently applied retroactively to the comparison period of 2004, except where the Group has made use of special exemptions available under IFRS 1. The most important exemption which has been used is in connection with classification and measurement of financial instruments as provided for in standards 32 and 39 (IAS 32 and IAS 39). The Group adopt these standards from 1 January 2005 and will not apply them retroactively.

Until 31 December 2004, the Group's consolidated financial statements were prepared in accordance with Generally Accepted Accounting Principles for financial institutions in Iceland (GAAP). The former accounting policies differ in some aspects from IFRS. The comparative figures for 2004 were restated to accord with the latter, except where otherwise expressly stated.

Reconciliations and descriptions of the effect of the transition to IFRS on the Group's equity and its net income and cash flows are provided in Note 40.

These consolidated financial statements have been prepared under the historical cost convention, having regard to the revaluation of financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss.

The preparation of financial statements in accordance with IFRS requires the use of certain accounting estimates. It also requires management to exercise judgement in the process of applying various accounting policies. Accounting assumptions and estimates of major significance are disclosed in particular in Note 3.

2.2 Consolidation

(a) Subsidiaries

Subsidiaries are all entities over which the Group has the power generally accompanying a shareholding of more than one-half of the voting rights to govern financial and operating policies. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases. On the date of reporting, the Bank's subsidiaries were comprised of the following:

Landsbanki Holdings (UK) plc.	100%
- Heritable Bank Ltd. (UK)	100%
- Teather & Greenwood Holdings plc. (UK)	100%
Landsbanki Holdings (Europe) plc. (Luxembourg)	100%
- Landsbanki Luxembourg S.A. (Luxembourg)	100%
- Kepler Equities S.A. (France)	84%
Landsvaki hf.	100%
Merrion Capital Group Ltd. (Ireland)	50%
Landsbankinn eignarhaldsfélag ehf.	100%
LI Asset Management (UK)	100%
Landsbankinn - Fjárfesting hf.	100%
Landsbankinn fasteignafélag ehf.	100%
LI Investments Ltd. (UK)	100%
Hömlur hf.	100%
Stofnlánadeild Samvinnufélaga	100%
Verðbréfun hf.	100%
SP - Fjármögnun hf.	51%

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

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated in the consolidated accounts. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

(b) Associates

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the share capital conferring voting rights. Investments in associates are accounted for by the equity method of accounting and are initially recognised at cost. The Group's investment in associates includes goodwill (net of any accumulated impairment loss) identified on acquisition.

The Group's share of its associates' post-acquisition profits or losses is recognised in the income statement, and its share of movements of reserves is recognised in reserves under equity. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

Investments in associates held for the purpose of investment banking and restructuring are accounted as Financial asset designated at fair value through profit and loss.

2.3 Segment reporting

A business segment is a part of the Group's assets and operations which is subject to risks and returns differing from those of other business segments. A geographical segment is a part of the assets and operations within a specific economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

2.4 Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of the Group's individual entities are measured using the currency of the economic environment in which the entity operates (the functional currency). The consolidated financial statements are presented in millions of Icelandic kronas (ISK), which is the Company's functional and presentation currency.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates of the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions, and the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies, are recognised in the income statement, except when deferred in equity as qualifying net investment hedges. Translation differences on non-monetary items, such as equities held at fair value in the income statement, are reported as part of these income statement movements.

(c) Group companies

The results and financial position of Group companies that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- (i) the assets and liabilities of each balance sheet are translated at the closing rate at the year-end;
- (ii) items of each income statement are translated at the average exchange rate for the year;
- (iii) all resulting exchange differences are recognised as a separate component of equity.

Exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges on such investments, are taken to shareholders' equity. When a foreign company is sold, such exchange differences are recognised in the income statement as part of the gain or loss on the sale.

2.5 Derivative financial instruments and hedge accounting

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their current fair value. Fair values are based on quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and options pricing models, as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

The best evidence of the fair value of a derivative at initial recognition is the transaction price (i.e. the fair value of the consideration given or received) unless the fair value of that instrument is based on comparison with comparable transactions in similar instruments. Fair value can also be based or founded on the basis of pricing models.

Derivatives embedded in other financial instruments 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 on the income statement. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement.

The method of recognising the resulting fair value gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group designates certain derivatives as hedges of the fair value of assets or liabilities (fair value hedge). Hedge accounting is used for derivatives designated in this way provided certain criteria are met.

The Group documents, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The relationship is documented and an assessment made, both at hedge inception and at each reporting period, of whether the derivatives used in hedging transactions are highly effective in offsetting changes in fair values of hedged items.

(a) Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortised to profit or loss over the period to maturity. The adjustment to the carrying amount of a hedged equity security remains in retained earnings until the disposal of the equity security.

(b) Net investment hedge

Any gain or loss on a hedging instrument relating to the effective portion of a hedge of net investments in foreign operations is recognised in equity as translation reserve; the gain or loss relating to the ineffective portion is recognised immediately in the income statement. Gains and losses on net investments accumulated in equity are included in the income statement when the foreign operation is disposed of.

(c) Derivatives that do not qualify for hedge accounting

Derivative financial instruments which do not qualify for hedge accounting are recognised on the balance sheet as trading assets or trading liabilities. Changes in their fair value are recognised immediately in the income statement.

2.6 Interest income and expense

Interest income and expense are recognised in the income statement using the effective interest method for all instruments measured at amortised cost.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that discounts estimated future cash flows or receipts through the expected life of the financial instrument or, when appropriate, a shorter period, making it equivalent to the net carrying amount of the financial asset or financial liability in the balance sheet. When calculating the effective interest rate, the Group estimates cash flows, considering all contractual terms of the financial instrument, but does not consider future credit losses. The calculation generally includes all fees and amounts paid or received between parties to the contract that are an integral part of the effective interest rate, as well as transaction costs and all other premiums or discounts.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised at the rate of interest used to discount the 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.

2.7 Fee and commission income

Fees and commissions are generally recognised on an accrual basis when the service has been provided. Loan commitment fees for loans are generally deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loan. Commission and fees arising from negotiating, or participating in the negotiation of, a transaction for a third party – such as arrangement of transactions with equities or other securities or the purchase or sale of businesses – are recognised on completion of the underlying transaction. Portfolio and other management advisory and service fees are recognised based on the applicable service contracts, usually on a time-apportionate basis. Asset management fees related to investment funds are recognised ratably over the period the service is provided. The same principle for income reporting is applied for other custody services that are continuously provided over an extended period of time.

2.8 Financial assets

The Group classifies its financial assets in the following categories: trading assets, financial assets designated at fair value through profit or loss at inception and loans and advances. Management determines the classification of its investments at initial recognition.

(a) Trading assets

A financial asset is classified in this category if it is primarily held for the purpose of selling in the short term. Derivatives are also classified as trading assets unless designated as hedges.

(b) Financial assets designated at fair value through profit or loss at inception

According to IAS 39, management may classify financial assets in this category when initially recognised. Such financial assets are reported on the balance sheet at current fair value and changes recognised in the income statement. The classification of financial assets placed in this category cannot be changed after their original classification.

(c) Loans and advances

Loans and advances are financial assets with defined payments that are not quoted in an active market. They arise when the Group provides funds directly to a debtor with no intention of trading the receivable.

Purchases and sales of trading assets and financial assets designated at fair value through profit or loss are recorded on the date on which the Group commits to purchase or sell the asset. Loans are recognised when the funds related to the loan are disbursed to the borrowers. All financial assets are initially recorded at fair value plus transaction costs. Transaction costs are, however, not included in the initial cost of trading assets and financial assets designated at fair value through profit or loss. Financial assets are derecognised when they have been transferred to another party, for instance when the rights to receive cash flows from the financial assets have expired or where the Group has transferred substantially all risks and rewards of ownership.

Financial assets designated at fair value through profit or loss and trading assets are subsequently carried at fair value. Loans and receivables are carried at cost using the effective interest method. Gains and losses arising from changes in the fair value of the financial assets at fair value on the income statement and trading assets are included in the income statement in the period in which they arise.

The fair values of quoted investments in active markets are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value by using recognised valuation techniques. These include the use of recent arm's length transactions, references to other materially equivalent instruments, discounted cash flow analysis and option pricing models and other valuation techniques commonly used by market participants.

2.9 Offsetting financial instruments

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

2.10 Sale and repurchase agreements

Repurchase agreements (repos) are financial instruments providing for the sale of securities under agreement to repurchase the same securities at a predetermined price. Control of the securities remains in the hands of the Group during their entire transaction period and the securities remain on its balance sheet as trading assets or as financial assets designated at fair value through profit or loss, as appropriate.

2.11 Impairment of loans and advances

At each balance sheet date, the Group assesses whether there is objective evidence that a loan or loan portfolio is impaired. A loan or loan portfolio is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset and that loss event (or events) has an impact on the estimated future cash flows of the loan or group of loans that can be reliably estimated. Objective evidence of impairment includes observable data about the following loss events:

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

The Group defines loans that are individually significant and assesses first whether objective evidence of their impairment exists, and individually or collectively for loans and advances that have not been defined as individually significant. If the Group determines that no objective evidence of impairment exists for significant loans, it includes the loan in a group of loans with similar credit risk characteristics and collectively assesses them for impairment. Individual significant assets for which an impairment loss is recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on loans and receivables has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount the asset's recoverable value. The recoverable value is the present value of estimated future cash flows (excluding future credit losses that have not been incurred), discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced by the amount of impairment through the use of an allowance account and the amount of the loss is recognised in the income statement. In the case of a loan at variable interest rates, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

For impairment calculation of the present value of the estimated future cash flows of a collateralised financial asset, regard is had for estimated sale or redemption value of the collateral less costs for obtaining and selling the collateral. Such calculation is made on the basis of objective assessment of loss, whether or not foreclosure is probable.

For the purposes of a collective evaluation of impairment, loans and advances are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the Group's grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors). Such classification, based on credit risk, gives a good indication of the impairment of a group of assets.

Future cash flows in a group of loans evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the Group and historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience was originally based and to remove the effects of previously existing loss factors which do not exist currently.

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

When a loan is uncollectible, it is fully written off against the provision for loan impairment on the balance sheet. Loans are written off after all the necessary procedures have been completed, as provided for in the Group's rules, and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the income statement.

If the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the original impairment was recognised, the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in the income statement.

2.12 Intangible assets

(a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary/associate on the date of acquisition. Goodwill related to a merger and on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of associates is included in investments in associates. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of a subsidiary/associate include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. Impairment of goodwill, based on impairment test procedures of IAS 36, is expensed in the income statement.

(b) Computer software

Acquired computer software licenses are capitalised on the basis of the costs incurred to acquire and take into service the specific software. These costs are amortised on the basis of their expected useful lives (five years).

The Group assess at each reporting date whether there is any indication that an software asset may be impaired. If any such indication exists, the Group estimates the recoverable amount of the asset. The recoverable amount is the higher of the asset's fair value less costs to sell or its value in use. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Costs associated with developing or maintaining computer software programs are recognised when the expense is incurred.

2.13 Property, plant and equipment (PPE)

Land and buildings consist of mainly the Bank's branches and offices. All property, plant and equipment is stated at historical cost less depreciation. Historical cost of PPE includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, as follows:

Buildings	25-100 years,
Computer equipment	3-5 years,
Other chattels	3-10 years.

The assets' residual values and useful lives are reviewed annually and adjusted if appropriate.

Assets that are subject to depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may be lower than the estimated recoverable value. The recoverable amount is the higher of the asset's fair value less costs to sell or its value in use. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

Gains and losses on disposals are determined by comparing the sale price of an asset with its carrying amount. Gains and losses are included in the income statement.

2.14 Non-current assets and disposal group classified as held for sale

Non-current assets held for sale are the Group's appropriated assets which are in the process of being sold. This item includes also a disposal group which is held for sale. Liabilities connected with the disposal group are recognised as a special liability on the balance sheet. The presentation and measurement of these assets and liabilities are based on IFRS 5, Non-current assets held for sale and discontinued operations. Items included under non-current assets held for sale are recognised at the lower of carrying amount or fair value less cost to sell, taken into account the measurement requirement exception in IFRS 5.

2.15 Leases

(a) A Group company is the lessee

The leases entered into by the Group are primarily operating leases, including house rental agreements. The total payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, the total amount of the entire leasing contract until the end of the period is expensed.

(b) A Group company is the lessor

When assets are held subject to a finance lease, the present value of the lease payments is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as income due. Lease income is recognised over the term of the lease using a method which reflects a constant periodic rate of return.

2.16 Cash and cash equivalents

In the cash flow statement, cash and cash equivalents are defined as cash and non-restricted balances with the Central Bank, amounts due from other banks and treasury bills.

2.17 Provisions

Provisions for restructuring cost and disputes are recognised in the consolidated financial statements when it is more likely than not that an outflow of Group resources will be required to settle the obligation and the amount can be reliably estimate.

2.18 Share-based compensation

The Group has entered in to stock options contracts with its employees enabling them to acquire shares in the Bank. In all instances the exercise price corresponds to the market value of the shares at grant date. The stock options were granted after 7 November 2002 and cost related to the agreements is expensed during the vesting period based on the related terms. The agreements are both equity and cash settled and the expenses recognised in the income statement.

2.19 Deferred income tax

Deferred income tax is recognised in full as a liability, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is, however, not recognised if it arises from the original recognition of an asset or liability in a transaction other than a merger of companies, which affects neither its accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

The principal temporary differences arise from revaluation of certain financial assets and liabilities, including derivative contracts and depreciation of property, plant and equipment. Temporary differences also include tax losses carried forward and the difference between the fair values of assets acquired and their tax base.

Deferred tax assets are recognised where it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax arising from temporary differences in connection with investments in subsidiaries and associates is recognised in the consolidated financial statements. This is not done, however, where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the difference will not reverse in the foreseeable future.

Income tax payable on profits, based on the applicable tax law in each jurisdiction, is recognised as an expense in the period in which profits arise. The tax effects of income tax losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

2.20 Borrowings

Borrowings are recognised initially at fair value, being their issue proceeds net of transaction costs incurred. Borrowings are subsequently stated at amortised cost using the effective interest method.

2.21 Subordinated loans

The Group has borrowed funds by issuing bonds on subordinated terms. The bonds have the characteristics of equity in being subordinated to other liabilities of the Group. In the calculation of the capital ratio, the bonds are included with equity, as shown in note 32. The loans are entered as liabilities with accrued interest and indexation.

2.22 Trading liabilities

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

Gains and losses realised on disposal or redemption and unrealised gains and losses from changes in the fair value of trading liabilities are reported as Net gain on financial assets and liabilities held for trading. Interest and dividend expense on trading liabilities are included in Net interest income.

2.23 Share capital

(a) Share issue costs

Costs directly attributable to the issue of new shares are shown in equity as a deduction from the proceeds.

(b) Dividends on ordinary shares

Dividends on ordinary shares are recognised in equity in the period in which they are approved by the Bank's shareholders meeting.

(c) Treasury shares

Where the Bank, or other member of the consolidated Group, purchases the Bank's equity share capital, the consideration paid is deducted from total shareholders' equity as treasury shares until they are cancelled. Where such shares are subsequently sold or reissued, any consideration received is included in shareholders' equity.

2.24 Fiduciary activities

The Group acts as custodian, holding or placing assets on behalf of individuals, institutions and pension funds. These include various mutual funds managed by the Group. These assets and income arising thereon are excluded from these financial statements, as they do not belong to the Group.

3 Critical accounting estimates, and judgements in applying accounting policies

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The accounting estimated based on these assumptions will by definition seldom be equivalent to the relevant real outcome. The discussion below examines estimates and assumptions which involve a substantial risk of causing material correction to the carrying amounts of assets and liabilities within the next financial year.

(a) Impairment losses on loans and advances

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

(b) Fair value of derivatives

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

(c) Securitisations and special purpose entities (SPEs)

The Group sponsors the formation of special purpose entities (SPEs) primarily for the purpose of allowing clients to hold investments, for asset securitisation, and for buying or selling credit protection. The Group does not consolidate SPEs that it does not control. Where it is difficult to determine whether the Group does control an SPE, it makes an objective assessment about its exposure to risk and reward, as well as about its ability to make operational decisions for the SPE in question. In many instances, elements are present that, considered in isolation, indicate control or lack of control over an SPE, but when considered together make it difficult to reach a clear conclusion. In such cases, the SPE is consolidated.

4 Management of financial risk

The Group's risk policy and procedures ensure that the risks involved in its operations are known, measured and monitored. Risk is managed to ensure that it remains within the limits adopted by the Group for its operations and complies with regulatory requirements. Landsbanki follows a policy dealing with different types of risks in combination, to ensure that fluctuations resulting from unexpected events, affecting both the Group's equity and its performance, will be both limited and manageable.

The Board of Directors is responsible for the Group's basic policy on risk, ensuring that it conforms to the Bank's strategy, the experience of its management, its capital adequacy and readiness to accept risk. The Bank's CEOs are responsible to the Board for its normal operations and manage its risk through committees. Furthermore, managing directors are responsible to the CEOs for the activities of their respective divisions and for ensuring that risk accords with the Bank's policy.

The Bank has four standing committees: the Asset and Liability Committee (ALCO), the Asset Management Committee, the Credit Committee and the Operations Committee. In addition to these committees, meetings of managing directors serve as a forum for consultation between the CEOs and managing directors. Two committees operate within the Board of Directors, an Audit Committee and Compensation Committee, preparing examination by the Board of specific areas of operation and investigating in more detail matters related to them.

The compliance officer ensures that the Bank's rules on securities trading and insider trading are followed, and that Group operations comply with the Act on Securities Transactions, Act on Actions to Combat Money Laundering and other relevant statutes and regulations. Each of Landsbanki's subsidiaries has a compliance officer, and the Group compliance officer supervises their work and reports to the Board of Directors. Since Landsbanki's internal auditing is carried out on a Group basis, the director of Internal Audit for the parent company audits all Group companies. Internal auditing is an essential aspect of the Bank's risk management control; each operating unit is audited at least once a year.

4.1 Financial instruments and risk management strategy

Clients' assets and liabilities can bear fixed or variable rates of interest, for a longer or shorter term. It is essential for the Group to control its investments closely, in order to maintain a balance in interest rates and maturities of assets and liabilities. The Landsbanki Group also endeavours to increase its interest rate margin by offering both short-term and long-term credit, while at the same time it must maintain sufficient liquidity to meet its commitments. By extending credit to both corporations and individuals, on varying terms reflecting the risk of loss in each instance, the Group endeavours to achieve an acceptable interest rate margin. This risk is not limited to interest bearing assets on the Bank's balance sheet but also includes guarantees and other financial instruments.

By taking positions and trading in listed and unlisted financial instruments, Landsbanki can take advantage of short-term movements on the equity and bond markets, as well as currency and interest rate fluctuations. Currency risk is generally kept in balance. Part of the Group's currency risk is hedged with currency swaps. Interest rate risk is also partly hedged against any drop in the fair value of fixed interest rate assets and any increase in the fair value of customers' deposits on fixed terms through interest rate swaps and currency interest rate swaps.

4.1.1 Hedge accounting

The Group designates specific derivatives as hedges of the fair value of assets or liabilities. Hedge accounting is used for derivatives designated in this way provided certain criteria are met.

(a) Fair value hedge

The Group uses interest rate and currency swaps to hedge part of its interest rate risk against any possible impairment of the fair value of fixed interest rate assets and liabilities in both ISK and foreign currencies. The net fair value of these swaps as of 31 December 2005 was 1.965 ISK.

(b) Net investment hedge

The Group balances currency risk deriving from net investment in activities abroad against foreign currency borrowing. Loans amounting to ISK 11,648 (2004: ISK 6,535) were recognised as hedges, resulting in exchange rate profit in 2005 of ISK 359 (2004: ISK 411 recognised in equity against exchange rate loss from investments in subsidiaries. No amounts were entered against equity during the year (2004: 0) as no foreign operations were disposed of.

4.1.2 Counterparty Risk

Counterparty risk is the Group's greatest single risk factor. Counterparty risk is the risk that a borrower or counterparty in a transaction will be unable to meet its financial obligations. The Group manages this risk by setting limits for acceptable risk for individual borrowers or groups of borrowers, specific regions or industrial sectors. Such risk factors are under constant surveillance and are reviewed regularly. Counterparty risk is also managed through regular assessments of clients' credit ratings, modifications of lending authorisations or acquiring better collateral to secure clients' commitments.

The Board of Directors sets detailed lending rules, including maximum obligations for individual clients and related parties. The purpose of these rules is to limit the maximum risk of the Group. They cover clients' total exposures, so that the indirect risk to the Group through its clients is added to the direct claims of the Bank and its subsidiaries. Financial instruments issued by a client, which are used to guarantee other obligations of third parties not financially connected, are also added to the direct claims. According to the Bank's internal rules, the maximum total exposures through an individual customer or financially connected parties may not exceed 20% of the Group's equity.

Clients classified in the best risk classes according to the Bank's rating system, may comprise an aggregate exposure of as much as 25% of the Group's equity, but only in the form of short-term obligations. Parties in classified in poorer risk categories may not comprise overall exposures for the Group exceeding 10% of its equity. In similar fashion, however, this exposure may be increased to as much as 15%, provided the portion exceeding 10% is in the form of short-term commitments.

The Bank's Credit Committee sets detailed lending rules based on the basic policy laid down by the Board of Directors. Employees' lending authorisations are well defined and incremental. The Credit Committee delegates and reviews employees' authorisations and is responsible for reviewing lending rules. Comprised of the CEOs and managing directors, it meets regularly to discuss all credit decisions exceeding the authorisations of branches, subsidiaries or the Corporate Banking Division. The Committee checks the composition of the loan portfolio with regard to industrial sectors, geographical regions, collateral and other aspects, as well as monitoring defaults and default trends. Detailed reports on the position of the Group's largest debtors are reviewed by the Credit Committee, together with special reports, e.g. on the situation of the economy in general, specific industrial sectors, etc.

(a) Derivatives

Counterparty risk from derivative contracts is managed by the Bank's Securities and Treasury division. Risk from derivative contracts is assessed as a credit equivalent, comprised of the fair value of the contract and its assessed future risk.

(b) Credit-related commitments

Guarantees and letters of credit, which irrevocably commit the Group to make payment to a third-party in the event a customer cannot fulfil his obligations, involve the same credit risk as loans. Import guarantees and documentary credits are secured by the goods shipments they cover, thus representing a lower risk than direct loans. Unused credit lines represent a commitment to increase loans or guarantees. The Group could conceivably suffer losses equivalent to the total amount of open credit lines. The Group monitors the duration of credit lines, since longer-term obligations generally imply a greater credit risk.

(c) Netting arrangements

In order to further limit counterparty risk arising from financial instruments, the Group concludes netting agreements. These arrangements ensure that in the case of foreclosure, the Group can set off all contracts covered by the netting agreement against the debt. The arrangements generally include all market transactions between the Group and the client.

4.2 Geographical location of assets and liabilities

The following note incorporates IAS 32 credit risk disclosures, IAS 30 geographical concentrations of assets, liabilities and off balance sheet items disclosures and a public enterprise's IAS 14 (revised) secondary segment disclosures.

At 31 December 2005	Total assets	Total liabilities	Credit	
			commitments	Revenues
Iceland (Home country)	1,145,842	1,185,377	27,747	50,569
UK	78,692	55,415	29,851	6,887
Continental Europe	178,652	54,318	13,200	3,522
Other	2,275	291	0	0
Total	1,405,460	1,295,401	70,799	60,978

At 31 December 2004	Total assets	Total liabilities	Credit	
			commitments	Revenues
Iceland (Home country)	627,156	654,108	24,676	14,734
UK	41,069	33,966	7,841	8,651
Continental Europe	68,917	11,363	2,077	10,081
Other	0	0	0	0
Total	737,141	699,436	34,594	33,467

Geographic sector risk concentrations within the customer loan portfolio were as follows:

	2005	2005	2004	2004
		%		%
Iceland (Home country)	722,139	67	465,170	76
UK	154,337	14	65,166	11
Continental Europe	127,758	12	33,304	5
Other	67,279	6	50,634	8
	1,071,513	100	614,274	100

4.3 Market Risk

Market risk is the risk arising from the impact of changes in market prices on the value of the Group's assets and liabilities, both on and off its balance sheet. This includes both interest rate and equity risk on its trading portfolio, as well as currency risk on its portfolios. Market risk is, however, mainly limited to the Bank's trading book transactions.

The Board of Directors has set a ceiling on the Bank's market risk, which may not exceed 15% of its total risk-weighted asset base. Within this limit, equity risk may not exceed 12%, currency risk may not be more than 2% and the maximum interest rate risk on market bonds and other financial instruments may not exceed 6%. ALCO sets detailed rules on the Group's maximum market risk. Risk control is effected on a Group basis, under direction of Risk Management. Authorisations to take positions subject to market risk are mainly limited to the Securities and Treasury division of the parent company, where total market risk for the Group is also managed. In addition to the Securities and Treasury division of the parent company, trading desks of its subsidiaries Kepler, Teather & Greenwood and Merrion Capital have limited authorisations for exposures on own account.

Total market risk for the Group is calculated at the end of each banking day and controlled by means of an authorisation system adopted by ALCO. Since no single instrument can cover all the aspects of market risk. The Group applies several methods in its daily risk measurement, including VaR (Value-at-Risk) and stress testing, and uses indicators such as net position and value per bp (Vpb). VaR is used to measure trading book market risk. VaR is a statistical instrument which measures the Group's maximum expected loss for the next working day under normal market conditions for a 99% confidence interval. The Group's loss should only exceed the resulting value on one working day out of a hundred. VaR models are tested for reliability in accordance with the guidelines of the Basel Committee on Banking Supervision.

The following tables show the VaR estimate for market risk for the bank's total equity exposure with and without equity held in financial assets designated at fair value through profit and loss:

Market Risk	12 months to 31 December 2004			12 months to 31 December 2005			31.12.05
	Average	High	Low	Average	High	Low	
Interest rate risk	37	84	3	228	597	27	436
Foreign exchange risk	4	27	0	10	72	1	8
Equities risk	667	1,662	339	1,127	2,456	510	2,102
Total VaR	708	1,773	342	1,365	3,125	538	2,546

Market Risk without financial assets designated at FV through P/L	12 months to 31 December 2005			31.12.05
	Average	High	Low	
Interest rate risk	228	597	27	436
Foreign exchange risk	10	72	1	8
Equities risk	869	1,343	469	1,304
Total VaR	1,106	2,012	497	1,748

4.3.1 Currency Risk

The Group is exposed to risk from changes in the exchange rates of major foreign currencies, which affect the Bank's financial position and cash flow. ALCO sets risk limits for each currency and for total currency exposures both overnight and intraday, which are monitored daily. The following table shows the carrying amount of the Group's assets and liabilities by currency. Off-balance-sheet amounts show the notional amounts of financial instruments in foreign currencies.

Concentrations of assets, liabilities and off balance sheet items

At 31 December 2005	ISK	EUR	USD	GBP	JPY	Other	Total
Assets							
Cash and cash balances with Central Bank	8,479	4,793	0	3,247	0	93	16,611
Loans and advances	343,055	243,812	163,485	159,740	40,252	121,169	1,071,513
Trading assets	167,608	18,548	2,682	18,020	0	12,035	218,894
Financial assets designated at fair value through profit and loss	19,176	758	0	0	0	14,549	34,483
Derivatives held for hedging	4,634	0	0	55	0	(0)	4,689
Investment in Associates	2,771	437	0	1,248	0	(0)	4,456
Property and equipment	3,985	194	0	80	0	0	4,260
Intangible assets	878	2,451	0	7,132	0	0	10,461
Non-current assets and disposal groups classified as held for sale	16,005	0	0	454	0	0	16,459
Other assets	3,402	17,416	141	2,643	15	18	23,636
Total assets	569,993	288,408	166,309	192,619	40,267	147,864	1,405,460
Liabilities							
Deposits from credit institutions	63,560	64,682	11,643	4,291	177	242	144,596
Deposits from customers	183,041	68,720	17,957	61,615	(41)	2,872	334,163
Borrowing	72,645	433,183	57,349	58,984	24,353	43,474	689,989
Subordinated loans	4,715	39,778	1,894	0	2,688	(0)	49,074
Trading liabilities	26,207	0	13	283	0	(0)	26,504
Derivatives held for hedging	4,085	0	0	1	0	(0)	4,086
Tax liabilities	7,123	0	0	166	0	0	7,289
Liabilities included in disposal groups classified as held for sale	4,475	0	0	0	0	0	4,475
Other liabilities	2,644	20,719	201	7,989	5	109	31,668
Equity	113,617	0	0	0	0	0	113,617
Total liabilities	482,112	627,082	89,058	133,329	27,183	46,696	1,405,460
Net on-balance sheet position	87,882	(338,674)	77,251	59,290	13,085	101,167	(0)
Net off-balance sheet position	(89,834)	338,320	(77,071)	(57,518)	(13,084)	(100,813)	
Net position	(1,952)	(354)	180	1,771	0	354	

4.4 Mismatch of assets and liabilities

(a) Interest rate risk on portfolios

Portfolio interest rate risk arises from the impact on the interest margin and/or the market value of equity of interest rate changes on assets and liabilities outside of the Bank's trading book. This risk is primarily the result of duration mismatch of assets and liabilities. Portfolio interest rate risk is among the Group's more important risk factors.

(b) Liquidity Risk

Liquidity risk is the risk of losses the Group could incur should it be unable to meet its obligations when due. The Group's liquidity risk is divided into three types: intraday liquidity risk, short-term liquidity risk extending over several months, and risk due to mismatch of longer-term assets and liabilities. A distinction is also made, in measuring and managing liquidity risk, between domestic and foreign liquidity risk.

ALCO formulates liquidity management policy, monitors the Group's liquidity position and provides advice on the composition of its assets and liabilities. The objective is to minimise fluctuations in liquidity and ensure that the Group always has sufficient access to funding to cover outflows arising from its obligations in the coming month. Treasury implements this policy and estimates future cash flow in co-operation with Risk Management.

At the end of 2005, the Bank's liquidity ratio, calculated by balancing assets and liabilities in accordance with the Central Bank's Rules No. 386/2002 was 1.6.

The following table gives a summary of the Group's interest rate risk. It shows the carrying amounts of its assets and liabilities. The carrying amount classification is based on either the repricing date of the contract or its maturity, whichever comes first.

At 31 December 2005	Up to 1 month	1-3 months	3-12 months	1-5 years	Over 5 years	Non-interest bearing	Total
Assets							
Cash and cash balances with Central Bank	16,611	0	0	0	0	0	16,611
Loans and advances	425,218	242,666	236,960	66,483	99,292	893	1,071,513
Trading assets	20,338	4,236	1,935	14,666	47,777	129,942	218,894
Financial assets designated at fair value through profit and loss	0	0	0	0	0	34,483	34,483
Derivatives held for hedging	4,689	0	0	0	0	0	4,689
Investment in Associates	0	0	0	0	0	4,456	4,456
Property and equipment	0	0	0	0	0	4,260	4,260
Intangible assets	0	0	0	0	0	10,461	10,461
Non-current assets and disposal groups classified as held for sale	0	0	0	0	0	16,459	16,459
Other assets	0	0	0	0	0	23,636	23,636
Total assets	466,856	246,902	238,895	81,149	147,069	224,589	1,405,460
Liabilities							
Deposits from credit institutions	31,410	71,836	5,406	19,620	16,325	0	144,596
Deposits from customers	288,883	19,098	18,468	7,168	546	0	334,163
Borrowing	305,528	190,426	108,473	42,652	42,909	0	689,989
Subordinated loans	0	26,022	672	3,744	18,636	0	49,074
Trading liabilities	0	0	0	0	0	26,504	26,504
Derivatives held for hedging	2,724	0	0	0	0	1,362	4,086
Tax liabilities	0	0	0	0	0	7,289	7,289
Liabilities included in disposal groups classified as held for sale	0	0	0	0	0	4,475	4,475
Other liabilities	0	0	0	0	0	31,668	31,668
Equity	0	0	0	0	0	113,617	113,617
Total liabilities	628,545	307,382	133,019	73,185	78,416	184,914	1,405,460
Net on balance sheet position	(161,689)	(60,480)	105,876	7,964	68,653	39,674	
Net off balance sheet position	(61,295)	25,428	15,002	17,560	3,305	0	
Total interest sensitivity gap	(222,984)	(35,052)	120,879	25,525	71,958	39,674	

4.5 Fair value of financial assets and financial liabilities

The following table gives a summary of the carrying amount and fair value of financial assets and financial liabilities not carried at fair value. The fair value has been estimated by discounting the cash flow of financial assets and financial liabilities based on market interest rates for assets and liabilities of the same or similar duration.

	Carrying value 31.12.2005	Fair value 31.12.2005	Difference 31.12.2005
Financial assets			
Loans and advances	1,071,513	1,070,533	(980)
Financial liabilities			
Borrowing	689,989	689,657	332
Net difference			(648)

4.6 Inflation-indexed assets and liabilities

The Bank's balance sheet has a positive balance between indexed and non-indexed assets. At year-end, indexed assets exceeded indexed liabilities by ISK 139 billion. These amounts only apply to assets and liabilities in ISK.

	2005	2004
Assets	275,615	101,489
Liabilities	(136,559)	(73,985)
	139,056	27,504

4.7 Core Income

The Group's Income with reversal of its net gain from equity holdings, securities and FX trading, reflects its Core Income. The approach is to reverse net gain/loss from equity holdings of any kind, as well as gain from securities and FX trading. Instead the net interest revenues is increased by the cost of funds of the Group's positions in these items. To calculate the net interest revenues, a risk free rate of treasury shares for each underlying currency is used. Notwithstanding the Bank's definition of its core income, its performance also depends, for instance, on equity and bond positions taken on own account. The following table gives a comparison between the Group's Income and Core Income for the years 2002-2005:

Actual Income	2005	2004	2003	2002
Net interest revenues	22,996	14,734	9,331	7,732
Net commissions and fees	16,726	8,891	6,116	4,076
Net gain on equity, securities and FX	21,257	9,842	3,535	2,109
Net operating revenues	60,978	33,467	18,982	13,916
Operating expenses	20,967	14,460	10,815	8,505
Impairment on loans and advances and assets held for sale	6,197	4,485	4,656	2,863
Impairment on goodwill	3,033	0	0	0
Profit before income tax	30,781	14,157	3,511	2,548
Cost Income Ratio	34%	43%	57%	61%
ROE before tax	56%	56%	21%	17%
Adjustments				
Net interest revenues	3,652	1,200	992	950
Net gain on equity, securities and FX	(21,257)	(9,842)	(3,534)	(2,109)
Impairment on goodwill	3,033	0	0	0
	(14,572)	(8,642)	(2,542)	(1,159)
Core Income				
Net interest revenues	26,647	15,934	10,323	8,682
Net commissions and fees	16,726	8,891	6,116	4,076
Net operating revenues	43,373	24,825	16,439	12,757
Operating expenses	20,967	14,460	10,815	8,505
Impairment on loans and advances and assets held for sale	6,197	4,485	4,656	2,863
Profit before income tax	16,210	5,879	968	1,389
Core Cost Income Ratio	48%	58%	66%	67%
Core ROE before tax	30%	23%	6%	9%

4.8 Fiduciary activities

The Landsbanki Group provides asset custody, asset management, investment management and advisory services. All of them require the Group to make decisions on the treatment, acquisition or disposal of financial instruments. Assets in Landsbanki's custody are not reported in its accounts. Part of this service involves the Group approving objectives and criteria for the investment of assets in its custody. As of 31 December 2005, financial assets managed by the Group amounted to ISK 281 billion (2004:191 bn). Amounts in custody accounts amounted to ISK 1.321 billion (2004: 730 bn).

5 Income Statement by quarters

	Q4 2005	Q3 2005	Q2 2005	Q1 2005	Q4 2004
Operations					
Interest revenues	21,073	18,594	14,309	12,461	10,879
Interest expenses	13,818	12,272	9,180	8,172	6,268
Net interest revenues	7,255	6,322	5,129	4,289	4,611
Fee and commission income	5,359	4,775	4,864	3,481	3,191
Fee and commission expense	598	392	403	361	382
Net fee and commission income	4,761	4,383	4,461	3,120	2,809
Dividend income	191	161	616	105	11
Net gain on financial assets and financial liabilities held for trading	5,503	3,550	(163)	1,978	(41)
Net gain on financial assets designated at fair value through profit and loss	1,205	1,167	1,003	2,490	(2,220)
Fair value adjustments in hedge accounting	(361)	232	(81)	216	0
Foreign exchange difference	92	359	(161)	97	122
Share of profit of associates	643	505	275	484	(79)
Net gain of disposal groups held for sale	63	270	817	0	0
Other operating revenues	7,337	6,243	2,307	5,370	(2,207)
Net operating revenues	19,352	16,949	11,898	12,779	5,213
Salaries and related expenses	4,136	3,077	3,114	2,355	2,112
Administrative expenses	2,933	1,905	1,764	1,683	1,749
Operating expenses	7,069	4,982	4,879	4,037	3,862
Impairment on loans and advances during the period	1,805	1,687	1,359	1,345	1,223
Profit before impairment on goodwill and income tax	10,479	10,280	5,660	7,396	128
Impairment on goodwill	(259)	3,293	0	0	0
Income tax	1,929	1,882	602	1,351	(829)
Net profit	8,809	5,105	5,058	6,045	957
Attributable to:					
Shareholders of Landsbanki Islands hf.	8,734	4,995	5,000	6,011	905
Minority interest	75	110	58	34	53

6 Business segments

The Group operates in four Business Segments:

- Retail Banking
- Corporate Banking
- Securities and Treasury
- Asset Management and Private Banking

Retail Banking includes the Bank's branch network, SP Fjármögnun and the Residential Mortgages division of Heritable Bank.

Corporate Banking includes the Bank's Corporate division and Heritable's Bank Corporate Banking division.

Securities and Treasury is comprised of the parent company's securities operations and Teather & Greenwood Holding plc., Kepler Equities S.A. and Merrion Capital Group. This division includes securities brokerage, corporate advisory, FX and derivative trading, the Bank's treasury and debt management and proprietary trading.

Asset Management and Private Banking includes the parent company's Asset Management division, Landsvaki hf. and Landsbanki Luxembourg S.A.

Year 2005	Management					Group
	Retail Banking	Corporate Banking	Securities & Treasury	Private Banking	Other operations	
Net interest revenues	10,466	11,866	(1,063)	1,727	0	22,996
Net fee and commission income	3,131	2,343	8,785	2,466	0	16,726
Other revenues	66	247	20,789	154	0	21,257
Net operating revenues	13,664	14,456	28,511	4,348	0	60,978
Operating expenses	8,272	4,155	5,906	2,208	425	20,967
Impairment on loans and advances and assets held for sale	2,026	3,268	0	902	0	6,197
Impairment on goodwill	0	0	3,033	0	0	3,033
Profit before income tax	3,366	7,032	19,572	1,237	(425)	30,781
Total assets 31 December	261,638	636,014	285,652	215,144	7,012	1,405,460

6 Business segments (continued)

Year 2004	Management					Group
	Retail Banking	Corporate Banking	Securities & Treasury	Private Banking	Other operations	
Net interest revenues	6,838	6,943	(187)	1,141	0	14,734
Net fee and commission income	2,781	979	3,663	1,228	0	8,651
Other revenues	0	(46)	10,043	85	0	10,081
Net operating revenues	9,619	7,876	13,519	2,454	0	33,467
Operating expenses	6,594	2,078	2,246	1,653	1,890	14,460
Impairment on loans and advances and assets held for sale	2,870	1,385	(4)	235	0	4,485
Profit before income tax	156	4,413	11,277	566	(1,890)	14,521
Total assets 31 December	148,538	364,233	117,035	100,709	6,626	737,141

7 Geographical segments - breakdown of revenues

Year 2005		Iceland	UK	Continental		Total
				Europe		
Net interest revenues		17,362	3,921	1,712		22,996
Net fee and commission income		12,820	2,314	1,592		16,726
Other revenues		20,388	652	218		21,257
Net operating revenues		50,570	6,887	3,522		60,978

Year 2004		Iceland	UK	Continental		Total
				Europe		
Net interest revenues		12,868	725	1,142		14,734
Net fee and commission income		8,096	554	240		8,891
Other revenues		9,737	21	85		9,842
Net operating revenues		30,701	1,300	1,467		33,467

8 Net interest revenues

Interest revenues	2005	2004
Interest on deposits and loans to financial institutions	4,343	1,672
Interest on loans and advances	54,571	29,954
Interest on other financial assets	4,118	1,261
Other interest revenues	3,405	1,364
	66,437	34,252
Interest expenses	2005	2004
Interest on deposits from credit institutions	5,106	1,110
Interest on deposits from customers	15,608	8,961
Interest on borrowing	18,087	7,229
Interest on subordinated loans	1,789	866
Other interest expenses	2,851	1,351
	43,441	19,517
Net interest revenues	22,996	14,734

9 Net fee and commission income

Fee and commission income	2005	2004
Securities	9,261	4,006
Asset management	1,860	1,216
Lending	3,515	1,653
Cards	1,139	859
Interbank revenues	989	1,084
Collection and payment services	526	503
Foreign trade	386	344
Other commissions and fees	804	570
	18,479	10,234
Fee and commission expense	1,754	1,344
Net fee and commission income	16,726	8,891

10 Dividend income

	2005	2004
Trading	846	292
Financial assets designated at fair value through profit and loss	227	161
	1,073	453

11 Net gains on trading in equity, bonds, currency and associated companies

	Stock trading	Bond trading	FX	Share of profit of associates	Other	Total 2005	Total 2004
Dividend income	1,073	0	0	0	0	1,073	453
Net gain on financial assets and financial liabilities held for trading	10,923	(219)	0	0	164	10,868	4,116
Net gain on financial assets designated at fair value through profit and loss	5,866	0		0	0	5,866	4,918
Fair value adjustments in hedge accounting					6	6	0
Foreign exchange difference	0	0	387	0	0	387	364
Share of profit of associates	0	0	0	1,907	0	1,907	(8)
Net gain on sale of disposal groups held for sale	0	0	0		1,150	1,150	0
	17,862	(219)	387	1,907	1,320	21,257	9,842

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

Equity securities:	2005	2004
Listed	4,409	4,918
Unlisted	1,457	0
Total	5,866	4,918

13 Salaries and related expenses

	2005	2004
Salaries	10,512	6,726
Pension-fund contributions	1,042	693
Other personnel expenses	1,128	374
	12,682	7,794
Number of positions at year end	1,725	1,121

14 Impairment on loans and advances and assets held for sale

	2005	2004
Loans and advances	6,347	4,556
Assets held for sale	(14)	0
	6,333	4,556
Collected previously written-off loans	137	71
	6,197	4,485

15 Income tax

	2005	2004
Current tax	2,181	1,895
Deferred tax note 31	3,583	(97)
	5,764	1,798

Further information about deferred income tax is presented in Note 31. The tax on Group's profit before tax differs from the theoretical amount that would arise using the basic tax rate of the parent as follows:

	2005	2004
Profit before tax	33,815	14,521
Tax calculated at a tax rate of (local 18)% (2004: 18%)	6,087	2,614
Effect of different tax rates in other countries	387	125
Income not subject to tax	(646)	(766)
Other	(64)	(175)
	5,764	1,798

16 Earnings per share

Basic

Basic earnings per share is calculated by dividing the net profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year, excluding the average number of ordinary shares purchased by the Company and held as treasury shares.

	2005	2004
Profit attributable to equity holders of the Company	24,740	12,574
Weighted average number of ordinary shares in issue	9,020	7,831
Basic earnings per share (ISK per share)	2.74	1.61

Diluted

Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. For the share options, a calculation is done to determine the number of shares that could have been acquired at fair value (determined as the average annual market share price of the Company's shares) based on the monetary value of the subscription rights attached to outstanding share options. The number of shares calculated as above is compared with the number of shares that would have been issued assuming the exercise of the share options.

	2005	2004
Profit attributable to equity holders in the company	24,740	12,574
Weighted average number of ordinary shares in issue	9,020	7,831
Adjustments for:		
– share options	476	267
Weighted average number of ordinary shares for diluted earnings per share	9,495	8,098
Diluted earnings per share (ISK per share)	2.61	1.55

17 Loans and advances

	2005	1.1.2005
Financial institutions	86,919	67,107
Public entities	7,670	3,131
Corporates	745,435	439,952
Consumers	244,634	112,444
Allowance for losses on loans and advances	(13,144)	(8,359)
Total loans and advances	1,071,513	614,274

A large part of the consumer loan growth (residential mortgage loans) has been funded via private placements of credit linked notes.

Provisions for credit losses

Changes during the year:	2005	1.1.2005
Balance at beginning of year	8,359	7,700
Acquisitions	436	0
Impairment on loans and advances	6,347	4,270
Loans written off	(1,998)	(3,611)
Balance at year-end	13,144	8,359
Provision ratio	1.17%	1.29%

18 Trading assets

	2005	1.1.2005
Bonds and other fixed-income securities	100,498	18,529
Equity and other variable-income securities	104,509	37,499
Derivatives held for trading	13,886	8,702
	218,894	64,730
Forward contracts against trading assets		
Bonds and other fixed-income securities	48,963	1,785
Equity and other variable-income securities	80,701	23,596
Net trading assets	89,231	39,349

19 Derivatives held for trading and trading liabilities

	Contract/notional amount	2005 Fair value		Contract/notional amount	1.1.2005 Fair value	
		Assets	Liabilities		Assets	Liabilities
Foreign exchange derivatives						
Currency forwards	477,283	4,422	3,791	164,302	3,501	3,193
OTC currency options bought and sold	212,798	3,331	4,098	182,024	2,694	3,147
	690,081	7,753	7,889	346,326	6,195	6,340
Interest rate derivatives						
Interest rate swaps	214,910	3,091	2,264	56,936	535	621
Cross-currency interest rate swaps	58,905	1,572	1,613	13,735	147	197
	273,815	4,662	3,877	70,671	682	819
Equity derivatives						
Equity forwards	81,269	213	14,503	26,399	1,607	918
OTC stock options - bought and sold	13,454	1,257	235	2,110	219	1
	94,723	1,471	14,738	28,509	1,826	918
Total derivatives held for trading	1,058,619	13,886	26,504	445,506	8,702	8,077

20 Financial assets designated at fair value through profit and loss

Equity securities:	2005	1.1.2005
Listed	33,299	12,817
Unlisted	1,183	0
Total	34,483	12,817

21 Derivatives held for hedging

	Contract/notional amount	2005 Fair value		Contract/notional amount	1.1.2005 Fair value	
		Assets	Liabilities		Assets	Liabilities
Derivatives designated as fair value hedges						
Interest rate swaps	96,003	3,205	3,201	52,138	2,084	1,235
Cross-currency interest rate swaps	105,011	1,484	885	57,612	2,846	347
	201,014	4,689	4,086	109,750	4,930	1,582

22 Investment in Associates

As at 31 December 2005	Ownership %	Profit share	Book value 2005	Book value 1.1.2005
Fjárfestingafélagid Grettir hf.	17.4	1,578	2,556	2,375
Greislumiðlun hf.	38.0	187	694	531
Reiknistofa bankanna	35.9	0	515	427
Kreditkort hf.	20.0	46	224	218
Creditinfo Group hf.	26.4	33	184	151
Intrum hf.	25.0	6	83	84
Liftryggingamiðstöðin	34.0	(1)	135	0
Other partially owned companies		59	64	5
		1,907	4,456	3,792

All these investments are unlisted.

23 Property and equipment

Fixed assets:	Premises	Other	Total
Book value at beginning of year	2,908	1,238	4,146
Additions	455	1,921	2,376
Sold	(1,282)	(294)	(1,576)
Disposals	(47)	(349)	(395)
Depreciation charge	(240)	(51)	(291)
Net book value at year-end	1,794	2,465	4,260
Depreciation (straight-line)	1-4%	10-33%	
Assessment value of land and Bank Premises:			
		2005	2004
Official assessment value of land and Bank premises		1,756	2,787
Replacement value of buildings		2,470	5,034

24 Intangible assets

	2005	1.1.2005
Goodwill		
Opening net book amount	1,160	1,159
Exchange differences	(12)	1
Acquisition of Teather & Greenwood	4,088	0
Acquisition of Key Bussines Financial Corporation	603	0
Acquisition of Kepler Equities	2,144	0
Acquisition of Merrion	1,397	0
Merger with Burðarás hf.	3,293	0
Impairment	(3,293)	0
Net book value at year-end	9,380	1,160
Software and other intangible assets		
Opening net book amount	425	491
Additions	819	472
Disposals	0	0
Amortisation	(163)	(408)
Impairment	0	(130)
Net book value at year-end	1,081	425
Total Intangible assets	10,461	1,585

An impairment charge of goodwill in the amount of ISK 3.033 million is included in the income statement. This amount is explained by a charge of ISK 3.293 million due to an impairment of goodwill relating to the merge with Burðarás and an income of ISK 259 million due to a negative goodwill arising from the acquisition of the Agricultural Loan Fund.

All goodwill has been tested for impairment. The conclusion of the test was that no charges were needed except for the goodwill arising from the Burðarás hf. merger. The goodwill has been divided between the smallest cash generating units based on the required rate of return from each unit. An assessment of a recoverable value of a goodwill is based on it's use value.

25 Non-current assets and disposal groups classified as held for sale

	2005	1.1.2005
Appropriated assets	920	1,031
Allowance for appropriated assets	(208)	(241)
	712	790
Disposal group held for sale		
– Investments properties included in disposal groups	15,613	8,265
– Other assets included disposal groups	135	908
	15,748	9,173
Total non-current assets and disposal groups classified as held for sale	16,459	9,962

26 Other assets

	2005	1.1.2005
Unsettled payments	11,264	0
Other assets	12,372	2,668
	23,636	2,668

27 Deposits from credit institutions

	2005	1.1.2005
Loans from Central Bank and repurchase agreements	44,730	4
Loans from other credit institutions	99,866	61,233
	144,596	61,236

28 Deposits from customers

	2005	1.1.2005
Demand deposits	113,834	84,225
Time deposits	220,328	133,745
	334,163	217,970

29 Borrowing

	2005	1.1.2005
Securities issues	620,793	328,417
Borrowing	69,196	46,667
	689,989	375,084
Securities issues:	2005	1.1.2005
EMTN	469,919	248,468
ECP	23,318	18,136
Other	127,556	61,813
	620,793	328,417

30 Subordinated loans

	2005	1.1.2005
Tier I – Non-innovative hybrid capital	7,472	8,358
Tier I – Innovative hybrid capital	14,928	3,197
Tier II	26,675	11,015
	49,074	22,570

Subordinated loans	Classification	Currency	Interest	Maturity	2005	1.1.2005
Iceland Stock Exchange	Tier I	ISK	5,8%+vtr	callable	1,106	1,064
Iceland Stock Exchange	Tier I	ISK	6,5%+vtr	callable	1,132	1,089
Iceland Stock Exchange	Tier I	ISK	8,65%+vtr	callable	1,075	1,047
Luxembourg Stock Exchange	Tier I	EUR	Euribor+0,78%	callable	11,615	0
Unlisted	Tier I	EUR	Euribor+1,23%	callable	7,472	8,364
Unlisted	Tier II	ISK	5,6%+vtr	callable	1,680	1,615
Unlisted	Tier II	ISK	6,09%+vtr	callable	844	812
Unlisted	Tier II	ISK	6,09%+vtr	2010	0	250
Luxembourg Stock Exchange	Tier II	EUR	Euribor+0,8%	2013	301	337
Luxembourg Stock Exchange	Tier II	EUR	Euribor+1,2%	2018	760	921
Luxembourg Stock Exchange	Tier II	EUR	Euribor+0,4%	2015	14,949	0
Luxembourg Stock Exchange	Tier II	EUR	Euribor+1,35%	2026	823	851
Unlisted	Tier II	EUR	Euribor+1,35%	2011	375	420
Luxembourg Stock Exchange	Tier II	JPY	Euribor+0,8%	2033	2,691	2,990
Unlisted	Tier II	USD	Libor+0,15%	2011	1,897	1,839
Unlisted	Tier II	EUR	9%	2008	1,494	
Unlisted	Tier II	USD	Libor+0,66%	2006	859	971
					49,074	22,570

Subordinated loans are a part of equity according to regulation on the calculation of equity ratio (see note 32). Subordinated loans are fully applicable to the calculation of CAD ratio.

31 Tax liabilities

Tax liabilities specific as follows	31.12.2005	1.1.2005
Tax to be paid	3,082	1,547
Taxliabilities	4,207	127
	7,289	1,674

The movement on the deferred income tax account is as follows:	2005	1.1.2005
At 1 January	127	224
Income statement charge	3,583	(97)
Exchange differences	497	0
	4,207	127

Deferred income tax liabilities	2005	1.1.2005
Premises and equipment	284	243
Financial assets designated at fair value through profit and loss	3,773	0
Non-current assets and disposal groups classified as held for sale	380	0
Miscellaneous assets	2	1
	4,439	244

31 Tax liabilities (continued)

Deferred income tax assets	2005	1.1.2005
Obligations	(64)	(68)
Shareholdings	0	(27)
Agricultural Loan Fund	(72)	0
Loan commitment fee	(96)	(22)
	(233)	(117)

The deferred tax charge in the income statement comprises the following temporary differences:

	2005	1.1.2005
Premises and equipment	75	(72)
Miscellaneous assets	167	27
Obligations	3	4
Non-current assets and disposal groups classified as held for sale	380	0
Financial assets designated at fair value through profit and loss	3,103	(34)
Agricultural Loan Fund	(72)	0
Loan commitment fee	(74)	(22)
	3,583	(97)

32 Capital ratio

	2005	2004
Risk-adjusted assets	1,065,074	576,498
Capital:		
Tier I capital:		
Equity	110,059	38,016
Subordinated loans	22,399	6,722
Goodwill	(9,381)	(918)
Minority interests	3,557	991
	126,635	44,811
Tier II capital:		
Subordinated loans	26,675	15,831
– deduction in accord with Articles 28 and 85 of Act No 161/2002	(13,601)	(749)
Total capital	139,710	59,893
Tier I ratio	11.9%	7.8%
Capital ratio	13.1%	10.4%

33 Off-balance sheet items

	2005	1.1.2005
Guarantees issued	40,737	23,994
Available overdrafts	28,291	24,676
Unused credit commitments	42,507	9,918
	111,536	58,588

34 Related-parties

Loans to CEOs and managing directors, and to companies fully owned by these persons, amounted to ISK 78 million as of 31 December 2005.

Loans to members of the Board of Directors and their fully owned companies amounted to ISK 11,656 million. In addition, Landsbanki has granted credit to companies with which members of the Board are related through membership of the companies' Boards or ownership ties, including companies which number among the Bank's major clients.

The holding company, Samson eignarhaldsfélag ehf., which has a 40.17% holding in the Bank, is owned by four legal entities. The Bank has not provided the company with any provision of credit. One of the company's owners sits on Landsbanki's Board of Directors and loans granted to this person are included in the above amounts.

Total credit extended to associated companies by the Bank amounted to ISK 19,912 million as of 31 December 2005.

All of the loans referred to here have been granted in accordance with the Bank's credit rules and on normal commercial terms. No impairment charges has been made by the Bank to cover these loans.

35 Management Payroll and Compensation

Payroll and stock options, in respect of the Bank's Board of directors, Group Managing Directors & CEO's, Managing Directors of the Parent is as follows:

	Stock Options					Holdings at year end
	Payroll and benefits	Exercised Options 2005	Unused	Contracts 2006-2008	Total	
Björgólfur Guðmundsson, Chairman of the Board of Directors	3		0	0	0	4,427
Kjartan Gunnarsson, Vice-chairman of the Board of Directors	2		0	0	0	92
Other Members of the Board of Directors	6		0	0	0	1
Halldór J. Kristjánsson, Group Managing Director & CEO	149 ¹	8	10	39	49	11
Sigurjón P. Arnason, Group Managing Director & CEO	83		58	52	110	0
Sixteen Managing Directors of the Landsbanki Group	598	8	135	101	236	11
	840	16	203	192	395	4,542

The stock option rights of the Managing directors & CEO and Managing Directors have a strike price of 3,58 - 14,25.

Stock option rights are transferable between years and can be accumulated and exercised at year-end.

Arrangements have been made to abide by contracts made and the related cost is included in the income statement.

A holding refers to holdings in the name of the parties in question themselves, their spouses, children who are not financially competent or legal entities in which they are involved.

1) Including a settlement of stock options

36 Stock option plan

Management and employees of the Group have a stock option with a strike price of 3,58 - 14,25. Stock options are offered at a market price on the day when they are granted. Arrangements have been made to abide by contracts made and the related cost is included in the Groups's income statement. Options are accumulated in the years 2003-2010. Stock options can be vested in four years and can be exercised by the end of the fourth year and during the two following years. Options are not transferable between individuals, and unused options are annulled at concurrent with employment termination. The nominal value of the management and employee stock option plan at year-end amounted to ISK 946,4 million. Accumulated unused options at 31 December 2005 had a nominal value of ISK 484,0 million.

The nominal value of stock options in the beginning of the year amounted to 467 million, granted option stock had a nominal value of 507,4 million, the nominal value of exercised purchase right during the year amounted to 28 million and the purchase right at the year-end had nominal value of 946,4 million.

Stock options with a nominal value of 176,7 million which were granted in 2003 with a strike price of 3,58 - 5,7 can be vested during the years 2003-2006 and can be exercised in the years 2006-2008. Stock options with a nominal value of 337,5 million which were granted during 2004 with a strike price of 7,0-9,0 can be vested during the years 2004-2007 and can be exercised in 2007-2009. Stock options with a nominal value of ISK 432,2 million and a strike price of 12-14,25 which were granted in 2005 can be vested during 2005-2010 and can be exercised during the years 2008-2010.

37 Auditors fee

	2005	2004
Audit and audit related services	95	59
Other professional services	23	24
	118	83

38 Acquisitions

An offer was made by Landsbanki Holding (UK) plc. for Teather & Greenwood Holding plc. on 1 February 2005. On 30 June 2005, the share of Landsbanki Holding (UK) plc. in Teather & Greenwood Holding plc. was 100%. Its Income Statement and Balance Sheet has been consolidated into Landsbanki Group.

The details of the fair value of the assets and liabilities acquired and goodwill arising are as follows (ISK millions):

Total Cost of acquisition (discharged by cash)	5,486
Fari value of assets and liabilities acquired	1,398
Goodwill (see note 24)	4,088

The goodwill was tested for impairment at the end of the year and the conclusion is that the carrying amount exceed the recoverable amount and therefore no impairment charges are needed.

On 15 April, Heritable Bank Ltd. announced that it had reached an agreement to acquire a 100% share of Key Business Finance Corporation plc. This acquisition was achieved through Landsbanki's direct acquisition of shares in Key Business Finance Corporation plc. The transaction was completed in April.

The details of the fair value of the assets and liabilities acquired and goodwill arising are as follows (ISK millions):

Total Cost of acquisition (discharged by cash)	1,530
Fari value of assets and liabilities acquired	926
Goodwill (see note 24)	603

The goodwill was tested for impairment at the end of the year and the conclusion is that the carrying amount exceed the recoverable amount and therefore no impairment charges are needed.

38 Acquisitions (continued)

On 4th of June, Landsbanki Luxembourg S.A. announced that it had reached an agreement to acquire a 97% share of Lex Life and Pension S.A. in Luxembourg. This acquisition was achieved through Landsbanki's direct acquisition of shares in Lex Life and Pension S.A. from an insurance company. The transaction was completed in June.

The details of the fair value of the assets and liabilities acquired and goodwill arising are as follows (ISK millions):

Total Cost of acquisition (discharged by cash)	468
Fair value of assets and liabilities acquired	468
Goodwill	0

On 1 August, part of the investment company Burðarás hf. merged with the Group. The shareholders of Burðarás hf. received share capital in Landsbanki in exchange for their shareholdings in Burðarás. The total amount of share capital issued in connection with the merger was ISK 2,121 million, and the amount based on a share price of 19.00 per share, which represents the cost of the acquisition. On the acquisition date, the fair value of individual acquired assets and liabilities was assessed. The cost of acquisition in excess of the fair value of the acquired individual assets and liabilities was recognised as goodwill.

The details of the fair value of the assets and liabilities acquired and goodwill arising are as follows (ISK millions):

Equity and other variable-income securities	20,110
Other assets	17,832
Tax liabilities	(942)
Goodwill (see note 24)	3,293
Cost of acquisition, value of issued share capital	40,293

At the end of the period the acquired goodwill arising in connection with the merger was tested for impairment, in accordance with the requirements of IAS 36. The conclusion of the impairment test was that the total amount of the goodwill should be expensed in the income statement. The impairment expensed in the income statement is not tax deductible. The impairment of goodwill needs to be reviewed in connection with the number of the Bank's new shareholders and the fact that shares were issued at market price without the volume discount traditionally used in such a large transaction. After the merger, the number of shareholders increased by about 17,000.

On 5 September, Landsbanki Íslands hf. announced that it had reached an agreement to acquire Kepler Equities S.A. (Kepler), a European securities company, previously known as Julius Bär Brokerage. Initially Landsbanki will acquire 84% of the total shares. This acquisition will be achieved through Landsbanki Holding Europe S.A. by direct acquisition of shares in Kepler from holding companies and from Kepler's employees. The transaction was completed in November.

The details of the fair value of the assets and liabilities acquired and goodwill arising are as follows (ISK millions):

Total Cost of acquisition (discharged by cash)	5,906
Fair value of assets and liabilities acquired	3,762
Goodwill (see note 24)	2,144

The goodwill was tested for impairment at the end of the year and the conclusion is that the carrying amount exceed the recoverable amount and therefore no impairment charges are needed.

On 4 October, the Icelandic state signed a purchase agreement with Landsbanki Íslands hf. providing for the acquisition by the Bank of specific assets and liabilities of the Agricultural Loan Fund. The transaction was concluded in October.

The details of the fair value of the assets and liabilities acquired and goodwill arising are as follows (ISK millions):

Total Cost of acquisition (discharged by cash)	2,653
Fair value of assets and liabilities acquired	2,912
Negative Goodwill (see note 24)	(259)

On 15 November, Landsbanki Íslands hf. announced that it had reached an agreement to acquire a 50% share of Merrion Capital Group Ltd. in Ireland. This acquisition will be achieved through Landsbanki's direct acquisition of shares in Merrion from an investment bank and from Merrion's employees. The transaction was completed in December.

The details of the fair value of the assets and liabilities acquired and goodwill arising are as follows (ISK millions):

Total Cost of acquisition (discharged by cash)	2,100
Fair value of assets and liabilities acquired	703
Goodwill (see note 24)	1,397

39 Litigation

The Bank Employees' Pension Fund has brought a suit in the Reykjavik District Court against Landsbanki Íslands hf. and the Icelandic State, demanding that a court verdict establish that the bank guarantee which Landsbanki Íslands, as a state-owned bank, provided for the Fund's obligations until 31 December 1997 has never been cancelled and is still fully valid. Furthermore, the plaintiff requests principally that the Court find that in the future Landsbanki Íslands should be responsible for this guarantee or, failing that, the National Treasury. Should this claim be rejected, the Fund requests, for instance, that the Bank's obligations be re-calculated due to changed assumptions, or that damages be paid.

The reason for the suit is that the Pension Fund's assets are not fully sufficient for its calculated obligations, in part due to increases in wages and purchasing power.

In 1997, Landsbanki Íslands, as a state-owned bank, together with other contributing companies of the Bank Employees' Pension Fund, reached an agreement with the fund on a final settlement, which the Pension Fund approved for its part at a meeting of fund members. The guarantee of the contributing companies was then cancelled and the Pension Fund therefore no longer has any legal entitlement to make claims on the contributing companies.

Should the Courts recognise any responsibility in this case, the claim would have to be directed at the National Treasury, as the agreement covered by the summons was concluded on the responsibility of Landsbanki as a state-owned bank and in connection with the establishment of a limited-liability company for the Bank's operation and original sale of share capital.

Claims advanced towards Landsbanki in the above-mentioned case must therefore be considered as not liable to have a significant impact on the Bank's operating performance.

40 Transition to International Financial Reporting Standards (IFRS)

40.1 Basis of the transition

40.1 Application of IFRS 1

The consolidated annual financial statements for 2005 is the first financial statements compiled by Landsbanki Íslands hf. that comply with International Financial Reporting Standards (IFRS). These consolidated financial statements have been prepared as described in Note 2.1. The Group has applied IFRS 1 First Time Adoption of International Financial Reporting Standards in compiling these consolidated statements.

As the transition date for Landsbanki Íslands hf. is 1 January 2004, the Group's IFRS opening balance sheet has been prepared as of that date. The reporting date of these consolidated financial statements is 31 December 2005. The Group's IFRS adoption date is 1 January 2005.

The Group must restate all its assets and liabilities retroactively in accordance with IFRS 1. The Group has decided to avail itself of the exemptions provided for in IFRS 1, cf. Sections 40.2 and 40.3

40.2 Optional exemptions

The Group has decided to apply the following IFRS exemptions from full retroactive restatement and presentation of assets and liabilities.

(a) Business combinations exemption

The Group has applied the business combinations exemption in IFRS 1. It has not restated business combinations that took place prior to the 1 January 2004 transition date.

(b) Fair value as deemed cost exemption

The Group has elected to measure certain items of property, plant and equipment at fair value as of 1 January 2004.

(c) Exemption from restatement of comparatives for IAS 32 and IAS 39

The Group applies previous GAAP rules to derivatives, financial assets and hedges for the 2004 comparative amounts. Adjustments required for differences between GAAP and IAS 32/39 are recognised in equity as of 1 January 2005.

(d) Designation of financial assets and financial liabilities exemption

In accordance with IAS 32/39, various securities are reclassified as trading assets and financial assets designated at fair value through profit and loss as of 1 January 2005. The resulting changes in the presentation are shown especially in the summary in 40.7 of this section.

40.3 Mandatory exceptions

The Group has applied the following exceptions:

(a) Derecognition of financial assets and liabilities exception

Financial assets and liabilities derecognised before 1 January 2004 are not re-recognised under IFRS. The application of the exemption from restating comparatives for IAS 32 and IAS 39 means that the Group recognised from 1 January 2005 any financial assets and financial liabilities derecognised since 1 January 2004 that do not meet the IAS 39 derecognition criteria. Management did not choose to apply the IAS 39 derecognition criteria prior to this date.

(b) Hedge accounting exception

Hedge accounting is applied from 1 January 2005 if the hedge relationship meets all the hedge accounting criteria set in IAS 39.

(c) Estimates exception

Estimates under IFRS as of 1 January 2004 must be consistent with estimates made for the same date under previous GAAP, unless there is evidence that those estimates were in error.

(d) Assets held for sale and discontinued operations exception

IFRS 5 is applied prospectively from 1 January 2005, i.e. assets held for sale and discontinued operations are recognised in accordance with IFRS 5 only from 1 January 2005.

The following tables show the effects of the change in measurement and presentation from previous GAAP to IFRS has had on the Group's equity, income statement and balance sheet. Changes to cash flows were negligible.

40.4 Reconciliations transition changes in equity

Summary of changes in equity to IFRS from previous GAAP:

Equity under previous GAAP 31.12.2004		38,016
Changes in presentation of minority interest	IAS 1	1,004
Total equity, including minority interest		39,020
Total equity under IFRS 1.1.2005		38,709
Total changes in equity from previous GAAP		(311)

Changes in equity 1.1.2004:

Equity under previous GAAP 1.1.2004		22,382
Changes in presentation of minority interest	IAS 1	862
Total equity, including minority interest		23,244
Total equity under IFRS 1.1.2004		23,244
Total changes in equity 1.1.2004		0

Changes in equity during the year 2004:

Valuation changes:		
Changes related to loan commitment fee	IAS 18	(124)
Reversal of goodwill amortised	IAS 36, IFRS 3	184
Impairment of software	IAS 36, IAS 38	(130)
Impairment of equipment	IAS 36, IAS 16	(45)
Expense due to share-based compensation	IFRS 2	(94)
Exchange rate impact of foreign subsidiaries	IAS 21	20
Recalculations of Tax liability	IAS 12	54
Total valuation changes restated in income statement		(135)
Exchange rate impact of foreign subsidiaries	IAS 21	(20)
Total IFRS transition changes in equity 2004		(155)

Changes in equity 1.1.2005:

Changes in presentation of treasury shares	IAS 32	(259)
Valuation changes:		
Impairment of loans and advances	IAS 39	150
Change in fair value of unlisted securities	IAS 39	(206)
Value changes - Hedge accounting	IAS 39	289
Changes in fair value due to trading derivatives	IAS 39	(62)
Recalculation of Tax liability	IAS 12	(68)
Total value changes in equity 1.1.2005		103

Total changes in equity from previous GAAP (311)

The total change in equity as a result of transition to IFRS is a decrease of ISK 311 million. The Group's equity in the opening IFRS balance sheet is ISK 38,709 million as compared to ISK 39,020 million after the altered presentation of minority interest. The principal changes to the Group's income statement and balance sheet are explained below.

Changes in presentation of minority interest

The transition to IFRS will mean that minority interest in equity is presented as part of equity in accordance with IAS 1 Presentation of Financial Statements. Previously minority interest was presented as a separate item outside shareholders' equity. The total amount of minority interest is ISK 1,004 million at year-end 2004. The change only affects the presentation, but not the valuation or measurement of equity.

Changes in presentation of treasury shares

Treasury shares, which were previously recognised as an asset in the trading book, are entered against equity in accordance with IAS 32. This equity decrease amounts to ISK 259 million on 1 January 2005.

Loan commitment fees on loans and advances and borrowings

In accordance with IAS 18, Revenue, loan commitment fees are amortised through the effective interest rate over the life of the loan, while under GAAP they were recognised at the time the loan was disbursed. This change results in a temporary decrease in income and for 2004 this income is ISK 124 million lower than according to previous accounting treatment. This decrease has a corresponding impact on equity.

Reversal of goodwill amortised

According to IFRS 3, Business Combinations, and IAS 36, Impairment of Assets, goodwill is not amortised systematically. Instead, goodwill is assessed especially by means of an annual impairment test. As a result of this change, goodwill previously amortised and expensed in 2004 has been reversed, since the result of an impairment test on goodwill did not result in a decrease for impairment. The total impact of this is to increase Group equity by ISK 184 million.

Impairment of intangible assets and equipment

According to the provisions of IAS 36, an impairment test shall be carried out on intangible assets with a defined useful life and on property, plant and equipment when there is indication that an impairment loss has been incurred. At year-end 2004, an impairment test was performed on software and equipment which resulted in an impairment loss of ISK 175 million. This amount is recognised in the 2004 restated income statement and reduces Group equity at year-end 2004 by this amount.

Expense due to share-based compensation

The cost of the share-based compensation contracts has been calculated according to IFRS and the 2004 cost, based on the underlying contracts, has been recognised as an expense and liability in accordance with IFRS 2, Share-based compensation. The total cost for 2004 was ISK 94 million, which decrease equity.

Exchange rate impact of foreign subsidiaries

In accordance with IAS 21, The Effects of Changes in Foreign Exchange Rates, all translation differences from investment in foreign subsidiaries shall be recognised directly in shareholders' equity as a separate reserve. Exchange rate adjustment of liabilities used to hedge these investments are also recognised directly against shareholders' equity. According to previous GAAP, both were recognised in the income statement. Adjustments resulting from the difference in these methods reduces the 2004 outcome by ISK 20 million, with a corresponding amount entered as a separate item against equity, translation reserve. The net impact on equity as a result is nil.

Impairment of loans and advances

The transition to IAS 39 changes the method of impairment calculation on loans, with the application of new methods based on the present value of future cash flows from loans, based on objective evidence and other historical data. This lowers provisions for credit losses by ISK 150 million, with a corresponding increase in equity.

Change in fair value of unlisted securities

In accordance with IAS 39, the Group will measure the fair value of unlisted securities. As a result, equity on 1 January 2005 will decrease by ISK 206 million.

Hedge accounting

The group has applied hedge accounting, in accordance with IAS 39, as of 1 January 2005. All derivatives held for hedging are recognised at fair value and the carrying value of hedged items is adjusted to take into account the designated risk being hedged in accordance with the defined hedge relationship. Changes in valuation resulting from the application of hedge accounting have resulted in a increase in equity of ISK 289 million.

Changes in fair value due to trading derivatives

In accordance with IAS 39, all derivative financial instruments are recognised at fair value. The total change in assessment as a result is to decrease Group equity by ISK 62 million on 1 January 2005. Of this amount, the increase to trading assets is ISK 603 million and the increase in trading liabilities is ISK 665 million.

40.5 Change in Income Statement 2004 from previous GAAP to IFRS

	Previous GAAP	Change in valuation	Change in presentation	IFRS
Net interest revenues	14,902	(124)	(43)	14,734 Net interest revenues
Net profit from shareholdings	22	0	(22)	
Commissions and fees	9,995	0	239	10,234 Commissions and fees
Commission expenses	(1,344)	0	0	(1,344) Commission expenses
Trading gains	9,830	0	(9,830)	
		0	453	453 Dividend income
		0	4,116	4,116 Net gain on financial assets and financial liabilities held for trading
		0	4,918	4,918 Net gain on financial assets designated at fair value through profit and loss
		0	0	0 Fair value adjustments in hedge accounting
		20	344	364 Foreign exchange difference
		0	(8)	(8) Share of profit of associates
Other revenues	194	0	(194)	
Salaries and related expenses	(7,700)	(94)	0	(7,794) Salaries and related expenses
Administrative expenses	(4,713)	0	(248)	(4,961) Administrative expenses
Depreciation of fixed assets	(1,715)	9	0	(1,706) Depreciation and amortisation
Other expenses	(246)	0	246	
Net provisions for credit losses	(4,485)	0	0	(4,485) Impairment on loans and advances and assets held for sale
Taxes	(1,882)	54	30	(1,798) Income tax
Net profit	12,858	(135)	0	12,723 Net profit
Minority interests	(149)			(149) Minority interests
Net profit according to previous GAAP	12,709			12,574 Net profit attributable to shareholders of Landsbanki Islands

4.0.6 Change in Income Statement 2004 from previous GAAP to IFRS by quarters

		Q4 2004	Q3 2004	Q2 2004	Q1 2004
Net profit	12,574	905	5,746	1,785	4,139
Income Statement from previous GAAP	12,709	1,014	5,660	1,941	4,094
Reversal of goodwill amortised	184	73	37	37	37
Impairment of software and equipment	(175)	(175)	0	0	0
Expense due to share-based compensation	(94)	0	(38)	(34)	(23)
Changes related to loan commitment fee	(124)	(66)	97	(197)	41
Exchange rate impact of foreign subsidiaries	20	16	6	1	(3)
Recalculation of Tax liability	54	43	(17)	35	(7)
Restated Income Statement	12,574	905	5,746	1,785	4,139

4.0.7 Changes in Balance Sheet from previous GAAP to IFRS

Previous GAAP 31 December 2004	31.12.2004	Change in presentation	Change in valuation 2004	Change in valuation 1.1.2005	IFRS 1 January 2005	
Cash and current account at Central Bank	13,432	4,805	0	0	18,237	Cash and cash balances with Central Bank
Treasury bills	4,805	(4,805)	0	0		
Financial institutions	73,435	(73,435)	0	0		
Loans to customers	537,378	77,396	(554)	54	614,274	Loan and advances
Capital leases	11,641	(11,641)	0	0		
Appropriated assets	782	(782)	0	0		
Bonds and other fixed income securities	18,529	(18,529)	0	0		
Equity and other variable income securities	52,970	(52,970)	0	0		
	0	64,594	(23)	159	64,730	Trading assets
	0	12,817	0	0	12,817	Financial assets designated at fair value through profit and loss
	0	4,930	0	0	4,930	Derivatives held for hedging
Shares in Associates	3,756	0	36	0	3,792	Investment in Associates
	0	4,191	(45)	0	4,146	Property and equipment
Premises	2,710	(2,710)	0	0		
Liquid assets	2,035	(2,035)	0	0		
Goodwill	1,012	555	18	0	1,585	Intangible assets
	0	9,866	0	96	9,962	Non-current assets and disposal groups classified as held for sale
Other assets	7,893	(5,226)	0	0	2,668	Other assets
Total assets	730,379	7,020	(567)	309	737,141	
Financial institutions	63,476	(2,239)	0	0	61,236	Deposits from credit institutions
Deposits from customers	217,970	0	0	0	217,970	Deposits from customers
Borrowing	372,424	2,880	(358)	138	375,084	Borrowing
Subordinated loans	22,552	18	0	0	22,570	Subordinated loans
	0	8,077	0	0	8,077	Trading liabilities
	0	1,582	0	0	1,582	Derivatives held for hedging
Computed commitments	563	(563)	0	0		
	0	1,660	(54)	68	1,674	Tax liabilities
	0	4,204	0	0	4,204	Liabilities included in disposal groups classified as held for sale
Other liabilities	14,387	(8,353)	0	0	6,035	Other liabilities
Minority interests	991	13	0	0	1,004	Minority interests
Equity	38,016	(259)	(155)	103	37,705	Equity
Total liabilities	730,379	7,020	(567)	309	737,141	