

**Frjalsi
Investment Bank Ltd.**

**Annual Accounts
31 December 2001**

Icelandic krónas

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Endorsement and Signatures of the Board of Directors and Manager

The Annual Accounts for Frjalsi Investment Bank Ltd. and its subsidiary, Logfang Ltd., are prepared in accordance with law and regulations on Annual Accounts of commercial banks, savings banks and other credit institutions.

According to the Profit and Loss Account the net operating income amounted to ISK 462 million. Equity, according to the Balance Sheet, amounted to ISK 2,237 million at the end of the year. The capital ratio of the Company, calculated according to provision no. 10 of the law on Credit Institutions other than Commercial Banks and Savings Banks, was 21.8%. This ratio is not allowed to go below 8.0%. The Board of Directors does not propose a payment of dividend in the year 2002. For other appropriations we refer to the Financial Statements.

Last year, the average number of employees was 36. Total salaries amounted to ISK 155 million and salary related expenses amounted to ISK 23 million.

During the year Kaupthing Bank hf. acquired four of the bank's subsidiaries, Verdbrefasjodurinn hf., Rekstrarfelag Fjarvangs hf., Ævisjodurinn hf and Lífvordur hf. with its asset management according to note 17. Kaupthing Bank hf. also increased its ownership in the bank, and now holds 99.4% of the banks's total share capital.

Share capital was decreased by ISK 122 million during year 2001 through the bank's acquisition of share capital. Frjalsi Investment Bank's share capital amounted to ISK 1,096 million at year-end. Shareholders at year-end 2001 numbered 49. At the end of the year, one shareholder owned more than 10.0% share in the Company, Kaupthing Bank hf. which owned 99.4%.

As is known accounting principles applied by Icelandic companies have been different from those in our neighbouring countries for the past 20 years with regards to calculating the effects of general price-level changes. In the end of the year 2001 the Icelandic Parliament, Althingi, passed changes on the Annual Accounts Act which aim to abolish accounting for the effects of general price-level changes in the next two years, thus making the accounts of Icelandic companies in more conformity with international accounting principles. The Bank plans to cease calculating these changes in the year 2002 and aims to further adjust its accounting principles to international standards. According to the Profit and Loss Account the Bank's net profit amounted to ISK 461 million, but without the effects of general price-level changes the net profit of the Bank would amount to ISK 596 million.

The Board of Directors and the Manager of Frjalsi Investment Bank hf. hereby confirm the Annual Accounts for the year 2001.

Reykjavík, 14 February 2002

Board of Directors

Sigurður Einarsson
Chairman

Ásgeir Sólbergsson

Geirmundur Kristinsson

Friðrik Friðriksson

Guðmundur Hauksson

Manager

Kristinn Bjarnason

Auditors' Report

To the Board of Directors and Shareholders of Frjalsi Investment Bank.

We have examined the accompanying Consolidated Balance Sheet of Frjalsi Investment Bank as of 31 December 2001 and the related Profit and Loss Account and Statement of Cash Flows for the year then ended. These Annual Accounts are the responsibility of the Company's management. Our responsibility is to express an opinion on these Annual Accounts based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Annual Accounts are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the Annual Accounts. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall Annual Accounts presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion the Annual Accounts give a true and fair view of the financial position of Frjalsi Investment Bank as of 31 December 2001, and the results of its operation and its cash flows for the year then ended, in accordance with the law and generally accepted accounting principles in Iceland.

Reykjavík, 14 February 2002

Sigurður Jónsson

KPMG Endurskoðun hf.

Profit and Loss Account for the Year 2001

	Notes	2001	2000
Financial income:			
Interest from credit institutions		248,826,543	39,102,768
Interest on loans		1,712,851,269	1,144,889,452
Interest on bonds		173,796,852	46,048,155
		<u>2,135,474,664</u>	<u>1,230,040,375</u>
Financial expenses:			
Interest to credit institutions		564,805,696	397,940,943
Interest on borrowings		1,055,597,219	620,598,565
Calculated inflation adjustment	2	161,757,500	43,966,644
		<u>1,782,160,415</u>	<u>1,062,506,152</u>
Net interest expenses		353,314,249	167,534,223
Other operating income:			
Dividends from shares and other holdings	32	563,476	45,604,836
Income from commissions and other service charges		47,154,853	307,070,915
Value adjustment of other financial operations	33	(111,840,066)	(80,670,718)
Other operating income	17	589,648,069	27,206,765
		<u>525,526,332</u>	<u>299,211,798</u>
Net operating income		878,840,581	466,746,021
Other operating expenses:			
Salaries and related expenses	30	178,726,527	264,436,465
Other administrative expenses		67,097,818	257,600,868
Depreciation	18	38,681,759	24,106,335
		<u>284,506,104</u>	<u>546,143,668</u>
Provision for losses	14	(120,000,000)	(120,000,000)
Profit (loss) before taxes		474,334,476	(199,397,647)
Income tax	24	(147,062,466)	33,465,670
Decrease in liability due to a change in the income tax rate.....	24	152,611,570	0
Net worth tax		(18,223,780)	(2,318,141)
Net earnings (loss)	25	<u>461,659,800</u>	<u>(168,250,118)</u>

Balance Sheet

Assets

	Notes	2001	2000
Amounts due from credit institutions:			
Required deposits with the Central Bank		244,120,796	158,451,999
Amounts due from other credit institutions		<u>1,003,926,848</u>	<u>945,297,840</u>
	7,8	<u>1,248,047,644</u>	<u>1,103,749,839</u>
Loans to customers:			
Loans to customers		11,124,744,468	9,452,439,106
Mortgages foreclosed		<u>35,908,135</u>	<u>12,167,794</u>
	9-14	<u>11,160,652,603</u>	<u>9,464,606,900</u>
Bonds and shares in other companies:			
Bonds and other fixed income securities	3,15	3,381,114,352	821,202,359
Shares and other variable yield securities	3,16	3,426,700	2,824,225,910
Shares in associated companies	4,17	<u>5,957,736</u>	<u>30,109,926</u>
		<u>3,390,498,788</u>	<u>3,675,538,195</u>
Other assets:			
Fixed assets	2,18	408,595,729	404,448,997
Other assets		<u>61,922,193</u>	<u>32,447,849</u>
		<u>470,517,922</u>	<u>436,896,846</u>
Total assets		<u><u>16,269,716,957</u></u>	<u><u>14,680,791,780</u></u>

31 December 2001

Liabilities and equity

	Notes	2001	2000
Amounts owed to credit institutions	22	<u>6,964,739,069</u>	<u>6,426,893,458</u>
Borrowings	23	<u>6,785,662,363</u>	<u>5,436,538,622</u>
Other liabilities:			
Sundry liabilities		<u>53,544,792</u>	<u>527,870,370</u>
Provision for deferred income tax liability	24	<u>228,916,974</u>	<u>216,970,750</u>
Equity:			
Share capital		1,096,702,168	1,215,419,015
Share premium		142,444,968	290,074,665
Revaluation reserve		60,404,523	123,999,019
Statutory reserve		131,730,574	143,920,154
Retained earnings		<u>805,571,526</u>	<u>299,105,727</u>
Equity 25-27		<u>2,236,853,759</u>	<u>2,072,518,580</u>
Total liabilities and equity		<u>16,269,716,957</u>	<u>14,680,791,780</u>

Off-Balance Sheet items:

Obligations	28
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Statement of Cash Flows for the Year 2001

	Notes	2001	2000
Cash flows from operations:			
Net earnings (loss)	25	461,659,800 (	168,250,118)
Difference between net earnings and cash from operations:			
Gain on sale of assets		(562,504,060)	0
Provision for losses	14	120,000,000	120,000,000
Income tax	24	11,946,224 (	44,406,276)
Other items		203,896,515	102,346,134
Changes in assets and liabilities		(191,991,589)	279,812,708
Net cash provided by operating activities		<u>43,006,890</u>	<u>289,502,448</u>
Cash flows from investing activities:			
Time deposits with the Central Bank		(85,668,797 ) (	28,009,663)
Other time deposits with credit institutions		(431,018,524 ) (	199,153,333)
Loans to customers, changes		(2,127,854,036 ) (	1,445,377,558)
Trading bonds, changes		(2,559,911,993 ) (	608,702,817)
Trading securities, changes		2,487,952,945 (	1,818,981,591)
Investment securities, changes		332,915,543	600,796,409
Investment in shares in other companies	17	586,586,972 (	2,446,891)
Investment in fixed assets	18	(21,735,822 ) (	358,277,124)
Proceeds from sale of fixed assets		9,183,000	0
Net cash used in investing activities		<u>(1,809,550,712)</u>	<u>(3,860,152,568)</u>
Cash flows from financing activities:			
Amounts owed to credit institutions, changes		537,845,611	3,698,266,493
Borrowings, changes		1,349,123,741	262,434,388
Dividend paid		0 (	133,214,000)
Treasury stock, bought	25	(492,815,045 ) (	16,150,547)
Net cash provided by financing activities		<u>1,394,154,307</u>	<u>3,811,336,334</u>
(Decrease) increase in cash		(372,389,515)	240,686,214
Cash and cash equivalents at beginning of year		<u>445,297,839</u>	<u>204,611,625</u>
Cash and cash equivalents at end of year	5	<u>72,908,324</u>	<u>445,297,839</u>
Other information:			
Dividends received		563,476	45,724,514
Income tax paid		2,318,141	0

Notes to Annual Accounts

Summary of accounting principles

1. The Consolidated Annual Accounts of Frjalsi Investment Bank and its subsidiary, Logfang Ltd., are prepared in accordance with law and regulations on Annual Accounts of Commercial Banks, Savings Banks and other Credit Institutions. The Annual Accounts have been prepared in accordance with the same accounting principles as for the previous year. In the Consolidated Annual Accounts intercompany balances and transactions for the included subsidiary are eliminated. At year-end 2001 the subsidiaries were two, but only Logfang Ltd. is included in the Consolidated Annual Accounts. The operation of Fjolphjodastjodurinn Ltd. is insignificant and therefore it is not a part of the Consolidated Annual Accounts.

2. The effect of general price level changes on the operation and financial position is calculated and included in the Annual Accounts based on the increase in the Official Consumer Price Index within the year, which increased by 8.6%.

The net book value of operating assets previously re-valued to year-end 2000 has been further re-valued to year-end 2001. The effects of general price level changes on assets and liabilities have been calculated and entered as expenses amounting to ISK 162 million. As a result of these price-level changes, amounts in the Balance Sheet are presented at year-end price level and the operating results at the average price-level during the year.

The revaluation of assets and the calculated inflation adjustment has been posted to the revaluation reserve account in the Balance Sheet, as shown in note 25.

3. The Bank's securities are partly presented as trading securities and partly as investment securities. Investment securities are those that by a formal decision will be held for more than one year, but other securities are categorized as trading securities.

The valuation of investment bonds is based on the yield at the time of purchase. Unlisted trading securities are valued at the inflationary adjusted purchase price or at year-end market price, whichever is lower.

4. The Bank holds shares in one associated companies and those shares are presented at a value corresponding to the Bank's share in their equity.

5. Cash and cash equivalents in the Statement of Cash Flows consist of demand deposits with the Central Bank and demand deposits with other credit institutions. Cash and cash equivalents amount to ISK 73 million at year-end.

6. The deferred income tax liability at the end of 2001 is calculated and entered in the Balance Sheet. The calculation is based on the difference between Balance Sheet items as presented in the tax report on the one hand, and in the Annual Accounts on the other. This difference is due to the fact that tax assessments are based on rules which differ from those governing the Annual Accounts. The income tax rate is 30.0% for the year 2001, but 18.0% from the year 2002, according to an Act passed by the Icelandic parliament, Althingi, at the end of the year 2001.

Notes cont.:

Amounts due from credit institutions

7. Amounts due from credit institutions:

	2001	2000
Required deposits with the Central Bank according to regulation.....	244,121	158,452
Amounts due from other credit institutions:		
Associated companies	931,018	500,000
Other	72,908	445,298
Total	1,003,926	945,298

8. Amounts due from other credit institutions mature as follows:

On demand	72,908	445,298
Up to 3 months	931,018	0
Over 1 year and up to 5 years	0	500,000
Total	1,003,926	945,298

Loans to customers

9. Loans to customers specified by types of loans:

Bills of exchange	10,463	37,617
Bonds	6,579,420	7,181,700
Other loans	4,534,861	2,233,122
Total	11,124,744	9,452,439

10. Loans to customers specified by sectors:

Business enterprises:		
Commerce and services	25.2%	21.3%
Fishing industry and agriculture	11.1%	4.8%
Industry and contractors	13.1%	7.9%
Individuals	50.6%	66.0%
Total	100.0%	100.0%

11. Loans to customers specified by maturity:

On demand	158,983	163,370
Up to 3 months	878,555	1,598,685
Over 3 months and up to a year	2,684,500	1,279,349
Over 1 year and up to 5 years	3,947,205	3,146,888
Over 5 years	3,455,501	3,264,147
Total	11,124,744	9,452,439

Notes cont.:

12. The bank has redeemed assets on foreclosed mortgages. Foreclosed mortgages are valued at estimated market prices and are specified as follows:

	2001	2000
Operating assets	14,360	6,290
Buildings	21,548	5,878
Total	<u>35,908</u>	<u>12,168</u>

13. Non-performing loans are specified as follows:

Loans with a specific provision for losses	109,996	137,692
Specific provision for losses	(95,951)	(126,024)
Other non-performing loans	79,437	50,958
Non-performing loans, total	<u>93,482</u>	<u>62,626</u>

14. Provision for losses on the loan portfolio is made to meet the risk attached to lending operations. The loss provision is based on estimation and does not represent a final write-off. In addition to the required contribution, certain risk factors are evaluated to determine the total contribution for this purpose. First there are specific provisions to adjust for obligations of creditors that have received a poor risk evaluation, and secondly there is a general provision to meet the general risk of lending operations. Interest on loans, the collection of which is uncertain, has not been entered as income. The provision has been deducted from the appropriate Balance Sheet items. The changes in the provision are as follows:

	Provision for losses		2001	2000
	Specific	General	Total	Total
Balance on 1 January 2001	126,024	117,023	243,046	257,206
Provision for losses over the year	73,506	46,494	120,000	120,000
Actual losses during the year	(103,579)	(103,579)	(103,579)	(134,160)
Balance on 31 December 2001	<u>95,951</u>	<u>163,517</u>	<u>259,468</u>	<u>243,046</u>
Provision for losses on the loan portfolio as a percentage of loans and issued guarantees			2.3%	2.1%

Bonds and shares in other companies

15. Bonds and other fixed income securities specify as follows:

	Market value	Book value
Investing bonds:		
Listed on the Iceland Stock Exchange	<u>3,395,150</u>	<u>3,381,114</u>

The Bank has entered into swaps with associated companies amounting to ISK 3,381 million against its bonds. The agreements are entered at market value. These bonds are issued by public bodies and mature within a year.

16. Shares and other variable-yield securities specify as follows:

	Book value
Unlisted trading securities	<u>3,357</u>

Notes, cont.:

17. During the year the bank sold four of its subsidiaries, Verdbrefasjodurinn Ltd., Rekstarfelag Fjarvangs Ltd., Ævisjodurinn Ltd. and Lifvordur Ltd., as well as the asset management. The payment consisted of shares in Kaupthing Bank hf. at a nominal value of ISK 40 million. Proceeds from sale of the subsidiaries amounted to ISK 563 million as the selling price was ISK 608 million.

The bank has invested in shares in one associated company. These shares are unlisted. Shares in this company are presented at a value corresponding to the bank's share in their equity and is specified as follow:

	Ownership	Profit share	Nominal value	Book value
Fjолthjodasjodurinn Ltd., Reykjavik	100.0%	<u>0</u>	4,000	<u>5,958</u>

Other assets

18. Fixed assets, revaluation and depreciation are as follows:

	Real estate	Fixtures, equipment and vehicles	Total
Total value 1.1.2001.....	306,024	180,404	486,428
Revaluation during the year	26,980	15,236	42,216
Addition during the year	9,813	11,923	21,736
Disposals during the year	<u>0</u>	<u>(80,343)</u>	<u>(80,343)</u>
Total value 31.12.2001	<u>342,817</u>	<u>127,220</u>	<u>470,037</u>
Previously depreciated	3,174	78,805	81,979
Revaluation during the year	543	7,938	8,481
Depreciation during the year	6,530	32,152	38,682
Disposals during the year	<u>0</u>	<u>(67,701)</u>	<u>(67,701)</u>
Total depreciation 31.12.2001	<u>10,247</u>	<u>51,194</u>	<u>61,441</u>
Book value 31.12.2001	<u>332,570</u>	<u>76,026</u>	<u>408,596</u>
Annual depreciation ratio	2%	15-20%	

On 31 December 2001 the official value of buildings was ISK 201 million and ISK 18 million for land or a total of ISK 219 million. The insurance valuation of the buildings amounted to ISK 291 million at the end of 2001. Insurance value of the machinery and equipment amounted to ISK 55 million at the same time.

Balances with associated companies

19. Specification of balances with associated companies and subsidiaries:

Assets:	
Loans to credit institutions	931,019
Interest rate swaps	<u>3,381,114</u>
Assets, total	<u>4,312,133</u>
Liabilities:	
Amounts owed to credit institutions	249,328
Forward contracts	<u>13,783</u>
Liabilities, total	<u>263,111</u>

Notes, cont.:

Assets and liabilities index linked or in foreign currency

20. The total amount of indexed assets is ISK 6,109 million and the total amount of indexed liabilities is ISK 6,372 million at year-end.
21. The total amount of assets in foreign currencies in the Annual Account is ISK 4,358 million, and the total amount of liabilities amounted to ISK 4,389 million at year-end. Included in assets and liabilities are forward contracts and currency and interest rate swaps, see note 28.

Amounts owed to credit institutions

22. Liabilities owed to credit institutions mature as follows:	2001	2000
Up to 3 months	4,827,489	2,203,147
Over 3 months and up to a year	630,310	500,000
Over 1 year and up to 5 years	1,387,101	3,723,746
Over 5 years	119,839	0
Total	<u>6,964,739</u>	<u>6,426,893</u>

Borrowings

23. Borrowings are specified as follows:		
Bonds issued	6,620,698	5,308,417
Other borrowings	164,964	128,121
Total	<u>6,785,662</u>	<u>5,436,538</u>

Borrowings that mature within a year amount to ISK 686 million.

Deferred income tax liability

24. Deferred income tax liability is specified as follows:		
Provision for deferred income tax liability at the beginning of 2001		216.971
Index regulation		18.681
Calculated income tax for 2001		147.062
Income tax because of 2001 to be paid in the year 2002.....	(	1.186)
Deferred income tax liability according to applicable tax rate		381.528
Decrease in the liability due to a change in the income tax rate from 30.0% to 18.0% .....	(	152.611)
Provision for deferred income tax liability at the end of 2001.....		<u>228.917</u>
Income tax in the Profit and Loss Account is specified as follows:		
Calculated income tax for 2001		147.062
Decrease in the liability due to a change in the income tax rate from 30.0% to 18.0% .....	(	152.611)
Income tax in the Profit and Loss account .....	(	<u>5.549)</u>
The deferred income tax liability is specified as follows:		
Deferred gain on sale of assets		135.822
Fixed assets		<u>93.095</u>
Provision for deferred income tax liability at the end of 2001		<u>228.917</u>

Notes, cont.:

Equity

25. Changes in equity are as follows:

	Share capital	Share premium	Revaluation reserve	Statutory reserve	Retained earnings	Total
Equity 1.1.2001	1,215,419	290,075	123,999	143,920	299,106	2,072,519
Treasury stock, bought	(118,717)	(147,630)	(214,278)	(12,190)		(492,815)
Revaluation of assets			33,733			33,733
Calculated inflation adjustment			161,757			161,757
Net earnings					461,660	461,660
Revaluation of retained earnings ..			(44,806)		44,806	0
Equity 31.12.2001	<u>1,096,702</u>	<u>142,445</u>	<u>60,405</u>	<u>131,730</u>	<u>805,572</u>	<u>2,236,854</u>

According to the Bank's Articles of Association, total Share Capital amounts to ISK 1,215 million. At year-end 2001 own shares amounted to ISK 122 million and Share Capital, according to the Balance Sheet, amounted to ISK 1,097 million. During the year the bank sold Share Capital amounting to ISK 3 million and acquired Share Capital amounting to ISK 122 million. The reason for the aquirement is the high capital ratio in respect to the Balance Sheet.

26. The Bank's equity at year-end amounts to ISK 2,237 million, equivalent to 13.7% of total assets. The capital ratio of the bank, according to provision no. 10 in the law on Credit Institutions other than Commercial Banks and Savings Banks, is 21.8%. According to the law this ratio is not allowed to go below 8.0%. The ratio is calculated as follows:

	Book value	Weighted value
	2001	2000
Risk base:		
Assets recorded in the Annual Accounts	16,269,717	12,932,923
Assets subtracted from capital		(292,748)
Guarantees and other items not included in the Balance Sheet ..	9,273,449	<u>26,950</u>
Risk base, total		<u>1,937,451</u>
		<u>10,249,072</u>
		<u>14,577,626</u>
Capital:		
Recorded equity		2,072,519
Investment in credit institutions and subordinated loans		0 (292,748)
Total equity		<u>2,236,854</u>
		<u>1,779,771</u>
Capital ratio	21.8%	12.2%

27. The Bank's equity at the beginning of 2001 amounted to ISK 2,072 million, which equals ISK 2,251 million at year-end, when taking into account a 8.6% increase in the general price level during the year. According to the Balance Sheet, the equity amounted to ISK 2,236 million or ISK 14 million lower than at the beginning of the year when compared at the 31 December 2001 price level. The changes are specified as follows:

	According to Annual Accounts	At year-end price level
Equity 1.1.2001	2,072,519	2,250,963
Treasury stock, bought	(492,815)	(494,822)
Net earnings	461,660	480,713
Revaluation of assets and calculated inflation adjustment	195,490	
Equity 31.12.2001	<u>2,236,854</u>	<u>2,236,854</u>

Notes, cont.:

Obligations

28. The Bank has entered into currency and interest rate contracts with its customers. These agreements are specified as follows:

	2001	2000
Currency and interest rate contracts:		
Assets in ISK	4,838,328	99,025
Assets in foreign currencies	1,455,869	1,725,637
Liabilities in ISK	3,381,114	0
Liabilities in foreign currencies	2,916,252	431,612

The objective of the above mentioned agreements is to control currency and interest rate risk of the bank. The credit risk is valued at ISK 135 million when calculating the capital ratio of the bank.

Personnel

29. The total number of employees is as follows:

	2001	2000
Average number of employees during the year measured as full time	36	55
Full time equivalent positions at year-end	22	64

30. Salaries and related expenses are specified as follows:

Salaries	155,446	225,278
Salary related expenses	23,280	31,039
	<u>178,726</u>	<u>256,317</u>

31. Salaries paid to the Board of Directors and to three Managers amounted to ISK 30 million during the year.

Specifications

32. Dividends from shares and other holdings:

Dividend on tradings shares and investment shares	563	45,725
Profit share in net earnings of associated companies	0	(120)
Total	<u>563</u>	<u>45,605</u>

33. Value adjustment of other financial operations:

Trading securities	(141,796)	12,630
Trading bonds	19,016	(35,249)
Asset and liabilities in foreign currencies	10,940	(58,079)
Total	<u>(111,840)</u>	<u>(80,698)</u>