

Group

Consolidated Financial Statements 2016

Landsvirkjun
Háaleitisbraut 68
103 Reykjavík
Iceland

Id.no. 420269-1299

Contents

Key figures	3
Endorsement by the Board of Directors and CEO	5
Independent Auditors' Report	7
Income Statement	11
Statement of Comprehensive Income	12
Balance Sheet	13
Statement of Equity	14
Statement of Cash Flow	15
Notes	16
Appendix I: Statement of Corporate Governance	43
Appendix II: Non-financial information	45

Key figures - Unaudited

Management's presentation of the operation of Landsvirkjun

	2016	2015	2014	2013	2012
Operation					
Operating revenues	415,480	410,496	428,655	407,676	389,499
Realised aluminium hedges	4,890	10,956	9,629	15,228	18,325
Total operating revenues	420,370	421,452	438,284	422,904	407,824
Operating expenses	(118,630)	(99,932)	(106,126)	(93,768)	(86,488)
EBITDA	301,740	321,520	332,158	329,136	321,336
Depreciation and impairment loss	(118,571)	(115,554)	(114,045)	(117,670)	(112,288)
EBIT	183,169	205,966	218,113	211,466	209,048
Financial items	(60,045)	(73,418)	(69,838)	(86,988)	(103,093)
Associated companies	(5,448)	(1,921)	(1,419)	(2,647)	(2,229)
Profit before unrealised financial items	117,676	130,627	146,856	121,831	103,726
Unrealised financial items:					
Fair value changes in embedded derivatives	21,164	(59,925)	(88,484)	(174,641)	(3,391)
Fair value changes in other derivatives	(1,269)	5,466	(8,426)	5,014	13,653
Unrealised foreign exchange difference	(23,314)	47,657	60,271	(16,658)	(12,675)
	(3,419)	(6,802)	(36,639)	(186,285)	(2,413)
Profit (loss) before income tax	114,257	123,825	110,217	(64,454)	101,313
Income tax	(47,437)	(39,652)	(31,797)	25,913	(45,995)
Net Profit (loss)	66,820	84,173	78,420	(38,541)	55,318
Balance sheet					
Total assets	4,332,864	4,284,703	4,270,098	4,568,965	4,518,534
Equity	1,969,088	1,916,634	1,704,724	1,658,134	1,697,152
Liabilities	2,363,776	2,368,069	2,565,374	2,910,831	2,821,382
Net debt *	1,960,497	1,985,411	2,190,459	2,429,176	2,435,571
Cash flow					
Funds from operations (FFO)	235,602	240,354	258,226	257,704	241,584
Cash flow from operating activities	229,827	248,955	233,816	258,485	236,178
Investing activities	(172,277)	(77,486)	(88,271)	(149,455)	(122,979)
Financing activities	(59,305)	(235,465)	(220,687)	(12,893)	(151,670)
Liquidity					
Cash and cash equivalents at year end	144,534	142,127	207,070	287,987	187,916
Undrawn loans	472,448	360,824	200,000	301,947	409,979
Total liquidity	616,982	502,951	407,070	589,934	597,895
Key ratios					
Return on equity	3.5%	4.9%	4.7%	(2.3%)	3.3%
Equity ratio	45.4%	44.7%	39.9%	36.3%	37.6%
Interest cover (EBITDA/net interest expense)	5.15x	4.60x	3.76x	3.51x	3.27x
FFO / net debt	12.0%	12.1%	11.8%	10.6%	9.9%
FFO / interest expense	3.80x	3.27x	2.82x	2.66x	2.36x
Net debt / EBITDA	6.50x	6.18x	6.59x	7.38x	7.58x
Credit rating at year end without state guarantee					
Standard & Poor's	BBB-	BB+	BB	BB	-
Moody's	Baa3	Ba1	Ba2	Ba2	-

* Net debt are interest bearing long-term liabilities less cash and cash equivalent.

Quarterly statement 2016 - Unaudited

Management's presentation of the operation of Landsvirkjun, contd.

	Q1	Q2	Q3	Q4	Total
Operating revenues					
Power sales	87,707	83,703	82,787	93,668	347,865
Realised aluminium hedges	1,209	1,266	1,157	1,258	4,890
Transmission	15,873	15,654	15,692	17,326	64,545
Other income	714	801	554	1,001	3,070
	<u>105,503</u>	<u>101,424</u>	<u>100,190</u>	<u>113,253</u>	<u>420,370</u>
Operating expenses					
Energy production costs	7,900	10,835	13,185	14,939	46,859
Transmission costs	6,419	7,165	6,580	8,331	28,495
Cost of general research	1,921	2,489	2,177	3,557	10,144
Other operating expenses	7,056	7,935	7,840	10,301	33,132
Depreciation and impairment loss	29,273	29,198	29,250	30,850	118,571
	<u>52,569</u>	<u>57,622</u>	<u>59,032</u>	<u>67,978</u>	<u>237,201</u>
Operating profit	52,934	43,802	41,158	45,275	183,169
Financial income and (expenses)					
Interest income	839	565	741	1,178	3,323
Interest expenses	(16,020)	(16,317)	(15,227)	(14,379)	(61,943)
Realised foreign exchange difference	532	(730)	(1,240)	12	(1,426)
	<u>(14,649)</u>	<u>(16,482)</u>	<u>(15,726)</u>	<u>(13,189)</u>	<u>(60,045)</u>
Associated companies	(459)	(666)	(1,155)	(3,168)	(5,448)
Profit before income tax and unrealised items	37,826	26,654	24,277	28,918	117,676
Unrealised financial items:					
Fair value changes in embedded derivatives	(3,809)	18,200	15,437	(8,664)	21,164
Fair value changes in other derivatives	(155)	(2,753)	1,987	(348)	(1,269)
Unrealised foreign exchange difference	(26,896)	5,982	(17,265)	14,865	(23,314)
	<u>(30,860)</u>	<u>21,429</u>	<u>159</u>	<u>5,853</u>	<u>(3,419)</u>
Profit before income tax	6,966	48,083	24,436	34,771	114,257
Income tax	(3,522)	(16,694)	(11,781)	(15,440)	(47,437)
Net Profit	3,444	31,389	12,655	19,331	66,820
Attributable to:					
Owners of the parent company	5,646	30,119	17,478	18,151	71,394
Subsidiaries minority interest	(2,202)	1,270	(4,823)	1,181	(4,574)
	<u>3,444</u>	<u>31,389</u>	<u>12,655</u>	<u>19,332</u>	<u>66,820</u>
From cash flow					
Cash flow from operating activities	68,711	55,130	48,704	57,282	229,827
Other key metrics for Landsvirkjun (parent company)					
Installed capacity at year end (MW)	1,957	1,957	1,957	1,862	1,860
Average price for industrial users (incl. transm.) USD/MWh	23.9	24.5	25.9	25.8	26.2
Average price for retail sales comp.(excl. transm.) ISK/kWh	4.6	4.4	4.3	4.0	3.9
Sales in GWh	13,625	13,900	13,082	13,186	12,770
Research and development	16,829	19,529	30,606	26,799	32,514
Accident frequency: H200*	0.3	0.4	0.4	0.7	0.0

* H200 is the number of absence accidents per each 200,000 working hours.

Endorsement by the Board of Directors and CEO

Landsvirkjun's objective is to operate in the energy sector and to engage in other business and financial operations according to the Board of Directors' decision at each time. The Company's consolidated financial statements include, in addition to the parent company, four subsidiaries, Landsnet hf., Orkufjarskipti hf., Icelandic Power Insurance Ltd. and Landsvirkjun Power ehf.

The financial statements of Landsvirkjun for the year 2016 are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU. The functional currency of the Company is US Dollar (USD) and amounts in the financial statements are rounded to the nearest thousand USD.

The Group's operating revenues amounted to USD 420.4 million in the year 2016 compared to USD 421.5 million in the previous year. Thus, revenues decreased by USD 1.1 million. Operating expenses amounted to USD 237.2 million in the year 2016 compared to USD 215.5 million in the year 2015. Thus, the Company's operating profit amounted to USD 183.2 million in the year 2016 compared to USD 206.0 million in the previous year.

Landsvirkjun has entered into derivative agreements in order to manage risk. Agreements have been made due to interest rate risk and foreign exchange risk. In addition, derivative agreements have been made in order to hedge risk due to fluctuations of aluminium prices in the global market as a part of revenues is based thereon.

Financial expenses in excess of financial income amounted to USD 63.5 million in the year 2016, compared to USD 80.2 million the previous year. The change between years amounts to USD 16.8 million. The main reason for this difference between years are lower interest expenses, changes in currency exchange differences and fair value changes in derivatives which are mostly unrealised and must be kept in mind in the evaluation of the Company's results for the year. Profit before unrealised financial items amounted to USD 117.7 million during the year compared to USD 130.6 million in the year 2015. According to the income statement, profit for the year amounted to USD 66.8 million compared to USD 84.2 million in the previous year.

Equity at year end 2016 amounted to USD 1,969.1 million compared to USD 1,916.6 million at year end 2015 according to the balance sheet. The Company's Board of Directors propose that the profit for the year will be recognised as an increase in equity. The Company's Board of Directors will during the Annual General Meeting propose a dividend payment to the owners of the Company but otherwise refer to the notes to the financial statements and statement of equity for further changes in equity. Landsvirkjun is a partnership owned by the Icelandic State and Eignarhlutir ehf. The State owns 99.9% in the Company and Eignarhlutir ehf. 0.1%.

Cash and cash equivalents at year end amounted to USD 144.5 million and undrawn Revolving Credit and Loan Facilities amounted to USD 472.4 million. Cash and cash equivalents and undrawn Revolving Credit and Loan Facilities therefore amounted to USD 617.0 million at year end. Cash flow from operations amounted to USD 229.8 million. Landsvirkjun borrowed USD 241.5 million in the year and repaid debt amounting to USD 288.8 million. Cash and cash equivalents increased by USD 2.4 million during the year.

Endorsement by the Board of Directors and CEO, contd.

Corporate Governance

The Board of Directors of Landsvirkjun endeavours to maintain good corporate governance taking into consideration the Guidelines on Corporate Governance issued by the Icelandic Chamber of Commerce in collaboration with the Confederation of Icelandic Employers and Nasdaq OMX Nordic. The Board of Directors has laid down comprehensive guidelines wherein the competences of the Board is defined and its scope of work vis-à-vis the CEO. The Board of Directors has appointed an Audit Committee. In the year 2016, 15 Board meetings were held and 4 meetings in the Audit Committee. Meetings have been attended by the majority of the Board of Directors and the majority of the Audit Committee. According to changes to the Financial Statements Act enacted in June 2016, public interest entities shall provide information necessary for an understanding of the entity's development, performance, position and impact of its activity relating to environmental, social and employee matters, policy regarding human rights, how the entity counteracts corruption and bribery matters, and a brief description of the entity's business model etc. Information on the Company's policy and successes in these matters is provided in an appendix to the financial statements. Further information on the Parent Company's corporate governance and risk management is included in notes 28 to 37 and appendix to the financial statements. Landsnet hf. has disclosed information on corporate governance in an appendix to its financial statements.

Statement by the Board of Directors and the CEO

According to the best knowledge of the Board of Directors and the CEO, the consolidated financial statements are in accordance with International Financial Reporting Standards as adopted by the EU and additional requirements in the Icelandic Financial Statement Act and it is the opinion of the Board of Directors and the CEO that the financial statements give a fair view of the Groups's assets, liabilities and financial position as at 31 December 2016 and the Group's results and changes in cash in the year 2016.

Furthermore, it is the opinion of the Board of Directors and the CEO that the financial statements and the Endorsement by the Board of Directors for the year 2016 give a fair view of the Group's results, financial position and development and describe the main risk factors faced by the Group.

The Board of Directors and the CEO hereby confirm these consolidated financial statements with their signature.

Reykjavik, 28 February 2017.

The Board of Directors:

Jónas Þór Guðmundsson

Jón Björn Hákonarson

Helgi Jóhannesson

Þórunn Sveinbjarnardóttir

Álfheiður Ingadóttir

The CEO:

Hörður Arnarson

Independent Auditors' Report

To the Board of Directors and owners of Landsvirkjun

Opinion

We have audited the consolidated financial statements of Landsvirkjun for the year ended December 31, 2016 which comprise the consolidated statement of comprehensive income, the consolidated statement of financial position, the consolidated statement of changes in equity, the consolidated statement of cash flow for the year then ended and the notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of Landsvirkjun as at December 31, 2016, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and additional requirements in the Icelandic Financial Statement Act.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the consolidated Financial Statements section of our report. We are independent of Landsvirkjun in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and the Icelandic Institute of State Authorized Public Accountants, Code of Ethics (FLE Code) and we have fulfilled our ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key Audit Matters	How the matter was addressed in the audit
Power sales	
<p>More than 70% of Landsvirkjun power sales comes from sales to industry. The revenue is based on delivered power and contractual prices that are based on certain parameters. Due to both the magnitude and variability of prices, we believe that power sales to industry are a key audit matter.</p>	<p>During our audit of power sales to industry we have confirmed that there is an effective internal control at Landsvirkjun regarding calculation and approval of invoices.</p> <p>We have also confirmed calculation of sales prices by comparing the calculation to contractual agreement and public information in addition to comparing delivered power to metering.</p>
Valuation of power stations	
<p>Included in property, plant and equipment are power stations which amount to 2,928 million USD at year-end. Power stations are measured at cost less accumulated depreciation and impairment.</p> <p>We consider the valuation of power stations to be a key audit matter due to their magnitude and management estimation of their expected useful life.</p> <p>As to the valuation of the assets, we refer to fixed assets in note 8 and accounting policies note 49.</p>	<p>We reviewed the impairment test of power stations prepared by management. During our audit we examined the valuation methodology and its consistency with prior year. We also examined management assumption for the valuation. This included:</p> <ul style="list-style-type: none"> • Reviewing the operating plan which is the basis for the valuation. • Reviewing the assumptions for the weighted average cost of capital (WACC) used. <p>We assessed if the valuation's calculations were in accordance with IFRS and assessed that the disclosures were appropriate.</p>

Independent Auditors' Report, contd.

Valuation of transmission

The transmission network of Landsnet, subsidiary of Landsvirkjun, is recognised according to the revaluation method. At year-end its carrying amount was USD 631 million. Transmission network valuation is based on management estimations therefore we consider it to be a key audit matter.

Revaluation is performed on a regular basis and it is measured using a cash flow analysis. The assets were revaluated at year-end 2015 and it is management estimate that there is no basis for revaluation at year-end 2016.

As to the valuation of the assets, we refer to fixed assets in note 8 and accounting policies note 49.

Our audit was focused on management estimations of operating value of transmission lines and substations at the year-end 2016. We examined the valuation methodology and its consistency with prior year. We also examined management assumption for the valuation. This included:

- Reviewing the operating plan which is the basis for the valuation.
- Reviewing the assumptions for the weighted average cost of capital (WACC) used.

We assessed if the valuation's calculations and disclosures were in accordance with IFRS.

We have also examined management assumption related to depreciation methods in accordance with IFRS.

Valuation of development cost

Capitalised development cost consists of future power projects which amount to 141 million USD at year-end 2016.

Valuation of the capitalised development cost is based on management estimation of the future revenue they will generate, that valuation is made with an impairment test. As the valuation of the assets is based on management's estimate we believe that their valuation is a key audit matter.

As to the valuation of the assets, we refer to intangible assets in note 10 and accounting policies note 50.

We reviewed the impairment test of development cost prepared by management. During our audit we examined the valuation methodology and its consistency with prior year. We also examined management assumption for the valuation. This included:

- Reviewing the operating plan which is the basis for the valuation.
- Reviewing the assumptions for the weighted average cost of capital (WACC) used.

We assessed if the valuation's calculations were in accordance with IFRS and assessed that the disclosures were appropriate.

We have also selected a sample from capitalised cost during the year to make sure that it is in compliance with IFRS.

Other information

The Board of Directors and the CEO are responsible for the other information. The other information comprises key figures, the endorsement by the board of directors and CEO, statement of corporate governance and non-financial reporting.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon, except the confirmation regarding report of the board of directors as stated below.

Independent Auditors' Report, contd.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

In accordance with Paragraph 2 article 104 of the Icelandic Financial Statement Act no. 3/2006, we confirm to the best of our knowledge that the accompanying report of the board of directors includes all information required by the Icelandic Financial Statement Act that is not disclosed elsewhere in the financial statements.

Responsibilities of the Board of Directors and CEO for the Consolidated Financial Statements

The Board of Directors and the CEO are responsible for the preparation and fair presentation of the consolidated financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and additional requirements in the Icelandic Financial Statement Act, and for such internal control as the Board of Directors and the CEO determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the Board of Directors and the CEO are responsible for assessing Landsvirkjun's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Board of Directors and the CEO either intends to liquidate the company or to cease operations, or has no realistic alternative but to do so.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Landsvirkjun's internal control.

Independent Auditors' Report, contd.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated and separate financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with the Board of Directors and the Audit Committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Board of Directors and the Audit Committee with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Board of Directors and the Audit Committee, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Reykjavik, 28 February 2017.

Deloitte ehf.

Þorsteinn Pétur Guðjónsson
State Authorized Public Accountant

Lárus Finnbogason
State Authorized Public Accountant

Income Statement for the year 2016

	Notes	2016	2015
Operating revenues			
Power sales		347,865	349,598
Realised aluminium hedges		4,890	10,956
Transmission		64,545	57,908
Other income		3,070	2,990
		<u>420,370</u>	<u>421,452</u>
Operating expenses			
Energy production costs		134,094	126,310
Transmission costs		56,736	42,028
Cost of general research		10,144	13,449
Other operating expenses		36,227	33,699
		<u>237,201</u>	<u>215,486</u>
Operating profit	3	<u>183,169</u>	<u>205,966</u>
Financial income and (financial expenses)			
Interest income		3,323	3,473
Interest expense		(61,943)	(73,425)
Foreign exchange difference		(24,739)	44,190
Fair value changes in embedded derivatives	30	21,164	(59,925)
Fair value changes in other derivatives		(1,269)	5,466
	6	<u>(63,464)</u>	<u>(80,220)</u>
Associated companies	13	(5,448)	(1,921)
Profit before income tax		114,257	123,825
Income tax	7	(47,437)	(39,652)
Net profit for the year		<u>66,820</u>	<u>84,173</u>
Attributable to:			
Owners of the Parent Company		71,394	73,445
Minority interest in subsidiaries		(4,574)	10,728
		<u>66,820</u>	<u>84,173</u>

Notes 1 to 57 are an integral part of these financial statements.

Statement of Comprehensive Income for the year 2016

	2016	2015
Net profit for the year	66,820	84,173
Items that will not be reclassified subsequently to profit or loss		
Pension obligation after income tax, change	(3,110)	(1,795)
Revaluation of transmission	0	180,737
Income tax effects of revaluation of transmission	0	(36,147)
Other items	0	(50)
Items that may be reclassified subsequently to profit or loss		
Translation difference due to subsidiaries and associated companies	2,023	(3,980)
Total operating items moved to equity	(1,087)	138,765
Total Comprehensive Income for the year	<u>65,733</u>	<u>222,938</u>
Total Comprehensive Income attributable to:		
Owners of the Parent Company	70,008	162,185
Minority interest in subsidiaries	(4,275)	60,753
	<u>65,733</u>	<u>222,938</u>

Notes 1 to 57 are an integral part of these financial statements.

Balance Sheet as at 31 December 2016

Assets	Notes	2016	2015
Non-current assets			
Property, plant and equipment	8	3,614,704	3,685,410
Projects under construction	9	282,318	134,146
Development cost	10	141,401	141,799
Other intangible assets	10	48,701	48,469
Derivative financial instruments	12	9,528	2,915
Associated companies	13	10,619	13,401
Other non-current assets	14	150	5,795
Deferred tax asset	7	0	34,733
Total non-current assets		<u>4,107,421</u>	<u>4,066,668</u>
Current assets			
Inventories	16	5,101	4,582
Accounts receivables and other receivables	17	72,599	64,472
Derivative financial instruments	12	3,209	6,854
Cash and cash equivalents	18	144,534	142,127
Total current assets		<u>225,443</u>	<u>218,035</u>
Total assets		<u><u>4,332,864</u></u>	<u><u>4,284,703</u></u>
Equity and liabilities			
Equity			
Owners' contributions	19	586,512	586,512
Revaluation account	20	175,712	182,553
Restricted reserves	20	1,039	0
Translation difference	20	(41,120)	(42,844)
Other equity		1,138,169	1,076,224
Equity of the owners of the Parent Company		<u>1,860,312</u>	<u>1,802,445</u>
Minority interest		108,776	114,189
Total equity		<u>1,969,088</u>	<u>1,916,634</u>
Long term liabilities			
Interest bearing liabilities	21	1,883,049	1,890,556
Pension fund obligation	23	35,383	27,663
Deferred income tax liability	7	54,517	57,553
Obligation due to demolition	24	7,023	6,997
Prepaid income		2,862	2,936
Derivative financial instruments	12	33,690	67,044
		<u>2,016,524</u>	<u>2,052,749</u>
Current liabilities			
Accounts payable and other payables	25	82,753	58,342
Interest bearing liabilities	22	221,982	236,982
Income tax payable	7	14,121	7,895
Derivative financial instruments	12	28,396	12,101
		<u>347,252</u>	<u>315,320</u>
Total liabilities		<u>2,363,776</u>	<u>2,368,069</u>
Total equity and liabilities		<u><u>4,332,864</u></u>	<u><u>4,284,703</u></u>

Notes 1 to 57 are an integral part of these financial statements.

Statement of Equity for the year 2016

	Owners' contribution	Revaluation account	Restricted reserves	Translation difference	Other equity	Equity attributable to the owners of the Parent Company	Minority interest	Total equity
Changes in equity year 2015								
Equity at 1 January 2015.....	586,512	91,845	0	(39,786)	1,012,718	1,651,289	53,435	1,704,724
Revaluation of Transmission .		116,991				116,991	63,746	180,737
Income tax effects of revaluation		(23,398)				(23,398)	(12,749)	(36,147)
Translation difference.....				(3,058)		(3,058)	(922)	(3,980)
Other items						0	(50)	(50)
Pension obligation, change....					(1,795)	(1,795)		(1,795)
Net profit for the year.....					73,445	73,445	10,728	84,173
Total Comprehensive Income		93,593	0	(3,058)	71,650	162,185	60,753	222,938
Revaluation transferred to other equity.....		(2,885)			2,885	0	0	0
Dividend paid to owners.....					(11,029)	(11,029)	0	(11,029)
Equity at 31 December 2015..	586,512	182,553	0	(42,844)	1,076,224	1,802,445	114,189	1,916,634
Changes in equity year 2016								
Equity at 1 January 2016	586,512	182,553	0	(42,844)	1,076,224	1,802,445	114,189	1,916,634
Translation difference				1,724		1,724	299	2,023
Pension obligation, change....					(3,110)	(3,110)		(3,110)
Net profit for the year					71,394	71,394	(4,574)	66,820
Total Comprehensive Income		0	0	1,724	68,284	70,008	(4,275)	65,733
Share of profit of subsidiaries and associated companies....			1,039		(1,039)	0	0	0
Revaluation transferred to other equity.....		(6,841)			6,841	0	0	0
Dividend paid to owners.....					(12,141)	(12,141)	(1,138)	(13,279)
Equity at 31 December 2016 .	586,512	175,712	1,039	(41,120)	1,138,169	1,860,312	108,776	1,969,088

Notes 1 to 57 are an integral part of these financial statements.

Statement of Cash Flow for the year 2016

	2016	2015
Operating activities		
Operating profit	183,169	205,966
Adjustments for:		
Depreciation and impairment loss	118,571	115,554
Pension obligation, change	(1,356)	(963)
Obligation due to demolition, change	26	659
Other changes	(135)	(71)
Working capital from operation before financial items	300,275	321,145
Operating assets, change	(7,981)	10,620
Operating liabilities, change	3,105	3,128
Cash flow from operating activities before financial items	295,399	334,893
Interest income received	2,016	3,464
Interest expenses and foreign exchange difference paid	(58,870)	(83,870)
Taxes paid	(8,718)	(5,532)
Cash flow from operating activities	229,827	248,955
Investing activities		
Power stations in operation	(14,205)	(7,983)
Power stations under construction	(102,632)	(28,509)
Transmission	(45,208)	(29,517)
Power plant preparation cost	(6,831)	(9,546)
Purchased shares in other companies	(106)	(106)
Dividend received from associated companies	12	84
Other capital expenditure	(6,627)	(5,830)
Assets sold	2,048	316
Other receivables, change	1,272	3,605
Investing activities	(172,277)	(77,486)
Financing activities		
Dividend paid to owners	(13,279)	(11,029)
New loans	241,480	108,534
Amortisation of long-term debt	(288,842)	(332,970)
Currency swaps	1,336	0
Financing activities	(59,305)	(235,465)
Change in cash and cash equivalents	(1,755)	(63,996)
Effect of exchange difference on cash and cash equivalents	4,162	(947)
Cash and cash equivalents at the beginning of the year	142,127	207,070
Cash and cash equivalents at the end of the year	144,534	142,127

Notes 1 to 57 are an integral part of these financial statements.

Notes

General Information

1. Landsvirkjun

Landsvirkjun is a partnership having its place of business in Iceland and its headquarters at Háaleitisbraut 68, Reykjavik. Landsvirkjun operates on the basis of the Act on Landsvirkjun No. 42/1983. The Company's objective is to engage in operations in the energy sector. The financial statements include the consolidated financial statements of the Company and its subsidiaries (referred to as "the Group") and share of profit or loss of associated companies.

2. Basis of preparation

a. Statement of IFRS compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and additional requirements in the Icelandic Financial Statement Act.

The Company's Board of Directors approved the financial statements on February 28 2017.

Note 40 includes information on the Group's significant accounting policies and changes therein in the year.

b. Basis of measurement

The financial statements have been prepared on the historical cost basis except for the following assets and liabilities, which have been measured at fair value; derivative financial instruments, trading financial assets and shares in other companies. Operating assets and assets held for sale are recognised at the lower of book value or fair value. Operating assets of the subsidiaries Landsnet hf. and Orkufjarskipti hf. are recognised at revalued cost. The transmission network of the subsidiary Landsnet hf. was revalued during the year 2015, see note 8.

c. Presentation and functional currency

The financial statements are presented in USD, which is the Parent Company's functional currency. All financial information presented in USD has been rounded to the nearest thousand, unless otherwise stated.

d. Management's use of estimate and judgements

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis and the effect of the changes are entered in the periods that the changes are made and in subsequent periods if the change also affects those periods.

Information on management's estimates and decisions made in relation to the application of accounting methods that significantly affect the financial statements are presented in the following notes:

- notes 8 and 49 property, plant and equipment
- notes 10 and 50 intangible assets
- notes 12, 28, 30, 31, 32 derivative financial instruments
- notes 7 and 48 income tax
- note 23 pension fund obligations

Notes, contd.,

2. Basis of preparation, contd.

e. Determination of fair value

The Group's accounting policies and disclosures can require measurement of fair values, for both financial and non-financial assets and liabilities.

To the extent possible the Group uses market information in determining fair values but if such information is not available management's evaluation is used.

For derivatives, other than embedded derivatives, counterparty information is used where applicable to measure fair values. Then treasury division compares this to its own assessment and confirms that such valuations meet the requirements of IFRS, including the level in the fair value hierarchy in which such valuations should be classified.

Fair values are categorised into different levels in the fair value hierarchy based on assumptions used in the valuation techniques as follows.

- Level 1; quoted prices in active markets for identical assets or liabilities.
- Level 2; assumptions based on other than quoted prices included in Level 1 that can be acquired for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3; assumptions for value of asset or liability that are not based on available market data.

If the assumptions used to measure fair value of an asset or a liability might be categorised in different levels of the fair value hierarchy, the fair value measurement is categorised in the lowest level.

If the categorisation of fair value during the accounting period changes it is transferred between levels at the end of the period.

Further information on the assumptions made in measuring fair values is included in the following notes:

- note 12 derivative financial instruments
- note 30 embedded derivatives
- note 35 long-term debt
- note 49 property, plant and equipment

3. Segment reporting

Segment information is presented according to the nature of the operation and is based on the Group's organisation and internal disclosure.

Landsvirkjun Group's operating segments are specified as follows:

Electricity production

The parent company's operations fall under the segment electricity production but Landsvirkjun's objective according to law is to operate in the energy sector and operate other business and financial operations according to the decision of the Board of Directors at each time. Landsvirkjun's electricity production is based on hydroelectric power and geothermal heat. Landsvirkjun sells all its electricity production in Iceland, on the one hand to retail sales companies, and on the other to energy intensive industrial users. Furthermore, the operation of Icelandic Power Insurance Ltd. falls under this segment. The purpose of Icelandic Power Insurance Ltd. is to take care of insurances for Landsvirkjun's power stations.

Electricity transmission

The operations of Landsnet hf. fall under the segment electricity transmission, but the company was established in August 2004 on the basis of the Energy Act approved by the Parliament in spring 2003. The purpose of Landsnet hf. is to operate an electricity transmission network and system management in Iceland according to provisions of Chapter III of the Energy Act No. 65/2003 and may thus not carry out other operations than are necessary in order to fulfill its obligations according to the Energy Act.

Notes, contd.,

3. Segment reporting, contd.

Other segments

Other segments include the operations of Orkufjarskipti hf. and Landsvirkjun Power ehf., together with the latter company's subsidiary. The purpose of Orkufjarskipti hf. is to own and operate a telecommunications system which is necessary for the shareholders' electricity operations throughout the country and to rent access thereto in accordance with availability and law. Landsvirkjun Power ehf. takes care of sales of technical and operational advisory services to third parties and general research work, harnessing researches and projects for Landsvirkjun and related companies.

Almost all the operations of the Group are based in Iceland.

Operating segments year 2016	Electricity production	Electricity transmission	Other segments	Adjustments	Total
Income from third party	353,961	64,910	1,499	0	420,370
Income within the Group	14,904	64,832	4,294	(84,030)	0
Segment income	368,865	129,742	5,793	(84,030)	420,370
Segment operating expenses	(147,951)	(50,602)	(4,107)	84,030	(118,630)
EBITDA	220,914	79,140	1,686	0	301,740
Depreciation and impairment loss ..	(88,501)	(29,450)	(1,032)	412	(118,571)
Segment earnings, EBIT	132,413	49,690	654	412	183,169
Segment assets 2016	3,975,620	764,155	21,346	(438,877)	4,322,244
Associated companies	10,395	6,662	225	(6,663)	10,619
Total assets 2016	3,986,015	770,817	21,571	(445,540)	4,332,863
Segment liabilities 2016	2,106,828	462,407	4,462	(209,921)	2,363,776
Total liabilities 2016	2,106,828	462,407	4,462	(209,921)	2,363,776
Investing activities	125,486	48,243	1,775	0	175,504
Operating segments year 2015					
Income from third party	360,819	58,395	2,238	0	421,452
Income within the Group	16,532	64,340	3,453	(84,325)	0
Segment income	377,351	122,735	5,691	(84,325)	421,452
Segment operating expenses	(135,530)	(44,415)	(4,312)	84,325	(99,932)
EBITDA	241,821	78,320	1,379	0	321,520
Depreciation and impairment loss ..	(92,868)	(22,164)	(935)	413	(115,554)
Segment earnings, EBIT	148,953	56,156	444	413	205,966
Segment assets 2015	4,011,643	788,999	17,924	(547,264)	4,271,301
Associated companies	13,072	5,610	329	(5,610)	13,401
Total assets 2015	4,024,715	794,609	18,253	(552,874)	4,284,703
Segment liabilities 2015	2,203,621	470,852	3,701	(310,105)	2,368,069
Total liabilities 2015	2,203,621	470,852	3,701	(310,105)	2,368,069
Investing activities	47,417	33,044	924	0	81,385

4. Total number of employees

Total number of employees is specified as follows:	2016	2015
Average number of employees during the year, full-time equivalents	450	427
Full-time equivalent units at year-end	402	378

Notes, contd.,

5. Total salaries of employees

Total salaries of employees are specified as follows:	2016	2015
Salaries	44,151	36,755
Contribution to defined contribution plans	5,762	4,638
Defined pension benefit payments	2,218	1,582
Other change in pension obligations	(1,356)	(963)
Other salary related expenses	4,323	3,591
	<u>55,098</u>	<u>45,603</u>

Salaries and salary related expenses are allocated as follows in the income statement:

Energy production costs	18,131	14,717
Transmission costs	10,605	9,321
Other operating expenses	26,362	21,564
	<u>55,098</u>	<u>45,603</u>

Salaries of the Boards of Directors, CEO, Deputy CEO and Executive Directors are specified as follows:

Salaries of the Board of Directors of the parent company	127	104
Salaries of the Boards of Directors of two subsidiaries (same as in 2015)	103	87
Salaries and benefits of the CEO of the parent company	204	167
Salaries of five Directors and the Deputy CEO (same as in 2015)	1,354	1,151
Salaries and benefits of the CEO and 6 Man. Dir. of subsid. (same as at year end 2015) ..	1,124	692

6. Financial income and (expenses)

Financial income and (expenses) are specified as follows:

Interest income	3,323	3,473
Interest expenses	(58,647)	(63,826)
Guarantee fee	(9,025)	(10,322)
Indexation	(4,306)	(4,549)
Capitalised interest costs	10,035	5,272
Total interest expenses	(61,943)	(73,425)
Realised foreign exchange difference	(1,425)	(3,467)
Unrealised foreign exchange difference	(23,314)	47,657
Total foreign exchange difference	(24,739)	44,190
Fair value changes in embedded derivatives	21,164	(59,925)
Fair value changes in other derivatives	(1,269)	5,466
Total financial income and (expenses)	(63,464)	(80,220)

Capitalised finance cost amounted to 4.4% (2015: 5.0%) of invested cash in power stations under construction in the year 2016 and 6.5% (2015: 5.7%) of invested cash in transmission under construction.

Notes, contd.,

7. Income tax

Income tax is specified as follows:			2016	2015
Change in income tax asset / liability .....	(	31,697)	(	65,857)
Income tax payable .....	(	14,121)	(	7,895)
Income tax recognised among comprehensive income .....	(	1,749)		35,137
Foreign exchange and translation difference		149		22
Adjustments relating to subsidiaries .....	(	20)	(	1,060)
Income tax expensed .....	(	47,437)	(	39,652)

Effective tax rate		2016		2015
Profit for the year		66,820		84,173
Income tax for the year		47,437		39,652
Profit before income tax		114,257		123,825
Income tax acc. to the parent company's tax rate	36.0%	41,132	36.0%	44,577
Effect of different tax rates within the Group	2.0%	2,278	(5.2%)	(6,406)
Non-taxable and non-deductible items	1.9%	2,207	0.7%	904
Other items	1.6%	1,819	0.5%	576
Effective income tax	41.5%	47,437	32.0%	39,652

Income tax due to items recognised in other comprehensive income is specified as follows:			2016	2015
Income tax due to pension obligation recognised in other comprehensive income .....	(	1,749)	(	1,010)
Income tax effects of revaluation of operating assets of subsidiary		0		36,147
	(	1,749)		35,137

Changes in the tax asset / liability during the year is specified as follows:

		Deferred tax asset		Deferred tax liability	
		2016	2015	2016	2015
Balance at the beginning of the year		34,733	65,012	(57,553)	(21,975)
Change in temporary difference .....	(	23,247)	(20,455)	3,100	(36,123)
Change in carry forward loss .....	(	11,486)	(9,480)	85	87
Foreign exchange and translation difference		0	(344)	(149)	458
Balance at year end		0	34,733	(54,517)	(57,553)

The Group's deferred tax asset / liability is specified as follows:

Carry forward loss	0	11,486	218	111
Non-current assets and intangible assets	0	12,127	(77,405)	(58,840)
Derivative financial instruments	0	19,510	12,348	0
Other items	0	(8,390)	10,322	1,176
Balance at year end	0	34,733	(54,517)	(57,553)

The Group's carry forward tax losses may be utilised for 10 years from when it is incurred and are specified as follows:

Carry forward loss of the year 2009, usable until the year 2019	0	10,924
Carry forward loss of the year 2010, usable until the year 2020	0	866
Carry forward loss of the year 2011, usable until the year 2021	0	851
Carry forward loss of the year 2012, usable until the year 2022	0	8,795
Carry forward loss of the year 2013, usable until the year 2023	17	15
Carry forward loss of the year 2014, usable until the year 2024	128	10,551
Carry forward loss of the year 2015, usable until the year 2025	492	482
Carry forward loss of the year 2016, usable until the year 2026	455	-
Carry forward loss at year end	1,091	32,484

Deferred tax asset is recognised as assets as management considers it likely that it will be utilised against future taxable profit. Carry forward loss is recognised in Icelandic krona and, therefore, the exchange rate of the USD affects the carry forward loss at each year end.

Notes, contd.,

8. Property, plant and equipment

Property, plant and equipment is specified as follows:

	Power stations	Trans- mission	Communi- cation equipment	Other assets	Total
Cost value					
Total value at 1.1.2015	5,056,462	615,108	19,630	70,292	5,761,492
Effect of exchange rate changes	0 (	9,416) (	395) (	682) (	10,493)
Revaluation of transmission	0	242,562	0	0	242,562
Additions during the year	8,044	6,086	742	1,969	16,841
Transferred from projects under construction	0	8,498	0	0	8,498
Sold and disposed of	0	0	(20) (	900) (	920)
Total value at 31.12.2015	5,064,506	862,838	19,957	70,679	6,017,980
Effect of exchange rate changes	0	0	3,079	40	3,119
Additions during the year	14,926	4,467	1,628	2,221	23,242
Transferred from projects under construction	0	21,678	0	0	21,678
Sold and disposed of	0	0	(11) (	1,250) (	1,261)
Total value at 31.12.2016	5,079,432	888,983	24,653	71,690	6,064,758
Depreciation and impairment loss					
Total value at 1.1.2015	1,978,955	149,506	5,812	27,557	2,161,830
Revaluation of transmission	0	64,923	0	0	64,923
Effect of exchange rate changes	0 (	2,761) (	104) (	184) (	3,049)
Depreciation for the year	86,342	19,237	939	3,086	109,604
Sold and disposed of	0	0	(18) (	720) (	738)
Total value at 31.12.2015	2,065,297	230,905	6,629	29,739	2,332,570
Effect of exchange rate changes	0	0	1,058	2	1,060
Depreciation for the year	86,363	27,272	1,042	2,866	117,543
Sold and disposed of	0	0	0	(1,119) (	1,119)
Total value at 31.12.2016	2,151,660	258,177	8,729	31,488	2,450,054
Book value					
1.1.2015	3,077,507	465,602	13,818	42,735	3,599,661
31.12.2015	2,999,209	631,933	13,328	40,940	3,685,410
31.12.2016	2,927,772	630,806	15,924	40,202	3,614,704
Book value without revaluation					
1.1.2015	3,077,507	362,561	13,084	42,735	3,495,887
31.12.2015	2,999,209	355,696	12,719	40,940	3,408,564
31.12.2016	2,927,772	367,655	15,305	40,202	3,350,934

Official assessment of fixed assets and insurance value

The official assessment of the Company's real estates amounted to USD 426 million at year end 2016 (2015: USD 330 million). Insurance value of the Company's assets amounts to USD 4,607 million (2015: USD 4,731 million) and catastrophe insurance value amounts to USD 996 million (2015: USD 850 million).

Notes, contd.,

8. Property, plant and equipment, cont.:

Assumptions relating to the revaluation of property, plant and equipment

In accordance with the provision of IFRS the Group's transmission network and communication equipment were revalued during the year 2008 and powerlines and connection masts of Landsnet hf. at year end 2015. Two methods were applied when performing the revaluation. On one hand it is done by looking at the assets' replacement cost which was calculated by independent experts at the beginning of the year 2015 and projected to the end of the year 2015. On the other hand the value of the asset in operation is calculated by cash flow analysis. The forecast period was from the year 2016 until 2025 and after that terminal value of the operation was calculated. The revaluation was based on operational value of the current assets and assumed the investments would be equal to depreciations of current assets. Discounting of future cash flows was based on the weighted average cost of capital (WACC) which is allocated to Landsnet hf. for mass users and distributors. The revaluation is classified at level 3 in the fair value hierarchy.

9. Projects under construction

Projects under construction are specified as follows:

	2016	2015
Balance at 1.1.	134,146	6,377
Effect of exchange rate changes	0	160
Transferred from development costs	8,090	78,846
Additions during the year	161,760	57,261
Transferred to property, plant and equipment	(21,678)	(8,498)
Balance at 31.12.	<u>282,318</u>	<u>134,146</u>

10. Development cost and other intangible assets

Development cost and other intangible assets are specified as follows:

	Capitalised development costs	Water and geothermal rights	Software	Total
Cost value				
Total value at 1.1.2015	288,179	45,611	9,038	342,828
Effect of exchange rate changes	(254)	0	(75)	(329)
Additions during the year	13,290	0	647	13,937
Transf. to projects under construction	(83,907)	0	0	(83,907)
Sold and disposed of	0	0	(302)	(302)
Total value at 31.12.2015	<u>217,308</u>	<u>45,611</u>	<u>9,308</u>	<u>272,227</u>
Additions during the year	7,961	0	991	8,952
Transf. to projects under construction	(8,090)	0	0	(8,090)
Sold and disposed of	0	0	(267)	(267)
Total value at 31.12.2016	<u>217,179</u>	<u>45,611</u>	<u>10,032</u>	<u>272,822</u>
Depreciation and impairment loss				
Total value at 1.1.2015	75,385	0	6,105	81,490
Effect of exchange rate changes	(71)	0	(46)	(117)
Amortisation during the year	0	0	693	693
Impairment loss during the year	5,257	0	0	5,257
Sold and disposed of	0	0	(302)	(302)
Transf. to projects under construction	(5,061)	0	0	(5,061)
Total value at 31.12.2015	<u>75,510</u>	<u>0</u>	<u>6,450</u>	<u>81,960</u>
Amortisation during the year	0	0	759	759
Impairment loss during the year	269	0	0	269
Sold and disposed of	0	0	(267)	(267)
Total value at 31.12.2016	<u>75,779</u>	<u>0</u>	<u>6,942</u>	<u>82,721</u>

Notes, contd.,

10. Development cost and other intangible assets, contd.:

Book value

1.1.2015	212,794	45,611	2,935	261,339
31.12.2015	141,799	45,611	2,858	190,269
31.12.2016	141,401	45,611	3,090	190,102

Development cost is reviewed every year by management and checked whether there are indications of impairment. In testing for possible impairment the Parent Company's forecast on expected cash flow over the useful life of the assets was used. In the evaluation expected cash flow was discounted with the rate of 5.3% (2015: 5.0%) of weighted average required rate of return. If management concludes that impairment has occurred the relevant development cost is expensed as impairment.

11. Depreciation and impairment loss

The Group's depreciation and impairment is specified as follows:

	2016	2015
Power stations	86,363	86,342
Transmission	27,272	19,237
Telecommunication equipment	1,042	939
Other assets	2,866	3,086
Depreciation of assets in operation	117,543	109,604
Impairment loss on development cost	269	5,257
Amortisation of software	759	693
	<u>118,571</u>	<u>115,554</u>

The Group's depreciation and impairment is allocated as follows by sectors:

Energy production costs	87,236	87,100
Transmission costs	28,241	20,905
Cost of general research	0	4,486
Other operating expenses	3,094	3,063
	<u>118,571</u>	<u>115,554</u>

12. Derivative financial instruments

Derivative financial instruments in the balance sheet are specified as follows:

Assets:

Embedded derivatives in electricity sales agreements	4,858	3,047
Aluminium hedges	2,854	6,722
Currency swaps	5,025	0
	<u>12,737</u>	<u>9,769</u>

Derivative financial instruments are divided as follows:

Long-term component of derivative agreements	9,528	2,915
Short-term component of derivative agreements	3,209	6,854
	<u>12,737</u>	<u>9,769</u>

Liabilities:

Embedded derivatives in electricity sales agreements	35,908	55,261
Aluminium hedges	2,651	1,755
Currency swaps	20,164	14,929
Interest rate swaps	3,363	7,200
	<u>62,086</u>	<u>79,145</u>

Notes, contd.,

12. Derivative financial instruments, contd.

Derivative financial instruments are divided as follows:	2016	2015
Long-term component of derivative agreements	33,690	67,044
Short-term component of derivative agreements	28,396	12,101
	<u>62,086</u>	<u>79,145</u>

The assumptions for valuation of embedded derivatives are discussed in note 30.

The fair value of other derivatives than embedded derivatives is based on Landsvirkjun's evaluation and available evaluation of counterparties where applicable and verified by the treasury department with comparative calculations based on market information.

13. Associated companies

Shares in associated companies recognised according to the equity method are specified as follows:

		2016	
	Share	Share in return	Book value
Farice ehf., Kópavogur, Iceland	33.2%	(5,339)	9,999
SER eignarhaldsfélag ehf., Reykjavík, Iceland	35.4%	21	381
Sjávarorka ehf., Reykjavík, Iceland	33.6%	(4)	15
LP-Verkis, Georgia	40.0%	10	47
Hecla SAS, France	28.5%	(136)	177
		<u>(5,448)</u>	<u>10,619</u>
		2015	
	Share	Share in return	Book value
Farice ehf., Kópavogur, Iceland	28.9%	(1,952)	12,842
SER eignarhaldsfélag ehf., Reykjavík, Iceland	34.9%	24	214
Sjávarorka ehf., Reykjavík, Iceland	33.6%	(17)	16
Hecla SAS, France	28.5%	24	329
		<u>(1,921)</u>	<u>13,401</u>

14. Other non-current assets

Other long-term assets in the balance sheet are specified as follows:

Shares in other companies	150	128
Long-term receivables	0	5,667
	<u>150</u>	<u>5,795</u>

15. Landsvirkjun's subsidiaries

Landsvirkjun's subsidiaries are specified as follows:

		Share
Icelandic Power Insurance Ltd., Bermuda	100.0%	100.0%
Landsnet hf., Reykjavík, Iceland	64.7%	64.7%
Landsvirkjun Power ehf., Reykjavík, Iceland	100.0%	100.0%
Orkufjarskipti hf., Reykjavík, Iceland	100.0%	100.0%

16. Inventories

Inventories are specified as follows:

Spare parts and consumables	5,101	4,582
	<u>5,101</u>	<u>4,582</u>

Notes, contd.,

17. Accounts receivables and other receivables

Accounts receivables and other receivables are specified as follows:	2016	2015
Accounts receivables	60,512	52,808
Other short term receivables	12,087	11,664
	<u>72,599</u>	<u>64,472</u>

At year-end 2016, 85% of accounts receivables were under 30 days old (2015: 95%).

18. Cash and cash equivalents

Cash and cash equivalents are specified as follows:

Bank deposits	141,568	91,712
Market securities	2,966	50,415
	<u>144,534</u>	<u>142,127</u>

19. Equity

The Parent Company is a partnership owned by the Icelandic State and Eignarhlutir ehf. The Icelandic State owns 99.9% in the Company and Eignarhlutir ehf. 0.1%. Eignarhlutir ehf. is owned by the State. Landsvirkjun is an independent taxable entity. The Group's equity ratio at year end 2016 was 45.4% compared to 44.7% at year end 2015.

20. Revaluation account, translation difference and reserves

The revaluation account consists of the revaluation of transmission network and telecommunication equipment after income tax effect. Translation difference is the foreign exchange difference arising due to Landsvirkjun's subsidiaries and associated companies with other functional currencies than the Parent Company's. Reserves contain shares in the profit of subsidiaries and associated companies which are in excess of paid dividends from these entities in the year.

21. Liabilities

Interest bearing long term debt is specified as follows by currencies:

	Maturity date	2016 Average interest	Remaining balance	2015 Average interest	Remaining balance
Liabilities in ISK	2017-2034	3.8%	269,815	3.8%	230,643
Liabilities in CHF	2017-2022	0.0%	31,661	0.0%	38,364
Liabilities in EUR	2017-2026	0.6%	483,486	0.6%	548,376
Liabilities in USD	2017-2035	2.9%	1,320,069	2.4%	1,310,155
			<u>2,105,031</u>		<u>2,127,538</u>
Current maturities of long-term debt			(221,982)		(236,982)
Total long-term debt			<u>1,883,049</u>		<u>1,890,556</u>

Interest rate terms on loans of the parent company at year end were 0.0-5.6%. Nominal interest rates for the period were on average 3.3% (2015: 3.3%), taking into account the state guarantee fee.

The Company's payments due to guarantees for long-term loans are calculated according to the Act No. 121/1997 on state guarantees.

Notes, contd.,

22. Maturities of long-term debt

According to loan agreements, maturities of long-term debt are as follows:

	2016	2015
2016	-	236,982
2017	221,982	226,566
2018	274,547	324,791
2019	183,256	184,594
2020	304,833	266,876
2021	205,636	-
Later	914,777	887,729
	<u>2,105,031</u>	<u>2,127,538</u>

23. Pension fund obligations

The Company's obligation to refund the indexation charges on retirement payments to current and former employees, which hold pension rights with state and communal pension funds amounted to USD 35.4 million at year end 2016 according to an actuary's evaluation, which is based on estimated future changes in salaries and prices. Interest rates in excess of price increase are assessed at 3.5% and salary increase in excess of price increase is assessed at 1.5% per year on average. Premises on life expectancy and mortality are in accordance with the provisions of Regulation No. 391/1998 on obligatory pension benefits and operation of pension funds. The calculated retirement age is 68 years for current employees and 65 years for non-employees with vested benefits. This is consistent with criterion used by the Pension Fund for State Employees.

Change in the obligation is specified as follows:	2016	2015
Balance at 1.1.	27,663	26,345
Expensed during the year	825	610
Payments during the year	(2,181)	(1,573)
Actuarial change	4,859	2,805
Effect of foreign exchange rate changes	4,217	(524)
Balance at 31.12.	<u>35,383</u>	<u>27,663</u>

Pension fund obligation, 5 year statem:	2016	2015	2014	2013	2012
Present value of the obligation	<u>35,383</u>	<u>27,663</u>	<u>26,345</u>	<u>27,007</u>	<u>23,228</u>

24. Obligation due to demolition

Change in the obligation due to demolition is specified as follows:

	2016	2015
Balance at 1.1.	6,997	6,460
Reversal of discount in the year	26	659
Effect of foreign exchange rate changes	0	(122)
Balance at 31.12.	<u>7,023</u>	<u>6,997</u>

In accordance with IFRS, the initial value of fixed operating assets shall include estimated cost of their demolition after their use. Estimated demolition cost of power lines has been assessed and discounted on the basis of the useful life. In return, an obligation has been written up among long-term liabilities. A change in the obligation is recognised in the income statement amounting to the discounted value.

Notes, contd.,

25. Accounts payable and other payables

Accounts payable and other payables are specified as follows:	2016	2015
Accounts payable	45,662	24,708
Accrued interests	16,846	14,229
Other short term liabilities	20,245	19,404
	<u>82,753</u>	<u>58,342</u>

26. Related parties

Definition of related parties

Owners, associated companies, members of Boards of Directors, key management and companies and institutions owned by them are among the Company's related parties.

Transactions with related parties	2016	2015
<i>Other income</i>		
Associated companies	80	29
<i>Interest income</i>		
Associated companies	925	0
<i>Expenses</i>		
Associated companies	0	0
<i>Receivables</i>		
Associated companies	80	0

Transactions with related parties are on the same basis as transactions with non-related parties. Transactions with the State or companies or institutions owned by the State are not specified as a separate item but such transactions are comparable to as transactions with non related parties. The Group applies an exemption from disclosure requirements of IAS 24 as the Parent Company is owned by the State. See further information in note 19.

27. Fees to auditors

Fees to auditors of the Group in the year 2016 amounted to USD 263 thousand (2015: USD 283 thousand), whereof USD 173 thousand (2015: USD 156 thousand) was for the audit of financial statements.

Notes, contd.,

28. Risk management

The Company's Board of Directors has approved a risk management policy, which is based on the following factors:

- That risk is defined and its origin is known
- Generally accepted methods are used in evaluating risk
- Management is in accordance with authorisations
- Effective monitoring of risk factors is ensured
- That information provided to the executive risk committee and the Board of Directors is comprehensive and provided on a regular basis

The Company has implemented a formal process in risk management in order to identify the most important factors. Management and key employees of Landsvirkjun identify financial and non-financial risks for Landsvirkjun and evaluate their significance. The results are recorded in the Company's risk register and used to decide on appropriate action and management, with respect to possible effects on image, financial position, health and safety, environment and compliance.

The Board of Directors appoints the board risk committee which confirms the effectiveness of the Company's risk management and assists the Board with supervision of key risks and the Company's actions in managing risks.

The Company's executive risk committee revalues and approves processes relating to the Company's risk management. It is a venue for consultation regarding risk management and ensures that the Company operates in accordance with risk policy. The executive risk committee consists of the CEO, Deputy CEO and CFO. The CEO is chairman of the executive risk committee.

29. Financial risk

The treasury function is entrusted with analysing, managing and providing information regarding Landsvirkjun's financial risks. The Company's financial risk is divided into market risk, liquidity risk and counterparty risk, but the Company's market risk consists mainly of three risk categories:

- Aluminium price risk due to fluctuations in global market price of aluminium
- Interest rate risk due to the Company's liabilities
- Foreign exchange risk due to liabilities and cash flow

Landsvirkjun has been focused on reducing market risk in the last few years. For this purpose the ratio of USD and fixed interests has been significantly increased. Efforts have been made to reduce the ratio of aluminium linked revenue and an agreement between Landsvirkjun and Norðurál was renewed during the year. The renewed contract will enter into effect in November 2019 and is linked to the market price of electricity on Nord Pool instead of the aluminium price in the current agreement. Furthermore, efforts have been made during the year in renewing framework contracts for derivatives, so called ISDA agreements, and new derivative agreements are executed without state guarantee. Further efforts will be made in the year 2017 in reducing Landsvirkjun's market risk.

The credit rating companies S & P Global Ratings and Moody's upgraded Landsvirkjun's credit rating without state guarantee to investment grade in the year 2016. Financing has been successful, but two new loans without state guarantee were negotiated in relation to the construction of Þeistareykir. One loan agreement was with the European Investment Bank (EIB) amounting to USD 140 million and the other with the Nordic Investment Bank (NIB) amounting to USD 50 million. Landsnet issued a bond amounting to USD 200 million and the company's functional currency is USD. Half of Landsnet's bond was paid out in December and the other half will be paid out in March 2017. Landsnet negotiated in the year 2016 a credit line with Landsbankinn amounting to USD 50 million. The maturity profile, strong liquidity and access to loans secure the Company's liquidity at least until year-end 2018.

Notes, contd.,

30. Aluminium price risk

The Company is exposed to market risk due to possible aluminium price fluctuations as about one fourth of its income is linked to aluminium prices. Thus, the Company has entered into derivative agreements in order to secure its income base and reduce fluctuations. Such agreements consist in most cases of fixing aluminium price at a certain level. Therefore, the Company can lose income if the aluminium price goes up, but at the same time guarantees income should aluminium prices come down. Around 50% of 2017 estimated cash flow and 12% of 2018 estimated cash flow has been hedged. At year end 2016, fair value of the hedges was positive by USD 0.2 million (2015: USD 5.0 million).

Embedded derivatives

Landsvirkjun's contracts for sale and purchase of electricity are linked to aluminium prices and form embedded derivatives which are recognised in the Company's financial statements. Embedded derivatives in electric power contracts are recognised in the balance sheet at fair value on the reporting date. Fair value changes are recognised in the income statement among financial income and expenses.

	2016	2015
Fair value of embedded derivatives is specified as follows:		
Fair value of embedded derivatives at the beginning of the year	(52,214)	7,711
Fair value changes during the year	21,164	(59,925)
Fair value of embedded derivatives at year end	<u>(31,050)</u>	<u>(52,214)</u>
Division of embedded derivatives is specified as follows:		
Long term component of embedded derivatives	(25,229)	(42,233)
Short term component of embedded derivatives	(5,821)	(9,981)
Total embedded derivatives	<u>(31,050)</u>	<u>(52,214)</u>

The main assumptions Landsvirkjun uses in the evaluation of embedded derivatives are as follows:

Calculations are based on the forward price of aluminium, as disclosed in the LME and are based on the maximum time length of forward aluminium prices, or 123 months. Management's opinion is that aluminium price expectations after ten years will reflect the aluminium price at the time the agreements were made and therefore fair value changes will not arise for that period.

The calculations are limited to the revision time of electric power sales agreements or length of agreements. The time length can though never be more than the aforementioned 123 months.

According to provisions on energy buyers' purchase obligation the calculation is based on a secured minimum purchase.

Expected cash flow of contracts is discounted at USD rates sourced from Bloomberg, no spread added. At year end 2016, rates for discounting were in the range of 0.8 - 2.4% (2015: 0.5 - 2.2%).

Sensitivity analysis of aluminium price risk

The following tables show effects of changes in aluminium prices on fair value of financial instruments linked to aluminium prices. Amounts are in thousands of USD, pre tax.

	Aluminum price USD/ton	
	-100	+100
31/12/2016		
Embedded derivatives	(19,163)	18,859
Aluminium hedges	3,274	(3,412)
	<u>(15,889)</u>	<u>15,447</u>
31/12/2015		
Embedded derivatives	(19,967)	19,967
Aluminium hedges	3,653	(3,704)
	<u>(16,314)</u>	<u>16,263</u>

Notes, contd.,

31. Foreign exchange risk

Foreign exchange risk is the risk of loss due to unfavourable changes in foreign exchange rates. Landsvirkjun's foreign exchange risk is due to cash flows, assets and liabilities in addition to all general transactions in other currencies than the functional currency.

Landsvirkjun's functional currency is the USD and therefore a foreign exchange risk arises from the cash flow and open balances in currencies other than the USD. The Company's income is mainly in USD. Other income is mainly in ISK and NOK but foreign exchange risk due to those currencies is limited due to netting in the cash flow in ISK and income in NOK is relatively low. Currency risk due to amortisation and interest payments in EUR over the next years has been limited with derivative agreements.

The Company's reporting risk related to changes in exchange rate arises mainly due to its liabilities in EUR and ISK which are mainly long-term loans. The following table shows Landsvirkjun's open balance in currencies other than the functional currency.

Landsvirkjun's foreign exchange risk relating to monetary assets and liabilities at year end is specified as follows:

	EUR	ISK	CHF	Other currencies
2016				
Accounts receivables and other receivables.....	354	17,903	0	1,868
Cash and cash equivalents.....	555	9,944	4,828	493
Derivatives.....	161,557	42,978	0	0
Interest bearing liabilities.....	(483,486)	(267,686)	(31,661)	0
Accounts payable and other payables	(3,187)	(75,142)	0	(465)
Risk in balance sheet.....	(324,207)	(272,003)	(26,833)	1,896
2015				
Long term receivables.....	0	299,219	0	0
Accounts receivables and other receivables.....	315	12,177	0	9,690
Cash and cash equivalents.....	814	18,197	12,717	34,593
Derivatives.....	215,922	0	0	0
Interest bearing liabilities.....	(548,376)	(190,694)	(38,364)	0
Accounts payable and other payables	(1,115)	(36,310)	0	(723)
Risk in balance sheet.....	(332,440)	102,589	(25,647)	43,560

Exchange rates of the main currencies against the USD for the years 2016 and 2015 are specified as follows:

	Average rate		Rate at year end	
	2016	2015	2016	2015
EUR.....	0.90	0.88	0.95	0.91
GBP.....	0.74	0.64	0.81	0.67
CHF.....	0.99	0.94	1.02	0.98
JPY.....	108.65	117.63	116.84	118.95
NOK.....	8.40	7.85	8.61	8.68
ISK.....	120.67	131.85	112.82	129.59

Notes, contd.,

31. Foreign exchange risk, contd.,

Sensitivity analysis

The change of the USD by 10% against the following currencies, would have changed the Group's results and equity by the following amounts before tax. The analysis includes monetary assets and liabilities and assumes that all other variables, especially interest rates, remain unchanged. Changes between years on sensitivity for ISK is mainly in relation to Landsnet changing its functional currency to USD in 2016 and refinancing large part of its liabilities. Landsnet's previous functional currency was ISK.

	Profit (loss) / Equity	
	Strengthening	Weakening
2016		
EUR	32,380	(32,377)
ISK	27,085	(27,085)
CHF	2,683	(2,683)
Other currencies	(87)	87
2015		
EUR	34,467	(33,021)
ISK	(10,259)	10,259
CHF	2,565	(2,565)
Other currencies	3,936	(3,936)

The fair value of currency swaps was negative by USD 15.1 million at the end of December 2016 (2015: negative by USD 14.9 million).

32. Interest rate risk

Landsvirkjun faces interest rate risk as the Company has interest bearing assets and liabilities. The Company's liabilities carry both fixed and floating interest rates and interest rate derivatives and currency swaps are used in order to manage interest rate risk. The Company's risk consists of a possible increase in floating interest rates on loans which can lead to an increase in finance expenses.

At year end 2016, the proportion of loans with fixed interest rates including swap agreements was 60% (2015: 49%). At year end 2016, the estimated market value of the Company's long-term liabilities was USD 151 million higher than their book value (2015: USD 144 million higher) discounted by the underlying currencies yield curve without spread. The following table shows the division of financial assets and liabilities between floating and fixed interests.

	2016	2015
<i>Financial instruments with fixed interest</i>		
Financial liabilities	(1,269,965)	(1,048,876)
	(1,269,965)	(1,048,876)
<i>Financial instruments with floating interest</i>		
Financial assets	144,534	142,127
Financial liabilities	(835,066)	(1,078,662)
	(690,532)	(936,535)
<i>Derivative financial instruments</i>		
Embedded derivatives	(31,050)	(52,214)
Other derivatives	(18,299)	(17,162)
	(49,349)	(69,376)

The fair value of interest rate swaps was negative by USD 3.4 million at year end 2016 (2015: negative by USD 7.2 million).

Notes, contd.,

32. Interest rate risk, contd.,

Sensitivity analysis of interest risk

The following tables show the effect of changes in interest rates on book value and cash flows for one year. The amounts are in USD thousand before tax.

31/12/2016

	Cash flow		Book value	
	-100 bps	+100 bps	-100 bps	+100 bps
Embedded derivatives	0	0	(979)	938
Other derivatives	(1,604)	2,793	(375)	1,041
Interest bearing liabilities	7,136	(10,639)	0	0
Financial assets	(1,445)	1,445	0	0
	4,087	(6,401)	(1,354)	1,979

31/12/2015

	Cash flow		Book value	
	-100 bps	+100 bps	-100 bps	+100 bps
Embedded derivatives	0	0	(1,859)	1,765
Other derivatives	(1,192)	3,164	(3,373)	4,506
Interest bearing liabilities	8,348	(13,921)	0	0
Financial assets	(1,421)	1,421	0	0
	5,735	(9,336)	(5,232)	6,271

33. Liquidity risk

Liquidity risk consists of risk of losses should the Company not be able to meet its obligations at due date. Landsvirkjun limits liquidity risk by ensuring that there is sufficient cash at each time in order to be able to meet obligations. In order to keep balance between liabilities and expected revenues an emphasis is placed on securing liquidity in the form of cash and access to revolving credit facilities.

The Company's cash and cash equivalents amounted to USD 145 million at year end 2016 (2015: USD 142 million) but taking into account undrawn revolving credit facilities (USD 250 million and ISK 12,000 million) and undrawn long term loan facilities amounting to USD 116 million Landsvirkjun has access to a total of USD 617 million (2015: USD 503 million). Cash flow from operations, well spread maturity profile with strong liquidity, and access to facilities secure the Company's liquidity at least throughout the year 2018.

In order to ensure access to capital and maintain flexible funding possibilities, Landsvirkjun has used different types of funding. In past years, financing has mostly taken place through the Company's state guaranteed Euro Medium Term Note Programme (EMTN).

- At year end 2016, the balance of loans under the EMTN with state guarantee was USD 1 billion (2015: USD 1.3 billion). The total amount can at maximum be USD 2.5 billion.
- At year end 2016, the balance of loans under the EMTN without state guarantee was USD 115 million (2015: USD 115 million). The total amount can at maximum be USD 1.0 billion.

The Company's risk related to refinancing is reduced with a well spread maturity profile and long loan terms of outstanding loans. Weighted average life of interest bearing liabilities is 5.3 years and the proportion of loans with maturity within 12 months is 10.5%.

Notes, contd.,

33. Liquidity risk, contd.,

Contractual payments due to financial instruments, including interests, are specified as follows:

2016	Book value	Contractual cash flow	Within one year	1 - 2 years	2 - 5 years	More than 5 years
<i>Non-derivative financial instruments</i>						
Cash and cash equiv.	144,534	144,534	144,534	0	0	0
Short term receiv.	72,599	72,599	72,599	0	0	0
Interest bearing liab.	(2,105,031)	(2,447,520)	(254,563)	(320,139)	(813,553)	(1,059,265)
Current liabilities	(96,874)	(96,874)	(96,874)	0	0	0
	<u>(1,984,772)</u>	<u>(2,327,261)</u>	<u>(134,304)</u>	<u>(320,139)</u>	<u>(813,553)</u>	<u>(1,059,265)</u>
<i>Derivative financial instruments</i>						
Currency swaps	(15,139)	(16,458)	(19,659)	(895)	4,096	0
Interest rate swaps	(3,363)	(3,082)	(2,464)	(618)	0	0
Aluminium derivatives ..	203	309	83	226	0	0
Embedded derivatives in electr. sales agr.	(31,050)	(32,891)	(5,860)	(5,771)	(14,813)	(6,447)
	<u>(49,349)</u>	<u>(52,122)</u>	<u>(27,900)</u>	<u>(7,058)</u>	<u>(10,717)</u>	<u>(6,447)</u>
2015						
<i>Non-derivative financial instruments</i>						
Long term receivables ...	5,667	5,667	0	5,667	0	0
Cash and cash equiv.	142,127	142,127	142,127	0	0	0
Short term receiv.	64,472	64,472	64,472	0	0	0
Interest bearing liab.	(2,127,538)	(2,448,096)	(268,593)	(271,463)	(887,652)	(1,020,388)
Current liabilities	(66,237)	(66,237)	(66,237)	0	0	0
	<u>(1,981,509)</u>	<u>(2,302,067)</u>	<u>(128,231)</u>	<u>(265,796)</u>	<u>(887,652)</u>	<u>(1,020,388)</u>
<i>Derivative financial instruments</i>						
Currency swaps	(14,929)	(19,198)	(3,122)	(15,122)	(954)	0
Interest rate swaps	(7,201)	(7,074)	(3,893)	(2,473)	(708)	0
Aluminium derivatives ..	4,967	5,361	5,361	0	0	0
Embedded derivatives in electr. sales agr.	(52,214)	(55,453)	(10,027)	(9,185)	(21,113)	(15,128)
	<u>(69,376)</u>	<u>(76,364)</u>	<u>(11,681)</u>	<u>(26,780)</u>	<u>(22,775)</u>	<u>(15,128)</u>

Notes, contd.,

34. Counterparty risk

Counterparty risk is the risk that a counterparty to an agreement does not comply with provisions of the agreement. Landsvirkjun's counterparty risk arises first and foremost in relation to the Company's power contracts, derivative contracts and cash and cash equivalents. The amounts involved can be considerably high, but the risk is limited by the Company's requirements for counterparty quality.

The Company's counterparty risk is specified as follows at year end:	2016	2015
Derivative financial instruments	12,737	9,769
Long term receivables	0	5,667
Accounts receivables and other receivables	72,599	64,472
Cash and cash equivalents	144,534	142,127
	<u>229,870</u>	<u>222,035</u>

34. Comparison of fair value and book value of long-term debt

	2016		2015	
	Book value	Fair value	Book value	Fair value
Interest bearing long term liabilities	2,105,031	2,255,797	2,127,538	2,271,631

The fair value of other financial assets and liabilities is measured as book value.

Fair value of interest bearing long term liabilities is calculated by discounting the expected cash flows with the underlying currencies yield curve.

Interest rates are specified as follows:	2016	2015
Interest bearing liabilities in ISK	2.6-2.9%	2.6-2.8%
Interest bearing liabilities other than in ISK	-0.8-2.6%	0.0-2.5%

35. Fair value classification

The table shows the level categorisation for items in the financial statements recognised at fair value.

	Level 2	Level 3	Total
2016			
Embedded derivatives	(31,050)	(31,050)	(31,050)
Other derivatives	(23,324)	5,025	(18,299)
Revaluation of property, plant and equipment		263,770	263,770
Shares in other companies		150	150
	<u>(23,324)</u>	<u>237,895</u>	<u>214,571</u>
2015			
Embedded derivatives	(52,214)	(52,214)	(52,214)
Other derivatives	(17,162)		(17,162)
Revaluation of property, plant and equipment		276,846	276,846
Shares in other companies		128	128
	<u>(17,162)</u>	<u>224,760</u>	<u>207,598</u>

Main assumptions for valuation of derivatives can be seen in notes 12 and 30 and for revaluation of property, plant and equipment in note 8.

Notes, contd.,

37. Classification of financial instruments

Financial assets and liabilities are divided into defined groups. The classification affects how evaluation of the relevant financial instrument is measured. Those groups to which the Company's financial assets and liabilities pertain and their basis for evaluation are specified as follows:

- Assets and liabilities held for trading - are recognised at fair value through profit and loss.
- Financial assets and liabilities - are denominated at fair value and recognised at fair value through p&l.
- Loans and receivables - are recognised at amortised cost.
- Other financial liabilities - are recognised at amortised cost.

Financial assets and liabilities are divided into the following groups of financial instruments:

	Assets and liabilities held for trading	Financial assets and liabilities at fair value through p&l	Loans and receiva- bles	Financial liabilities recognised at amortised cost	Book value
2016					
Derivative financial instruments	12,737				12,737
Shares in other companies		150			150
Accounts receivables and other receivables			72,599		72,599
Cash and cash equivalents			144,534		144,534
Total assets	<u>12,737</u>	<u>150</u>	<u>217,133</u>	<u>0</u>	<u>230,020</u>
Interest bearing long term liabilities				2,105,031	2,105,031
Derivative financial instruments	62,086				62,086
Accounts payable and other payables				96,874	96,874
Total liabilities	<u>62,086</u>	<u>0</u>	<u>0</u>	<u>2,201,905</u>	<u>2,263,991</u>
2015					
Derivative financial instruments	9,769				9,769
Shares in other companies		128			128
Long-term receivables			5,667		5,667
Accounts receivables and other receivables			64,472		64,472
Cash and cash equivalents			142,127		142,127
Total assets	<u>9,769</u>	<u>128</u>	<u>212,266</u>	<u>0</u>	<u>222,163</u>
Interest bearing long term liabilities				2,127,538	2,127,538
Derivative financial instruments	79,145				79,145
Accounts payable and other payables				66,237	66,237
Total liabilities	<u>79,145</u>	<u>0</u>	<u>0</u>	<u>2,193,775</u>	<u>2,272,920</u>

38. Capital management

Landsvirkjun places emphasis on maintaining a strong equity base supporting further development of the Company.

39. Subsequent events

Nothing has come forth after the balance sheet date, which would require adjustments or changes to the financial statements for the year 2016.

Notes, contd.,

40. Significant accounting policies

The Group has adopted International Financial Reporting Standards, amendments thereto and interpretations adopted by the EU at year end 2016. It is the opinion of management that the implementation of new and amended standards and interpretations did not have significant effects on the consolidated financial statements. The Group has not adopted new or amended standards which have been issued but not entered into effect. It is the opinion of management that implementation of new and amended standards and interpretations which have not entered into effect will not have significant effect on the consolidated financial statements.

41. Basis of consolidation

Subsidiaries are entities controlled by the Company. A company controls an entity when it has the power to govern the investment, is exposed to, or has rights to variable returns from its involvement in the investment and has the ability to affect those returns through its power over the investment. In assessing control, potential voting rights that currently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Financial performances of subsidiaries have been taken into account. When the Company's share of losses exceeds its interest in a subsidiary, the carrying amount of that interest is reduced to nil and the recognition of further losses is discontinued except to the extent that the Company has an obligation or has made payments on behalf of the subsidiary. In case of a profit on the operation of a subsidiary in subsequent periods, a share in their profit is not recognised until the share in a loss has been fully set off.

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with equity accounted investees are eliminated against the investment to the extent of the Company's interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

Assets and liabilities of subsidiaries with another functional currency than the Parent Company are translated to USD at the exchange rate ruling at the accounting date. Income and expenses of that operation are translated to USD at the average exchange rate of the year. The exchange rate difference arising from the translation to USD is entered as a specific item in the statement of comprehensive income and under equity. Amounts in the statement of cash flow are translated to USD at the average exchange rate of the year. The exchange rate difference arising from the translation to USD is entered as a specific item in the statement of cash flow.

42. Associated companies

Associated companies are those companies in which the Group has significant influence, but not control, over financial and operating policies. Significant influence is presumed to exist when the Company holds between 20 and 50% of the voting power of another entity, including any other possible voting power.

The consolidated financial statements include share in the profit or loss of associated companies accounted for using the equity method, from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds the book value of an associated company the book value is reduced to nil and the recognition of further losses is discontinued except to the extent that the Group has an obligation or has made payments on behalf of the associated company. If in subsequent periods there is a profit on the operation of associated companies, the share in the profit is not recognised until the previous share in losses has been set off.

Notes, contd.,

43. Operating revenues

Revenues from sales and transmission of electricity consists of sales to power intensive industries and public utilities based on measured delivery of electricity during the year. Other income is recognised when earned or upon delivery.

44. Interest income and expenses

Interest income and expenses are recognised in the income statement using the effective interest method. Interest income and expenses include bank rates, premium, realised interest rate swaps and other differences arising on initial book value of financial instruments and amounts on the date of maturity using the effective interest method.

Effective interest is the imputed rate of interest used in determining the current value of estimated cash flow over the estimated useful life of a financial instrument or a shorter period if applicable, so that it equals the book value of the financial asset or liability in the balance sheet. When calculating the effective interest rate, the Company estimates cash flow taking into account all contractual aspects of the financial instrument.

45. Other financial income and expenses

Other financial income and expenses include profit or loss on assets and liabilities held for trading and all realized and unrealized fair value changes and changes in foreign exchange rates.

46. Foreign currency transactions

Transactions in foreign currencies are recognised at the exchange rate ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are recognised at the exchange rate ruling at the end of the year. The foreign currency gain or loss thereon relating to USD is recognised in the income statement. Non-monetary assets and liabilities measured at cost value in a foreign currency are translated to USD at the exchange rate ruling at the date of the transactions. Tangible assets and liabilities recognised in foreign currencies at fair value are translated to USD at the exchange rate ruling at the date of determination of fair value.

47. Impairment

a) Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss in respect of a financial asset available for sale is calculated by reference to its fair value at each time.

Impairment loss on financial assets is recognised in the income statement. Accumulated loss on financial assets available for sale previously recognised among equity, is recognised in the income statement when the impairment loss has incurred.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at amortised cost and debt securities which are financial assets available for sale, the reversal is recognised in the income statement. For equity securities which are financial assets available for sale, the reversal is recognised in the statement of comprehensive income.

Notes, contd.,

47. Impairment, contd.

b) Other assets

The carrying amounts of the Company's other assets, other than inventories and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. Intangible assets with unspecified useful lives are tested annually for impairment.

An impairment loss is expensed if the carrying amount of the asset or its cash generating unit exceeds its recoverable amount. A cash generating unit is the smallest group of assets that generates cash inflows that are largely independent of the cash inflows of other assets or cash generating units. Impairment loss is first recognised in the income statement and then to reduce the carrying amounts of the fixed assets in the cash generating unit.

The recoverable amount of an asset or cash generating unit is the greater of its value in use and its net fair value. Value in use is based on the estimated future cash flows, discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the assets.

For other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation.

48. Income tax

Income tax on the results for the year consists of current income tax and deferred income tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity or in statement of comprehensive income, in which case income tax is recognised among those items.

Current income tax is the expected tax payable on the taxable income for the year, using tax rates enacted at the reporting date, in addition to adjustments made to current income tax of previous years.

A deferred income tax asset (liability) is recognised in the financial statements. Its calculation is based on the difference in balance sheet items, according to the tax return, on the one hand, and the consolidated financial statements, on the other hand. The difference thus arising is due to the fact that the tax assessment is based on premises other than the Group's financial statements and is in main respect a temporary difference as expenses are entered in the financial statement in another period than in the tax return. Calculation of deferred tax is based on the expected tax ratio when temporary differences are estimated to be reversed based on current law at the reporting date.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against the asset. The tax asset is calculated at each reporting date and decreased to the extent that is considered likely that it will not be utilised against future taxable profit.

Notes, contd.,

49. Property, plant and equipment

Property, plant and equipment are initially measured at cost.

The cost of renewing single items of fixed asset is capitalised if it is considered likely that the proceeds on the asset will revert to the Company and the cost can be measured reliably. All other cost is expensed in the income statement as it is incurred.

The Group's transmission and telecommunication systems are recognised at a revalued cost in the balance sheet, which is their fair value less depreciation from the date of revaluation. The revaluation of those assets is carried out on a regular basis. All value increase due to the revaluation is recognised in the revaluation account among equity after income tax effect. Depreciation of the revalued cost is recognised in the income statement. Upon the sale, depreciation or disposal of an asset, the part of the revaluation account pertaining to the asset is transferred to retained earnings.

Other operating assets are capitalised at cost less accumulated depreciation and impairment.

Initial value of fixed assets includes the estimated cost of demolition following their use. Estimated demolition cost of power lines has been measured at a discounted value based on the useful life and an obligation in relation thereto has been recognised among long-term liabilities. A change in the obligation due to the discounted value is recognised through the income statement in addition to depreciation of demolition cost.

Cost value consists of all cost incurred due to the acquisition of the asset. Cost value of fixed assets constructed in own account is the aggregate cost of construction, such as cost of material and salaries in addition to all other costs the Company incurs in making the asset operative.

If single items of fixed assets have different estimated useful lives, they are divided in accordance with their different useful lives.

Interest expense on loans used to finance the cost value of projects are capitalised at the time of construction.

Profit or loss on the sale of fixed assets is the difference between the sales value and the book value of the asset and is recognised in the income statement.

Depreciation

Depreciation is calculated as a fixed annual percentage based on the estimated useful lives of the operating assets.

Depreciation method, estimated useful life and residual value are revalued at each accounting date.

Depreciation ratios and useful life are specified as follows:

	Depreciation	Useful life
Power stations:		
Power houses and other structures	1.67%	60 years
Machinery	2.5-6.67%	15-40 years
Dams and waterways	1.67-3.33%	30-60 years
Geothermal stations	1.67-6.67%	15-60 years
Windmills	5.00%	20 years
Substations	2.5-5%	20-40 years
Power lines	1.67-5%	20-60 years
Optical fibre	2,5-5%	20-40 years
Masts	7.00%	15 years
Telecommunication buildings	6.00%	17 years
Other telecommunication equipment	14-15%	7 years
Office buildings	2.00%	50 years
Equipment	10-25%	4-10 years
Vehicles	10-20%	5-10 years

Notes, contd.,

50. Intangible assets

Intangible assets are recognised at cost value, less accumulated impairment loss and amortisation.

Expenditure for general research cost is expensed in the period it incurs. Development cost for future power projects is capitalised among fixed assets, such as cost of materials, salary cost and all cost incurred by the Company in relation to capitalised development cost. Development cost is only capitalised if there is probability of future economic benefit and the Company intends and is able to conclude, use or sell it. The useful life of development cost is assessed to be unlimited until a decision is made concerning its use or sale, thus the cost is not depreciated at this stage but account is taken for possible impairment loss if a project changes.

Water and geothermal rights are capitalised in the balance sheet at cost value as intangible assets with unlimited useful life since it cannot be determined when these rights will no longer be financially viable.

Other intangible assets are stated at cost less accumulated amortisation and impairment loss.

Subsequent cost is only capitalised if it increases the estimated future economic benefit of the asset it relates to. All other cost is expensed in the income statement when incurred.

Depreciation is calculated on a straight line basis, based on the estimated useful lives of intangible assets from the date that they become applicable. Amortisation and estimated useful life is specified as follows:

	Depreciation	Useful life
Software	25%	4 years

51. Financial instruments

a) Non-derivative financial assets

Non-derivative financial assets are recognised when the Company becomes a part of contractual provisions of the relevant financial instrument.

Financial assets are derecognised if the Company's contractual right to cash flow due to the asset expires or the Company transfers the assets to another party without holding back control or almost all the risk and gain involved in the ownership. The component of the transferred financial assets arising or retained by the Company is recognised as a specific asset or liability.

Financial assets and financial liabilities are offset and the net amount presented in the balance sheet when, and only when, the Company has a legal right to offset the amounts and intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously.

The Group classifies non-derivative financial assets into the following categories: financial assets at fair value through profit or loss, loans and receivables and financial assets available for sale.

i) Financial assets measured at fair value through profit or loss

A financial asset is classified at fair value through profit or loss if it is classified as held-for-trading or is designated as such on initial recognition. Upon initial recognition attributable transaction costs are recognised in profit or loss when incurred. Financial assets at fair value through profit or loss are measured at fair value in the balance sheet, and changes therein are recognised in the income statement.

Financial assets at fair value through profit or loss are shares in other companies and marketable securities.

Notes, contd.,

51. Financial instruments, contd.

ii) Loans and receivables

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are initially measured at fair value plus all direct transaction costs. Subsequent to initial recognition, loans and receivables are recognised at the amortised cost value based on effective interests, less impairment if detected.

Loans and receivables comprise cash and cash equivalents, trade and other receivables. Cash and cash equivalents consist of cash and deposits on demand within three months.

iii) Assets available for sale

Assets available for sale are non-derivative financial assets held for sale and are not categorised in the aforementioned groups. Subsequent to initial recognition, they are measured at fair value and changes therein, other than impairment loss and foreign exchange differences, are recognised among other income and expenses in the statement of comprehensive income and stated as a separate item in equity.

b) Non-derivative financial liabilities

Non-derivative financial liabilities are initially measured at fair value plus all direct transaction costs. Subsequent to initial recognition the liabilities are recognised at the amortised cost value based on effective interests.

The Group derecognises a financial liability when the contractual obligations due to the debt instrument expire.

The Company's non-derivative financial liabilities are loans, accounts payables and other payables.

c) Derivative financial instruments

The Company enters into derivative financial instruments to hedge its foreign currency, interest rate and aluminium price risk exposures. Derivative financial instruments are recognised initially at fair value. Direct transaction cost is recognised in the income statement as it incurs. Subsequent to initial recognition, derivative financial instruments are recognised at fair value in the balance sheet and fair value changes are recognised in the income statement among financial income and expenses. Hedge accounting is not applied to derivative instruments that economically hedge monetary assets and liabilities denominated in foreign currencies.

i) Separable embedded derivatives

Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, other instruments with the same provisions as the embedded derivative would be defined as a derivative and the hybrid contract is not stated at fair value in the income statement.

Changes in the fair value of separable embedded derivatives are recognised in the income statement among financial income and expenses.

52. Inventories

Inventories are stated at the lower of the cost value or the net sales value. Cost value of inventories is based on "the First In First Out method" and includes cost incurred upon the purchase of the inventories and in bringing them to the sales location and in a saleable state.

53. Cash and cash equivalents

Cash and cash equivalents consist of cash, short-term market securities and demand deposits.

Notes, contd.,

54. Equity

The Group's equity is divided into owners' contribution, revaluation account, translation difference, restricted reserves, other equity and minority interest. The Parent Company's initial capital amounts to USD 587 million.

55. Employees' benefits

a) Defined contribution plan

Cost due to contribution to defined benefit plans is expensed in the income statement among salaries and salary related expenses when incurred.

b) Defined benefit plan

The Company's obligation due to defined benefit plans is calculated by estimating the future value of defined pension benefits accrued by current and former employees in current or previous periods. The benefits are discounted in order to determine their present value. An actuary has calculated the obligation on the basis of a method, which is based on accrued benefits. Actuarial changes in the obligation are recognised among operating items under equity in the statement of comprehensive income. Other changes are recognised in the income statement.

56. Provisions

Obligations are recognised in the balance sheet when the Company has a legal obligation or entered into obligations due to past events, it is considered probable that they will be settled and they can be reliably measured. The obligation is assessed on the basis of estimated future cash flow, discounted on the basis of interests reflecting market interests and the risk inherent with the obligation.

57. Operating segments

A segment is a distinguishable component of the Group, which is subject to risks and returns, including income and expenses related to other segments of the Group. In determining the distribution of resources to segments and evaluating the results, the return of the segments is reviewed by management on a regular basis.

Segment operating results, assets and liabilities consist of items that can be directly linked to each segment, in addition to the items that can be reasonably divided into segments.

Appendix I: Statement of Corporate Governance

Corporate Governance

Organisation

Landsvirkjun's operation is subject to Act No. 42/1983, with subsequent amendments. The Board of Directors of Landsvirkjun has established working procedures for the Board for further compliance with the law.

Objective, aim, vision and values

Landsvirkjun is an energy company owned by the Icelandic State. Landsvirkjun's objective is to maximise the yield of energy resources entrusted to the Company with emphasis on sustainable use, valuable products and efficiency. In order to uphold its objectives with ambition the Company has defined the following goals: Practise efficient electricity production and advancement, serve a diverse customer base, connect prices to European electricity markets, constantly develop skills and capabilities of the employees, and to create support and solidarity by open communication with stakeholders.

Landsvirkjun's vision is to be a progressive international electricity company in the field of renewable energy. We want to be among the best who produce and sell energy.

The values of Landsvirkjun are progressiveness, prudence and reliability.

The Board of Directors

According to law, the Board of Directors of Landsvirkjun is appointed by the Minister of Finance for a one year term at a time and it is responsible for the financial matters and operation of Landsvirkjun. The Board of Directors of Landsvirkjun consists of the following Directors: Jónas Þór Guðmundsson, Supreme Court Attorney, who is also the Chairman of the Board, Jón Björn Hákonarson, Chairman of the Municipal Board of Fjarðabyggð, Vice Chairman of the Board, Helgi Jóhannesson, Supreme Court Attorney, Þórunn Sveinbjarnardóttir, President of the Association of Academics (BHM), and Álfheiður Ingadóttir, Biologist.

Audit committee

Chapter IX of the Financial Statements Act No. 3/2006, cf. Act No. 80/2008, applies to the audit committee of Landsvirkjun. The working procedures for the committee are established by the Company's Board of Directors for further compliance with the law. The audit committee of Landsvirkjun exercises advisory functions for the Board and operates on the basis of the Board's authorisation. The committee has no executive power. The Company's audit committee consists of three individuals; two board members, Jónas Þór Guðmundsson and Álfheiður Ingadóttir, and Heimir Haraldsson, auditor and chairman of the committee.

Remuneration committee and board risk committee

A remuneration committee was appointed during the year. It consists of three board members, Jónas Þór Guðmundsson, Helgi Jóhannesson and Jón Björn Hákonarson. A board risk committee was also appointed. It consists of Jónas Þór Guðmundsson, Jón Björn Hákonarson and Þórunn Sveinbjarnardóttir. The Board of Directors of Landsvirkjun has approved working procedures for these committees.

Internal audit

The Company has entered into an agreement with KPMG ehf. for provision of internal audit services. The role of internal auditor is to perform analysis of certain aspects of internal audit in accordance with a plan approved by the audit committee.

Appendix I: Statement of Corporate Governance, contd.

CEO, Deputy CEO and Executive Directors

The Board of Directors of Landsvirkjun hires a CEO. The CEO is Hörður Arnarson. The Board of Directors and the CEO exercise executive power in the Company. Deputy CEO is Ragna Árnadóttir. The Deputy CEO's roles is to handle collective matters of the Company in addition to policy development, such as ensuring good corporate governance. At the end of the year the Company's executive directors were five.

Finance division. The Company's CFO is Rafnar Lárusson. The role of the division is to create a foundation for efficient operations and to promote maximum results in all units of the Landsvirkjun Group.

Project planning and construction division. The Head of project planning division is Gunnar Guðni Tómasson. The role of the division is to oversee Landsvirkjun's power station projects from the preparation stage to their completion. The division monitors the costs and safeguards the quality and progress of the various projects, keeping them in accordance with the expectations, plans and needs outlined by the company.

Marketing and business development division. Head of marketing and business development is Björgvin S. Sigurðsson. The role of the division is to maximise Landsvirkjun's long-term profit potential, through the innovative and effective promotion and sale of products and services, negotiating contracts and follow up of existing contracts.

Energy division. Head of the energy division is Einar Mathiesen. The role of the division is to ensure that electricity generation and delivery is secure and efficient and fulfills the terms of the agreements signed with Landsvirkjun's customers.

Research and development division. Head of research and development division is Óli Grétar Blöndal Sveinsson. The role of the division is to manage the preparation of new power projects and to conduct research on the existing power systems. The division ensures the efficient implementation of new power projects, increases the flexibility of energy production options and supports innovation in energy production with a long-term view of future energy supplies.

Appendix II: Non-financial information

Business model

Landsvirkjun is a partnership owned by the Icelandic State and is the largest power generation entity in Iceland. The Company produces over 70% of the country's electricity. Landsvirkjun produces electricity 100% from renewable energy sources where main emphasis is on hydroelectric power and geothermal heat. In addition to serving the Icelandic market, Landsvirkjun emphasises to offer its customers competitive prices.

Landsvirkjun's objective is to maximise the yield of energy resources entrusted to the Company with emphasis on sustainable use, valuable products and efficiency. Landsvirkjun's vision is to be a progressive electricity company in the field of renewable energy. The values of Landsvirkjun, progressiveness, prudence and reliability, are key factors in developing new projects and operating current power stations.

Landsvirkjun has defined that the Company's social responsibility is to create profit, treat resources and the environment properly and encourage that knowledge and positive effects of the Company's operations are returned to the community. In order to ensure that policy on social responsibility is enforced, objectives are approved each year. Furthermore, Landsvirkjun has committed to participate in UN Global Compact, a United Nation's project which relates to universal sustainability principles and annually produces a progress report, see <https://www.unglobalcompact.org/participation/report/cop/create-and-submit/active/229791//>

Importance

The operation of Landsvirkjun can have an extensive effect on the community, in particular in communities close to the Company's power stations. One of the Company's aims is to create support and solidarity with open communication with stakeholders. In all segments and in all construction projects, a stakeholders' analysis is performed and a communication plan developed with the aim to have the optimal communication relating to the operation.

Effects of the Company's operations can be significant and it has established formal risk management procedures in order to identify the factors which are most important. Management and key employees of Landsvirkjun identify Landsvirkjun's financial and non-financial risks and evaluate their importance. The results are entered into the Company's risk portfolio and they are used to decide on appropriate actions and management relating to possible effect on image, financial position, liabilities, health and security and environment.

Landsvirkjun performs surveys on a regular basis in order to examine the public's attitude toward the operation.

Environment

Landsvirkjun has a certified environmental control system in accordance with ISO 14001. The Company has formulated an environmental policy and systematically works at reducing environmental impact of the operation.

Important environmental elements relating to the operation of Landsvirkjun are managed and monitored. This includes utilisation of resources, air and water receptor emissions, quantity and treatment of waste and other factors. The Company's green accounting, which has been issued annually since 2007, includes numerical information on environmental effect of the Company's operation. The numbers published in the green accounting report are based on Landsvirkjun's finance systems, maintenance system, human resources system, geothermal database, Landsnet's database on power production and land use database and binding accounts of the Agricultural University of Iceland. The numbers are either actual or calculated from measuring values. The information is provided according to best knowledge.

Green accounts of Landsvirkjun are as usual issued with the Company's annual report.

Appendix II: Non-financial information, contd.

Employee matters

Landsvirkjun's equal opportunity policy and action plan are in accordance with the Act No. 10/2008 on equal status and equal rights of women and men. The Board of Directors has appointed a remuneration committee. The equal opportunity committee, which is appointed by the CEO for a term of two years, is responsible for implementing the equal opportunity policy. The committee oversees annual review of the policy and action plan. Implementation of the action plan is the responsibility of management and human resources division with assistance from the equal opportunity committee.

In 2015 Landsvirkjun received PwC's golden badge of equal pay certification the second year in a row.

Human rights

A part of Landsvirkjun's operation is construction of power production plants which can be very extensive. A large number of employees are involved in such constructions and thus protection of the work force is very important. Landsvirkjun emphasises to pursue strict standards in order to ensure the rights of its employees and service providers, health and safety and appropriate salaries and benefits. In order to ensure that standards, law and other obligations are met in this respect, Landsvirkjun has approved rules regarding chain responsibility. The rules are meant to ensure that every person working for Landsvirkjun indirectly through contractors, subcontractors or temporary work agencies, are awarded rights and terms of employment in accordance with law and collective agreements.

The Board of Directors of Landsvirkjun approved the rules at its meeting at the end of August 2016 and since then work has commenced on adding provisions on chain responsibility into Landsvirkjun's purchasing agreements, i.e. contracts, product agreements and agreements relating to purchase of services. According to this provision a contractor must ensure and be responsible for ensuring that all employees, whether they are employed by the contractor, subcontractor or temporary work agency, receive salaries, benefits, health and accident insurance and other rights in accordance with the contract, current collective agreements at law at each time.

In addition, the contractor is responsible for and must have valid insurances for damages for the contractor's employees caused by accidents, illness, disease, medical costs or death which can be traced to constructions. The contractor is responsible for that subcontractors and temporary work agencies and their employees have comparable insurances.

Thus far, the Company's contracts have stipulated that counterparties, contractors, subcontractors and temporary work agencies, shall in every respect adhere to law and agreements which apply to the labor market. With this new provision the responsibility is more defined, in addition to Landsvirkjun receiving resources to enforce that the rules are adhered to, since it contains penalty provision if the counterparty violates the provision or does not provide requested information.

The Company's policy on corruption and bribery matters

Code of Ethics for Landsvirkjun's employees was issued and implemented in December 2013. It contains nine categories, including employee safety, importance of honesty and respect in communication, treatment of confidential information and conflict of interest.

In the year 2014 work commenced regarding code of ethics for suppliers, which are based on the code of ethics for employees and principles of UN Global Compact on human rights, labor, environmental and anti-corruption. With this, Landsvirkjun was providing clear guidelines to suppliers and service providers on what is expected from them with regards to sound operating and management governance. The rules were implemented into working procedures relating to suppliers and service providers in the year 2015.

Appendix II: Non-financial information, contd.

The Company's policy on corruption and bribery matters, contd.

A policy regarding integrity in business was implemented into working procedures relating to Landsvirkjun's customers in the year 2015. Landsvirkjun's core standpoints on responsible operations and good morals are outlined in the Company's code of ethics. Landsvirkjun expects that its partners take into account the same core standpoints.

Non-financial key performance indicators

In goalsetting and approach to the Company's social responsibility, Landsvirkjun has relied on ISO 26000, Guidance on social responsibility. The progress of each year is reported annually and new goals set for the coming year on the Company's website. By participating in the United Nations' Global Compact project, Landsvirkjun adheres to ten principles of the project and annually reports on progress in the categories it covers.

Landsvirkjun has a certified environmental control system in accordance with ISO 14001. Furthermore, the Company is also certified according to the health and safety management standard OHSAS 18001, but companies with this certification must constantly work at reform regarding safety, health and well being of employees.

Provision of information where there is no policy

Landsvirkjun has approved specific policies and working procedures regarding matters relating to the Company's operation. Emphasis is on contractors and subcontractors to adhere to law and contracts and thus it has not been considered necessary to approve a specific policy on human rights. New rules regarding chain responsibility are a breakthrough due to them containing penalties if the rules are not adhered to and also if requested information is not provided. This ensures even more the rights of everyone working for Landsvirkjun.