Landsvirkjun

Group

Consolidated Financial Statements 2014

Landsvirkjun
Háaleitisbraut 68
103 Reykjavík

Id.no. 420269–1299

Contents

Key figures

Management's presentation of the operation of Landsvirkjun

Amounts are in USD thousand

	2014	2013	2012	2011	2010
Operation					
Operating revenues	428,655	407,676	389,499	419,708	383,991
Realised aluminium hedges	9,629	15,228	18,325	16,488	(6,342)
Total operating revenues	438,284	422,904	407,824	436,196	377,649
Operating expenses	(106,126)	(93,768)	(86,488)	(90,993)	(79,564)
EBITDA	332,158	329,136	321,336	345,203	298,085
Depreciation and impairment loss	(114,045)	(117,670)	(112,288)	(108,200)	(107,258)
EBIT	218,113	211,466	209,048	237,003	190,827
Financial items	(69,838)	(86,988)	(103,093)	(126,877)	(99,275)
Associated companies	(1,419)	(2,647)	(2,229)	(4,014)	(1,581)
Profit before unrealised financial items	146,856	121,831	103,726	106,112	89,971
Unrealised financial items:					
Fair value changes in embedded derivatives	(88,484)	(174,641)	(3,391)	(93,197)	(55,583)
Fair value changes in other derivatives	(8,426)	5,014	13,653	6,959	(39,438)
Unrealised foreign exchange difference	60,271	(16,658)	(12,675)	22,711	87,619
	(36,639)	(186,285)	(2,413)	(63,527)	(7,402)
Profit (loss) before income tax	110,217	(64,454)	101,313	42,585	82,569
Income tax	(31,797)	25,913	(45,995)	(16,135)	(9,653)
Net Profit (loss)	78,420	(38,541)	55,318	26,450	72,916
Balance sheet					
Total assets	4,270,098	4,568,965	4,518,534	4,635,989	4,850,037
Equity	1,704,724	1,658,134	1,697,152	1,661,312	1,644,322
Liabilities	2,565,374	2,910,831	2,821,382	2,974,677	3,205,715
Net liabilities *	2,190,459	2,429,176	2,435,571	2,502,873	2,673,966
Cash flow					
Funds from operations (FFO)	258,226	257,704	241,584	255,592	218,582
Cash flow from operating activities	233,816	258,485	236,178	267,172	229,595
Investing activities	(88,271)	(149,455)	(122,979)	(107,689)	(53,517)
Financing activities	(220,687)	(12,893)	(151,670)	(185,328)	(106,294)
Liquidity					
Cash and cash equivalents at year end	207,070	287,987	187,916	229,942	265,532
Undrawn loans	200,000	301,947	409,979	415,767	307,676
Total liquidity	407,070	589,934	597,895	645,709	573,208
Key ratios					
Return on equity	4.7%	(2.3%)	3.3%	1.6%	4.7%
Equity ratio	39.9%	36.3%	37.6%	35.8%	33.9%
Interest cover (EBITDA/net interest expenses)	3,76x	3,51x	3,27x	3,06x	3,68x
FFO / net liabilities	11.8%	10.6%	9.9%	10.2%	8.2%
FFO / interest expenses	2,82x	2,66x	2,36x	2,19x	2,58x
Net liabilities / EBITDA	6.59x	7.38x	7,58x	7,25x	8,97x
Credit rating at year end					
Standard & Poor's	BB	BB	BB	BB	BB+
Moody's	Baa3	Baa3	Baa3	Baa3	Baa3

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

Quarterly statement 2014

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

	Q1	Q2	Q3	Q4	Total
Operating revenues					
Power sales	86,023	79,465	87,176	95,812	348,476
Realised aluminium hedges	3,408	2,955	1,491	1,775	9,629
Transmission	14,713	14,816	14,508	14,973	59,010
Other income	902	958	1,392	17,917	21,169
	105,046	98,194	104,567	130,477	438,284
Operating expenses					
Energy production costs	8,885	10,031	13,740	11,607	44,263
Transmission costs	5,049	5,186	6,622	5,688	22,545
Cost of general research	1,552	1,668	2,159	2,319	7,698
Other operating expenses	6,972	9,038	6,185	9,425	31,620
Depreciation and impairment loss	27,416	28,415	29,471	28,743	114,045
	49,874	54,338	58,177	57,782	220,171
Operating profit	55,172	43,856	46,390	72,695	218,113
Financial income and (expenses)					
Interest income	1,224	630	732	653	3,239
Interest expenses	(23,807)	(25,359)	(22,824)	(19,705)	(91,695)
Realised foreign exchange difference	2,187	1,670	4,920	9,841	18,618
	(20,396)	(23,059)	(17,172)	(9,211)	(69,838)
Associated companies	(670)	(476)	(254)	(19)	(1,419)
Profit before income tax and unrealised items	34,106	20,321	28,964	63,465	146,856
Unrealised financial items:					
Fair value changes in embedded derivatives	(32,568)	26,918	5,672	(88,506)	(88,484)
Fair value changes in other derivatives	(1,231)	(5,335)	(4,921)	3,061	(8,426)
Unrealised foreign exchange difference	2,196	6,583	42,368	9,124	60,271
	(31,603)	28,166	43,119	(76,321)	(36,639)
Profit (loss) before income tax	2,503	48,487	72,083	(12,856)	110,217
Income tax	75	(16,518)	(24,663)	9,309	(31,797)
Net Profit (loss)	2,578	31,969	47,420	(3,547)	78,420
Attributable to:					
Owners of the parent company	754	29,974	43,667	(7,344)	67,051
Subsidiaries minority interest	1,824	1,995	3,753	3,797	11,369
	2,578	31,969	47,420	(3,547)	78,420
From cash flow					
Cash flow from operating activities	69,046	45,180	54,682	64,908	233,816

Other key metrics for Landsvirkjun (parent company)	**2014**	**2013**	**2012**	**2011**	**2010**
Installed power at year end (MW)	1,957	1,862	1,860	1,860	1,860
Average price for industrial users (incl. transm.) USD/MWh	25.9	25.8	26.2	28.7	25.7
Average price for retail sales comp.(excl. transm.) ISK/kWh	4.3	4.0	3.9	3.6	3.4
Sales in GWh	13,082	13,186	12,770	12,778	12,926
Research and development	30,606	26,799	32,514	17,203	19,575
Accident frequency: H200*	0.4	0.7	0.0	0.4	1.4

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

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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 decision of the Board of Directors 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., in addition to two subsidiaries of Landsvirkjun Power ehf.

The financial statements of Landsvirkjun for the year 2014 are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU. The functional currency of the Company is USD and amounts in the financial statements are rounded to the nearest thousand USD.

The Group’s operating income amounted to USD 438.3 million in the year 2014 compared to USD 422.9 million in the previous year. Thus, income increased by USD 15.4 million. Despite the fact that last spring Landsvirkjun needed to temporarily reduce delivery of electricity to its customers, due to difficulties with the level of water reservoirs, income from sales of electricity increased between years. Other revenues increased due to an agreement with Rio Tinto Alcan in Iceland. Recognised revenues due to realised aluminium hedges amounted to USD 9.6 million in the year 2014 compared to USD 15.2 million in the previous year. Operating expenses amounted to USD 220.2 million in the year 2014 compared to USD 211.4 million in the year 2013. Thus, the Company's operating profit amounted to USD 218.1 million in the year 2014 compared to USD 211.5 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 currency 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 106.5 million in the year 2014, compared to USD 273.3 million the previous year. The change between years amounts to USD 166.8 million. The main reason for this difference between years are changes in currency exchange differences and fair value changes in embedded 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 146.9 million during the year compared to USD 121.8 million in the year 2013. According to the income statement, profit for the year amounted to USD 78.4 million compared to a loss of USD 38.5 million in the previous year.

Equity at year end 2014 amounted to USD 1,704.7 million compared to USD 1,658.1 million at year end 2013 according to the balance sheet. The Company’s Board of Directors proposes that the profit for the year will be recognised as 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 refers to the notes to the financial statements and statement of equity for further changes in equity. Landsvirkjun is a partnership owned by the 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 207.1 million and undrawn Revolving Credit Facilities amounted to USD 200.0 million. Cash and cash equivalents and undrawn Revolving Credit Facilities therefore amounted to USD 407.1 million at year end. Cash flow from operations amounted to USD 233.8 million. Landsvirkjun borrowed USD 97.6 million in the year and repaid debt amounting to USD 304.9 million. Cash and cash equivalents decreased by USD 80.9 million during the year. The construction of Búðarháls power plant went according to schedule and the power station was taken into operation in March.

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 to the Guidelines on Corporate Governance issued by the Iceland Chamber of Commerce in collaboration with the Confederation of Icelandic Employers and Nasdaq OMX Iceland. 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 2014, 17 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. Landsnet hf. has disclosed information on corporate governance in an appendix in its 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.

Statement by the Board of Directors and the CEO

According to the best knowledge of the Board of Directors and the CEO, the financial statements are in accordance with International Financial Reporting Standards as adopted by the EU and it is the opinion of the Board of Directors and the CEO that the financial statements give a fair view of the Company's assets, liabilities and financial position as at 31 December 2014 and the Company's results and changes in cash in the year 2014.

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 2014 give a fair view of the Company's results, financial position and development and describe the main risk factors faced by the Company.

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

Reykjavik, 25 February 2015.

The Board of Directors:

Jónas Þór Guðmundsson

Jón Björn Hákonarson

Helgi Jóhannesson

Þórunn Sveinbjarnardóttir

Álfheiður Ingadóttir

The CEO:
Hörður Arnarson

Independent Auditor's Report

To the Board of Directors and owners of Landsvirkjun

We have audited the accompanying consolidated financial statements of Landsvirkjun for the year 2014, which comprise the endorsement of Board of Directors, statement of financial position as at 31 December 2014, and the income statement, statement of comprehensice incomve, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's and the Board of Directors' Responsibility for the Financial Statements

Management and the Board of Directors is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, as adopted by the EU, and for such internal control as management and the Board of Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements give a true and fair view, of the financial position of Landsvirkjun as at 31 December 2014, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards, as adopted by the EU.

Reykjavik, 25 February 2015.

Deloitte ehf.

Þorsteinn Pétur Guðjónsson
State authorized auditor

Lárus Finnbogason
State authorized auditor

Income Statement for the year 2014

	Notes	2014	2013
Operating revenues			
Power sales		348,476	346,480
Realised aluminium hedges		9,629	15,228
Transmission		59,010	56,531
Other income		21,169	4,665
		438,284	422,904
Operating expenses			
Energy production costs		131,047	116,936
Transmission costs		46,615	39,850
Cost of general research		7,698	19,007
Other operating expenses		34,811	35,645
		220,171	211,438
Operating profit	3	218,113	211,466
Financial income and (financial expenses)			
Interest income		3,239	3,031
Interest expenses		(91,695)	(96,760)
Foreign exchange difference		78,889	(9,917)
Fair value changes in embedded derivatives	30	(88,484)	(174,641)
Fair value changes in other derivatives		(8,426)	5,014
	6	(106,477)	(273,273)
Associated companies	13	(1,419)	(2,647)
Profit (loss) before income tax		110,217	(64,454)
Income tax	7	(31,797)	25,913
Net profit (loss) for the year		78,420	(38,541)
Attributable to:			
Owners of the Parent Company		67,051	(44,844)
Minority interest in subsidiaries		11,369	6,303
		78,420	(38,541)

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

Consolidated Financial Statements of Landsvirkjun 2014 8 Amounts are in USD thousand

Statement of Comprehensive Income for the year 2014

	2014	2013
Net profit (loss) for the year	78,420	(38,541)
Items that will not be reclassified subsequently to profit or loss		
Pension obligation after income tax, change	(1,838)	(1,088)
Items that may be reclassified subsequently to profit or loss		
Translation difference due to subsidiaries and associated companies	(16,600)	13,432
Total operating items moved to equity	(18,438)	12,344
Total comprehensive income (loss) for the year	59,982	(26,197)
Profit (loss) attributable to:		
Owners of the Parent Company	53,958	(37,230)
Minority interest in subsidiaries	6,024	11,033
	59,982	(26,197)

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

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Balance Sheet as at 31 December 2014

Assets	Notes	2014	2013
Non-current assets			
Property, plant and equipment	8	3,599,661	3,495,611
Projects under construction	9	6,377	221,820
Development cost	10	212,794	190,779
Other intangible assets	10	48,546	48,259
Derivative financial instruments	12	15,313	112,451
Associated companies	13	17,012	20,717
Other non-current assets	14	11,454	3,610
Deferred tax asset	7	65,012	89,536
Total non-current assets		3,976,169	4,182,783
Current assets			
Inventories	16	4,498	4,827
Accounts receivables and other receivables	17	73,368	67,630
Derivative financial instruments	12	8,993	25,738
Cash and cash equivalents	18	207,070	287,987
Total current assets		293,929	386,182
Total assets		4,270,098	4,568,965
Equity and liabilities			
Equity			
Owners' contributions	19	586,512	586,512
Revaluation account	20	91,845	94,898
Translation difference	20	(39,786)	(28,531)
Other equity		1,012,718	957,845
Equity of the owners of the Parent Company		1,651,289	1,610,724
Minority interest		53,435	47,410
Total equity		1,704,724	1,658,134
Long term liabilities			
Interest bearing liabilities	21	2,125,100	2,541,806
Accrued pension liabilities	23	26,345	27,007
Deferred income tax liability	7	21,975	21,076
Obligation due to demolition	24	6,460	6,739
Prepaid income		2,790	3,210
Derivative financial instruments	12	22,053	50,029
		2,204,723	2,649,867
Current liabilities			
Accounts payable and other payables	25	53,031	75,663
Interest bearing liabilities	22	272,429	175,357
Income tax payable	7	4,657	38
Derivative financial instruments	12	30,534	9,906
		360,651	260,964
Total liabilities		2,565,374	2,910,831
Total equity and liabilities		4,270,098	4,568,965

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

Consolidated Financial Statements of Landsvirkjun 2014 10 Amounts are in USD thousand

Statement of Equity for the year 2014

	Owners' contribution	Revaluation account	Translation difference	Other equity	Equity attrib-utable to the owners of the Parent Company	Minority interest	Total equity
Changes in equity year 2013							
Equity at 1 January 2013...........	586,512	98,281	(37,233)	1,013,216	1,660,776	36,376	1,697,152
Translation difference			8,702		8,702	4,730	13,432
Pension obligation, change.......				(1,088)	(1,088)		(1,088)
Loss for the year.......................				(44,844)	(44,844)	6,303	(38,541)
Total comprehensive loss..........			8,702	(45,932)	(37,230)	11,033	(26,197)
Revaluation transferred to other equity.......................		(3,383)		3,383	0	0	0
Dividend paid to owners...........				(12,822)	(12,822)	0	(12,822)
Equity at 31 December 2013.....	586,512	94,898	(28,531)	957,845	1,610,724	47,410	1,658,134
Changes in equity year 2014							
Equity at 1 January 2014	586,512	94,898	(28,531)	957,845	1,610,724	47,410	1,658,134
Translation difference			(11,255)		(11,255)	(5,345)	(16,600)
Pension obligation, change.......				(1,838)	(1,838)		(1,838)
Profit for the year				67,051	67,051	11,369	78,420
Total comprehensive income ...			(11,255)	65,213	53,958	6,024	59,982
Revaluation transferred to other equity.......................		(3,053)		3,053	0	0	0
Dividend paid to owners...........				(13,393)	(13,393)	0	(13,393)
Equity at 31 December 2014	586,512	91,845	(39,786)	1,012,718	1,651,289	53,435	1,704,724

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

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Statement of Cash Flow for the year 2014

	Notes	2014	2013
Operating activities			
Operating profit		218,113	211,466
Adjustments for:			
Depreciation and impairment loss		114,045	117,670
Pension obligation, change		(910)	(748)
Obligation due to demolition, change		374	334
Other changes		3,491	466
Working capital from operation before financial items		335,113	329,188
Operating assets and liabilities, change		(23,438)	975
Cash flow from operating activities before financial items		311,675	330,163
Interest income received		3,261	2,183
Interest expenses and foreign exchange difference paid		(81,082)	(73,757)
Taxes paid		(38)	(104)
Cash flow from operating activities	27	233,816	258,485
Investing activities			
Hydropower stations in operation		(10,674)	(3,965)
Hydropower stations in construction		(26,380)	(74,535)
Transmission		(22,887)	(48,674)
Development costs for power plants		(23,111)	(22,747)
Purchased shares		(139)	0
Dividend received from associated company		99	0
Other capital expenditure		(12,969)	(7,887)
Assets sold		929	2,188
Other receivables, change		6,861	6,165
Investing activities		(88,271)	(149,455)
Financing activities			
Dividend paid to owners		(13,393)	(12,822)
New loans		97,644	158,105
Amortisation of long-term debt		(304,938)	(155,299)
Currency swaps		0	(3,601)
Prepaid income, change		0	724
Financing activities		(220,687)	(12,893)
Change in cash and cash equivalents		(75,142)	96,137
Effect of exchange difference on cash and cash equivalents		(5,775)	3,934
Cash and cash equivalents at the beginning of the year		287,987	187,916
Cash and cash equivalents at end of year		207,070	287,987

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

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Notes

Reporting entity

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 main 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 compliance

The consolidated financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the EU.

The Company's Board of Directors approved the financial statements on 25 February 2015.

Note 40 includes information on the Group's 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.

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. Use of estimates and judgements

The preparation of financial statements in conformity with the 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. Revisions to accounting estimates are recognised 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 the 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 accrued pension liabilities

Notes, contd.:

2. Basis of preparation, contd.:

e. Determination of fair value

A number of the Group's accounting policies and disclosures require the 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 to measure fair values. Then treasury division assesses the evidence obtained from the third parties to support the conclusion 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 a fair value hierarchy based on the inputs used in the valuation techniques as follows.

- Level 1: quoted prices in active markets for identical assets or liabilities.
- Level 2: inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3: inputs for the asset or liability that are not based on observable market data.

If the inputs used to measure the fair value of an asset or a liability might be categorised in different levels of the fair value hierarchy, then 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 about the assumptions made in measuring fair values is included in the following notes:

- note 12 other derivatives
- note 30 embedded derivatives
- note 35 long-term loans
- note 49 property, plant and equipment

3. Statement of segments

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 operations of the parent company fall under the segment electricity production but Landsvirkjun's objectives 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 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 the insurances of 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 electricity transmission 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.

3. Statement of segments, contd.:
Other segments

Other segments include the operation of the companies Orkufjarskipti hf. and Landsvirkjun Power ehf. together with Landsvirkjun Power ehf.'s subsidiaries. The purpose of Orkufjarskipti hf. is to own and operate a telecommunications system throughout the country and to rent access thereto. 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 2014	Electricity production	Electricity transmission	Other segments	Adjustments	Total
Income from third party	376,021	59,501	2,762	0	438,284
Income within the Group	14,399	63,415	3,968	(81,782)	0
Segment income	390,420	122,916	6,730	(81,782)	438,284
Segment operating expenses	(138,324)	(44,986)	(4,598)	81,782	(106,126)
EBITDA	252,096	77,930	2,132	0	332,158
Depreciation and impairment loss	(88,025)	(25,420)	(1,020)	420	(114,045)
Segment earnings, EBIT	164,071	52,510	1,112	420	218,113
Segment assets 2014	4,086,657	639,498	17,872	(490,941)	4,253,085
Associated companies	16,582	5,573	430	(5,573)	17,013
Total assets 2014	4,103,239	645,071	18,302	(496,514)	4,270,098
Segment liabilities 2014	2,433,266	493,703	3,801	(365,397)	2,565,374
Total liabilities 2014	2,433,266	493,703	3,801	(365,397)	2,565,374
Investing activities	62,978	30,905	2,139	0	96,022

Operating segments year 2013	Electricity production	Electricity transmission	Other segments	Adjustments	Total
Income from third party	362,940	56,954	3,010	0	422,904
Income within the Group	12,729	56,556	3,386	(72,671)	0
Segment income	375,669	113,510	6,396	(72,671)	422,904
Segment operating expenses	(123,157)	(38,818)	(4,464)	72,671	(93,768)
EBITDA	252,512	74,692	1,932	0	329,136
Depreciation and impairment loss	(95,829)	(21,293)	(990)	442	(117,670)
Segment earnings, EBIT	156,683	53,399	942	442	211,466
Segment assets 2013	4,386,118	668,862	19,354	(526,085)	4,548,248
Associated companies	20,224	5,815	492	(5,815)	20,717
Total assets 2013	4,406,342	674,677	19,846	(531,900)	4,568,965
Segment liabilities 2013	2,769,722	540,397	4,743	(404,031)	2,910,831
Total liabilities 2013	2,769,722	540,397	4,743	(404,031)	2,910,831
Investing activities	104,081	52,448	1,280	0	157,809

4. Total number of employees

Total number of employees is specified as follows:

	2014	2013
Average number of employees during the year, full-time equivalents	431	430
Full-time equivalent units at year-end	379	381

Consolidated Financial Statements of Landsvirkjun 2014 15 Amounts are in USD thousand

Notes, contd.:

5. Total salaries of employees

Total salaries of employees are specified as follows:

	2014	2013
Salaries	37,480	33,791
Contribution to defined contribution plans	4,747	4,134
Defined pension benefit payments	1,578	1,397
Other change in pension obligation	(910)	(748)
Other salary related expenses	3,864	3,647
	46,759	42,221

Salaries are divided as follows in the income statement:

Energy production costs	14,976	12,781
Transmission costs	9,871	8,970
Other operating expenses	21,912	20,470
	46,759	42,221

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

Salaries of the Board of Directors of the parent company	115	95
Salaries of Boards of Directors of two subsidiaries (same as in 2013)	91	82
Salaries and benefits of the CEO of the parent company, Hörður Arnarson	174	168
Salaries of five Directors and the Deputy (same as in 2013)	1,198	991
Salaries and benefits of the CEO and three Man. Dir. of subsid. (same as in 2013)	636	552

The Director of Project Planning Division resigned in the middle of the year 2014 and another person was hired to fill that position later in the year. The CEO of Landsnet hf. resigned at the end of the year and another person took over.

6. Financial income and (expenses)

Financial income and (expenses) are specified as follows:

Interest income	3,239	3,031
Interest expenses	(77,149)	(78,826)
Guarantee fee	(11,982)	(12,422)
Indexation	(4,622)	(13,793)
Capitalised interest costs	2,058	8,281
Total interest expenses	(91,695)	(96,760)
Realised foreign exchange difference	18,618	6,741
Unrealised foreign exchange difference	60,271	(16,658)
Total foreign exchange difference	78,889	(9,917)
Fair value changes in embedded derivatives	(88,484)	(174,641)
Fair value changes in other derivatives	(8,426)	5,014
Financial income and (expenses)	(106,477)	(273,273)

Capitalised finance cost amounted to 3.5% of invested cash in hydropower stations under construction in the year 2014 (2013: 3.5%) and 4.8% of invested cash in transmission under construction (2013: 7.0%).

Consolidated Financial Statements of Landsvirkjun 2014 16 Amounts are in USD thousand

Notes, contd.:

7. Income tax

Income tax is specified as follows:

	2014	2013
Change in income tax asset / liability	(25,423)	26,792
Current tax	(4,657)	(37)
Income tax due to pension liability recognised among comprehensive income	(1,034)	(612)
Foreign exchange difference	(673)	(230)
Adjustment due to previous year with subsidiary	(11)	0
Income tax recognised as income (expensed)	(31,797)	25,913

Effective tax rate

		2014		2013
Profit (loss) for the year		78,420		(38,541)
Income tax for the year		31,797		(25,913)
Profit (loss) before income tax		110,217		(64,454)
Income tax acc. to the parent company's curr. tax rate	36.0%	39,678	36.0%	(23,203)
Effect of different tax rates within the Group	(6.2%)	(6,862)	6.2%	(4,002)
Effect of merger of subsidiary with parent company	0.0%	0	(0.2%)	97
Non-deductible items	(1.3%)	(1,466)	(0.6%)	358
Other items	0.4%	448	(1.3%)	837
Effective income tax	28.8%	31,797	40.2%	(25,913)

Income tax due to items recognised in other comprehensive income is specified as follows:

	2014	2013
Income tax due to pension liability recognised in other comprehensive income	(1,034)	(612)

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

	Deferred tax asset		Deferred income tax liability	
	2014	2013	2014	2013
Balance at the beginning of the year	89,536	56,218	(21,076)	(14,550)
Change from asset to liability between years	0	(20)	0	20
Change in temporary difference	(26,545)	32,945	(1,506)	863
Change in carry forward loss	3,971	(1,852)	(1,613)	(5,394)
Foreign exchange difference	(1,951)	2,245	2,221	(2,015)
Balance at year end	65,012	89,536	(21,975)	(21,076)

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

Carry forward taxable loss	21,309	19,289	26	1,665
Non-current assets and intangible assets	41,133	83,303	(22,932)	(25,315)
Derivative financial instruments	8,005	(26,883)	0	0
Other items	(5,435)	13,827	932	2,574
Balance at year end	65,012	89,536	(21,975)	(21,076)

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

Carry forward loss of the year 2008, usable until the year 2018	0	9,317
Carry forward loss of the year 2009, usable until the year 2019	36,319	40,733
Carry forward loss of the year 2010, usable until the year 2020	975	975
Carry forward loss of the year 2011, usable until the year 2021	958	958
Carry forward loss of the year 2012, usable until the year 2022	9,908	9,908
Carry forward loss of the year 2013, usable until the year 2023	15	17
Carry forward loss of the year 2014, usable until the year 2024	11,145	0
Carry forward loss at year end	59,321	61,909

Consolidated Financial Statements of Landsvirkjun 2014 17 Amounts are in USD thousand

Notes, contd.:

7. Income tax, cont.:

Deferred tax asset is calculated on all carry forward loss as it is considered 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.

8. Property, plant and equipment

Property, plant and equipment is specified as follows:

Cost value	Power stations	Trans-mission	Communicat. equipment	Other assets	Total
Total value at 1.1.2013	4,857,421	531,044	16,486	70,399	5,475,350
Effect of exchange rate changes	0	66,761	2,031	3,411	72,203
Additions during the year	4,719	5,527	1,050	5,320	16,616
Transferred from development costs ..	4,065	0	0	0	4,065
Transferred from transmission under construction	0	49,882	0	0	49,882
Sold and disposed of	0	0	0	(7,642)	(7,642)
Total value at 31.12.2013	4,866,205	653,214	19,567	71,488	5,610,474
Effect of exchange rate changes	0	(63,100)	(1,995)	(3,392)	(68,487)
Additions during the year	9,850	6,519	2,064	4,287	22,720
Transferred from projects under construction	231,574	18,475	0	979	251,028
Sold and disposed of	(51,167)	0	(6)	(3,070)	(54,243)
Total value at 31.12.2014	5,056,462	615,108	19,630	70,292	5,761,492
Depreciation and impairment loss					
Total value at 1.1.2013	1,856,852	110,400	3,806	28,009	1,999,067
Effect of exchange rate changes	0	14,351	519	913	15,783
Depreciation of the year	81,974	18,587	1,058	2,953	104,572
Sold and disposed of	0	0	0	(4,559)	(4,559)
Total value at 31.12.2013	1,938,826	143,338	5,383	27,316	2,114,863
Effect of exchange rate changes	0	(15,148)	(585)	(1,003)	(16,736)
Depreciation of the year	86,117	21,316	1,020	3,310	111,763
Sold and disposed of	(45,988)	0	(6)	(2,066)	(48,060)
Total value at 31.12.2014	1,978,955	149,506	5,812	27,557	2,161,830
Book value					
1.1.2013	3,000,569	420,644	12,680	42,390	3,476,284
31.12.2013	2,927,379	509,876	14,184	44,172	3,495,611
31.12.2014	3,077,507	465,602	13,818	42,735	3,599,661
Book value without revaluation					
1.1.2013	3,000,569	308,080	11,534	42,390	3,362,573
31.12.2013	2,927,379	390,038	13,155	44,172	3,374,744
31.12.2014	3,077,507	362,561	13,084	42,735	3,495,887

Official assessment of fixed assets and insurance value

The official assessment of the Company's real estates amounted to USD 311 million at year end 2014 (2013: USD 329 million). Insurance value of the Company's assets amounts to USD 4,614 million (2013: USD 4,154 million) and catastrophe insurance amounts to USD 891 million (2013: USD 955 million).

Consolidated Financial Statements of Landsvirkjun 2014 18 Amounts are in USD thousand

9. Projects under construction

Projects under construction are specified as follows:

	2014	2013
Balance at 1.1.	221,820	151,509
Effect of exchange rate changes	(694)	1,289
Transferred from development costs	981	403
Additions during the year	34,319	118,501
Transferred to property, plant and equipment	(250,049)	(49,882)
Balance at 31.12.	6,377	221,820

10. Intangible assets

Intangible assets are specified as follows:

	Capitalised development costs	Water and geothermal rights	Software	Total
Cost value				
Total value at 1.1.2013	247,051	45,611	7,137	299,799
Effect of exchange rate changes	1,408	0	381	1,789
Additions during the year	20,747	0	1,012	21,759
Transf. to transm. under constr. / power stations	(4,468)	0	0	(4,468)
Total value at 31.12.2013	264,738	45,611	8,530	318,879
Effect of exchange rate changes	(1,423)	0	(404)	(1,827)
Additions during the year	25,845	0	912	26,757
Transf. to transmission under construction	(981)	0	0	(981)
Total value at 31.12.2014	288,179	45,611	9,038	342,828
Depreciation and impairment loss				
Total value at 1.1.2013	61,038	0	5,199	66,237
Effect of exchange rate changes	243	0	263	506
Amortisation during the year	0	0	421	421
Impairment loss during the year	12,678	0	0	12,678
Total value at 31.12.2013	73,959	0	5,883	79,842
Effect of exchange rate changes	(385)	0	(249)	(634)
Amortisation during the year	0	0	471	471
Impairment loss during the year	1,811	0	0	1,811
Total value at 31.12.2014	75,385	0	6,105	81,490
Book value				
1.1.2013	186,013	45,611	1,938	233,563
31.12.2013	190,779	45,611	2,647	239,038
31.12.2014	212,794	45,611	2,932	261,340

At year end, an impairment test was performed on the Company's intangible assets. 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 4.9% (2013: 5.5%) of weighted average required rate of return. The result of the test did not show any indication of impairment but during the year impairment had been recorded due to individual projects.

Consolidated Financial Statements of Landsvirkjun 2014 19 Amounts are in USD thousand

Notes, contd.:

11. Depreciation and impairment loss

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

	2014	2013
Power stations	86,117	81,974
Transmission	21,316	18,587
Telecommunication equipment	1,020	1,058
Other assets	3,310	2,953
Depreciation of assets in operation	111,763	104,572
Impairment loss on development cost	1,811	12,678
Amortisation of software	471	421
	114,045	117,670

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

Energy production costs	86,784	82,594
Transmission costs	24,070	19,379
Cost of general research	0	12,062
Other operating expenses	3,191	3,635
	114,045	117,670

12. Derivative financial instruments

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

Assets:

Embedded derivatives in electricity sales agreements	13,620	109,465
Aluminium hedges	10,437	14,833
Currency swaps	0	4,303
Other derivatives	249	9,588
	24,306	138,189

Derivative financial instruments are divided as follows:

Long-term component of derivative agreements	15,313	112,451
Short-term component of derivative agreements	8,993	25,738
	24,306	138,189

Liabilities:

Embedded derivatives in electricity sales agreements	5,909	13,271
Aluminium hedges	2,939	4,786
Currency swaps	5,695	0
Interest rate swaps	33,630	38,124
Other derivatives	4,414	3,754
	52,587	59,935

Derivative financial instruments are divided as follows:

Long-term component of derivative agreements	22,053	50,029
Short-term component of derivative agreements	30,534	9,906
	52,587	59,935

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

The fair value of other derivatives than embedded derivatives is based on available evaluation of counterparties and verified by treasury division with comparative calculations based on market information.

Consolidated Financial Statements of Landsvirkjun 2014 20 Amounts are in USD thousand

Notes, contd.:

13. Associated companies

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

		2014	
	Share	Share in return	Book value
Farice ehf., Kópavogur, Iceland	28.9%	(1,477)	16,455
SER eignarhaldsfélag ehf., Reykjavík, Iceland	33.3%	0	93
Sjávarorka ehf., Reykjavík, Iceland	33.6%	(38)	34
Hecla SAS, France	28.5%	96	430
		(1,419)	17,012

		2013	
	Share	Share in return	Book value
Farice ehf., Kópavogur, Iceland	28.9%	(2,788)	20,185
Sjávarorka ehf., Reykjavík, Iceland	30.3%	38	40
Hecla SAS, France	28.5%	103	492
		(2,647)	20,717

14. Other non-current assets

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

	2014	2013
Shares in other companies	120	133
Long-term receivables	11,334	3,477
	11,454	3,610

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:

Oil	0	39
Spare parts and consumables	4,498	4,788
	4,498	4,827

17. Accounts receivables and other receivables

Accounts receivables and other receivables are specified as follows:

Accounts receivables	59,763	48,393
Other short term receivables	13,573	18,960
Assets available for sale	32	277
	73,368	67,630

At year-end 2014, 95% of accounts receivables were under 30 days old (2013: 97%).

Consolidated Financial Statements of Landsvirkjun 2014 21 Amounts are in USD thousand

Notes, contd.:

18. Cash and cash equivalents

Cash and cash equivalents are specified as follows:

	2014	2013
Bank deposits	135,375	202,447
Market securities	71,695	85,540
	207,070	287,987

19. Equity

The Parent Company is a partnership owned by the State and Eignarhlutir ehf. The State owns 99.9% in the Company and Eignarhlutir ehf. 0.1%. Eignarhlutir ehf. is owned by the State. The Company is an independent taxable entity. The Group's equity ratio at year end 2014 was 39.9% but was 36.3% at year end 2013.

20. Revaluation account and translation difference

The revaluation account consists of revaluation of fixed assets of subsidiaries after income tax effect. Translation difference is the foreign exchange difference arising due to Landsvirkjun's subsidiaries and associated companies with other functional currencies.

21. Liabilities

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

	Maturity date	2014 Average interest	Remaining balance	2013 Average interest	Remaining balance
Liabilities in ISK	2015-2034	3.8%	320,758	3.8%	380,002
Liabilities in CHF	2015-2022	0.3%	44,439	0.3%	55,951
Liabilities in EUR	2016-2026	0.9%	611,294	1.1%	796,182
Liabilities in GBP			0	10.4%	4,961
Liabilities in JPY			0	4.0%	12,380
Liabilities in USD	2015-2032	2.9%	1,421,038	3.0%	1,467,687
			2,397,529		2,717,163
Current maturities of long-term debt			(272,429)		(175,357)
Total long-term debt			2,125,100		2,541,806

Interest rate terms on loans at year end are from 0.1-6.5%. Nominal interest rates for the period were on average 3.5%, taking into account the state guarantee fee, which is virtually unchanged from the previous year.

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

22. According to loan agreements, the current maturities of long-term debt are as follows:

	2014	2013
2014	-	175,357
2015	272,429	189,966
2016	242,640	250,225
2017	242,863	264,243
2018	325,818	328,315
2019	208,717	-
Later	1,105,062	1,509,057
	2,397,529	2,717,163

Consolidated Financial Statements of Landsvirkjun 2014 22 Amounts are in USD thousand

Notes, contd.:

23. Pension fund obligation

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 26.3 million at year end 2014 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 death rate are in accordance with the provisions of Regulation No. 391/1998 on obligatory pension benefits and operation of pension funds. The retirement age is 68 years for current employees and 65 years for non-employees with vested benefits and this is consistent with the relevant pension funds' regulation.

Change in the obligation is specified as follows:	**2014**	**2013**
Balance at 1.1.	27,007	23,228
Expensed during the year	606	583
Payments during the year	(1,516)	(1,331)
Actuarial change	2,872	1,700
Effect of foreign exchange rate differences	(2,624)	2,827
Balance at 31.12.	26,345	27,007

Pension fund obligation, 5 year statem:	**2014**	**2013**	**2012**	**2011**	**2010**
Present value of the obligation	26,345	27,007	23,228	23,238	23,442

24. Obligation due to demolition

Change in the obligation due to demolition is specified as follows:	**2014**	**2013**
Balance at 1.1.	6,739	5,704
Reversal of discount in the year	374	334
Increase in obligation	8	0
Effect of foreign exchange rate differences	(661)	701
Balance at 31.12.	6,460	6,739

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.

25. Accounts payable and other payables

Accounts payable and other payables are specified as follows:

Accounts payable	20,153	30,620
Accrued interests	18,029	24,882
Other short term liabilities	14,849	20,161
	53,031	75,663

Consolidated Financial Statements of Landsvirkjun 2014 23 Amounts are in USD thousand

Notes, contd.:

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	**2014**	**2013**
Other income		
Associated companies	7	0
Interest income		
Associated companies	0	12
Expenses		
Associated companies	6	5
Receivables		
Associated companies	9	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 defined as transactions with non related parties.

27. Cash flow

Cash flow from operation is an indicator for the Company's ability to meet its payment obligations. The following operating activities are presented according to the direct method:

	2014	**2013**
Operating activities		
Cash received from customers	419,203	427,712
Cash expenses	(107,528)	(97,549)
Cash flow from operation excluding interest	311,675	330,163
Interest income received	3,261	2,183
Interest expenses and foreign exchange difference paid	(81,082)	(73,757)
Taxes paid	(38)	(104)
Cash flow from operating activities	233,816	258,485

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
- Effective management is applied in accordance with authorisations
- Effective monitoring on risk factors is ensured
- That information provided to the risk committee and the Board of Directors is accurate and provided on a regular basis

Decisions and supervision of risk management are entrusted to a risk management committee. The risk management committee consists of the CEO, his deputy and the CFO. The CEO is the chairman of the risk management committee.

Consolidated Financial Statements of Landsvirkjun 2014 24 Amounts are in USD thousand

Notes, contd.:

28. Risk management, cont.:

The objectives of treasury division are to analyse and manage Landsvirkjun's risks in order to stabilise operating return by reducing operating fluctuations. Financial risk is divided into market risk, liquidity risk and counterparty risk. 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

29. Financial risk

Landsvirkjun aims to reduce market risk related to foreign currencies by increasing the weight of USD in the parent Company's loan portfolio. In the past three years, Landsvirkjun has for that purpose entered into agreements to change the terms of loans from EUR to USD in the amount of EUR 265 million. In December 2014 the Company repurchased around 36% of the bond LAND 05 1 for a nominal value of ISK 7.96 billion. During the year 2014, debt in JPY og GBP was fully repaid. Therefore, the Company's debt is now only in USD, EUR, CHF and ISK. The majority of the Group's debt is in USD. During the year 2015, Landsvirkjun will continue to work on changes on the Company's debt portfolio for the purpose of reducing currency risk.

At year end 2014, the Company had access to undrawn Revolving Credit Facilities in the amount of USD 200 million but the Company's Revolving Credit Facilities in the amount of ISK 10.500 million had been fully drawn. The maturity profile, strong liquidity, and access to loans secure the Company's liquidity at least until year end 2016.

30. Aluminium price risk

The Company is exposed to risk due to possible aluminium price fluctuations as around 30% of its income is linked to the aluminium price. 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 increases, but at the same time guarantees better cash flow should the price of aluminium decrease. Treasury division may hedge up to 100% of aluminium price risk for next year and proportionally less over the next years but is not limited by minimum hedges. Around 50% of 2015 estimated cash flow and 20% of 2016 estimated cash flow has been hedged. At year end 2014, fair value of the hedges was positive by USD 7.5 million (2013: USD 10 million), but the agreements are in effect over the next two years.

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 sales agreements are recognised in the balance sheet at fair value on the reporting date. Fair value changes of the agreements during the year are recognised in the income statement among financial income and expenses.

	2014	2013
The fair value of embedded derivatives is specified as follows:		
Fair value of embedded derivatives at the beginning of the year	96,195	270,836
Fair value changes during the year	(88,484)	(174,641)
Fair value of embedded derivatives at year end	7,711	96,195
Division of embedded derivatives is specified as follows:		
Long term component of embedded derivatives	7,728	95,711
Short term component of embedded derivatives	(17)	485
Total embedded derivatives	7,711	96,195

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Notes, contd.:

30. Aluminium price risk, contd.:

Embedded derivatives, contd.:

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 up on the maximum time length of forward aluminium prices, or 123 months. The 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.

Valuation method for embedded derivatives was changed during the year. The main change on the valuation method is that current calculations include credit risk and effects of inefficient markets. The effects of the changed valuation method is that the fair value of embedded derivatives is USD 7.7 million instead of USD 35.4 million as it would be under previous method. It is the management's opinion that the changed method gives a more true and fair view of fair value of embedded derivatives.

Expected cash flow of contracts is discounted at USD rates according to Bloomberg, no spread added. At year end 2014, rates for discounting were in the range of 0.2 - 2.4% (2013: 0.3 - 3.3%).

Sensitivity analysis of aluminium price risk

The following table shows effects of changes in aluminium prices on fair value of financial instruments linked to aluminium prices.

Amounts are in thousands of USD, pre tax.

31/12/2014	**Aluminum price USD/ton**	
	-100	+100
Embedded derivatives	(11,811)	11,811
Aluminium hedges	4,109	(4,358)
	(7,702)	7,453

31/12/2013	**Aluminum price USD/ton**	
	-100	+100
Embedded derivatives	(48,836)	48,836
Aluminium hedges	4,747	(5,105)
	(44,089)	43,731

Notes, contd.:

31. Foreign exchange risk

Foreign currency 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.

The parent Company'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 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. Treasury division has the authority to hedge foreign currency cash flows against the functional currency for up to three years in advance with forward agreements and options and for ten years with currency swaps.

The Company's reporting risk related to changes in exchange rate arises mainly due to its debt in EUR, which are mainly long-term loans. Foreign currency risk due to open positions in EUR was at the end of December 2014 about 20% of the Company's interest bearing debt (2013: 20%). The following table shows Landsvirkjun's open balance in currencies other than the functional currency.

Landsvirkjun's foreign exchange risk at year end is specified as follows:

2014	**EUR**	**ISK**	**CHF**	**Other currencies**
Accounts receivables and other receivables	358	18,689	0	2,227
Cash and cash equivalents	848	33,088	44	2,193
Derivatives	139,688	0	0	0
Interest bearing liabilities	(611,294)	(320,758)	(44,439)	0
Accounts payable and other payables	(1,542)	(42,091)	(44)	(494)
Risk in balance sheet	(471,942)	(311,072)	(44,439)	3,926

2013	**EUR**	**ISK**	**CHF**	**Other currencies**
Long term receivables	0	3,477	0	0
Accounts receivables and other receivables	571	15,179	0	3,564
Cash and cash equivalents	3,745	33,624	226	11,466
Derivatives	261,801	0	0	0
Interest bearing liabilities	(796,182)	(380,002)	(55,951)	(17,341)
Accounts payable and other payables	(2,635)	(50,619)	(57)	(5,176)
Risk in balance sheet	(532,700)	(378,341)	(55,782)	(7,487)

Exchange rate of the main currencies against the USD, (USD/currency) for the years 2014 and 2013 is specified as follows:

	Average rate		**Rate at year end**	
	2014	**2013**	**2014**	**2013**
EUR	0.75	0.75	0.82	0.73
GBP	0.61	0.64	0.64	0.60
CHF	0.92	0.93	0.99	0.89
JPY	105.84	97.55	119.48	105.00
NOK	6.31	5.88	7.40	6.08
ISK	116.75	122.23	126.90	115.03

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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 after tax. The analysis is based on that all variables, especially interest rates, remain unchanged.

	Profit (loss)		Equity	
2014	Strengthening	Weakening	Strengthening	Weakening
EUR	45,630	(49,194)	43,984	(47,549)
ISK	(8,247)	8,247	(24,829)	24,829
CHF	4,444	(4,444)	4,444	(4,444)
USD*	(9,025)	9,025	(9,025)	9,025
2013	Strengthening	Weakening	Strengthening	Weakening
EUR	61,147	(67,978)	59,129	(77,432)
ISK	(5,585)	5,585	(20,518)	20,518
CHF	5,578	(5,578)	5,578	(5,578)
USD*	(7,240)	7,240	(7,240)	7,240

(*) Risk in USD is due to assets and liabilities of subsidiaries which do not have USD as their functional currency.

The fair value of currency swaps was negative by USD 5.7 million at the end of December 2014 (2013: positive by USD 4.3 million). The fair value of currency options was negative by USD 4.2 million (2013: positive by USD 5.8 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 are used in order to manage interest rate risk. Interest bearing financial liabilities with floating interest rates are more than interest bearing financial assets and therefore, the Company's risk consists of possible increase in interests and increased interest expenses. The Company's financial instruments with fixed interests are not sensitive for changes in interest rates.

At year end 2014, the proportion of loans with floating interest rates including swap agreements was 57% (2013: 59%). At year end 2014, the estimated market value of the Company's long-term liabilities was USD 151 million higher than their book value (USD 187 million higher in the year 2013) 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.

Financial instruments with fixed interest	**2014**	**2013**
Financial assets	0	3,477
Financial liabilities	(1,028,164)	(1,114,037)
	(1,028,164)	(1,110,560)
Financial instruments with floating interest		
Financial assets	207,070	287,987
Financial liabilities	(1,369,365)	(1,603,126)
	(1,162,295)	(1,315,139)
Derivative financial instruments		
Embedded derivatives	7,711	96,195
Other derivatives	(35,992)	(17,940)
	(28,281)	78,255

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Notes, contd.:

32. Interest rate risk, contd.:

The fair value of interest rate swaps was negative by USD 33.6 million at year end 2014 (2013: negative by USD 38.1 million).

Sensitivity analysis

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

31/12/2014	**Cash flow**		**Fair value**	
	-1 bps	+1 bps	-1 bps	+1 bps
Embedded derivatives	0	0	6	(6)
Derivatives	(19)	19	(48)	48
Interest bearing liabilities	158	(158)	0	0
Financial assets	(21)	21	0	0
	118	(118)	(42)	42

31/12/2013	**Cash flow**		**Fair value**	
	-1 bps	+1 bps	-1 bps	+1 bps
Embedded derivatives	0	0	61	(58)
Derivatives	(21)	21	(67)	67
Interest bearing liabilities	181	(181)	0	0
Financial assets	(57)	57	0	0
	103	(103)	(6)	9

33. Liquidity risk

Liquidity risk consists of risk of losses should the Company not be able to meet its obligations at maturity date. The Company limits liquidity risk with effective liquidity management by ensuring that there is sufficient cash at each time in order to be able to meet the Company's obligations. The Company's liquidity balance is monitored and the emphasis is placed on having sufficient cash position and access to Revolving Credit Facilities. At year end 2014, the Company had access to undrawn Revolving Credit Facilities in the amount of USD 200 million but the Company's Revolving Credit Facilities in the amount of ISK 10.500 million had been fully drawn.

The Company's cash and cash equivalents amounted to USD 207 million at year end 2014 (2013: USD 288 million) but when taking into account undrawn credit facilities the Company has access to a total of USD 407 million. Cash flow from operations, well organised maturity profile with strong liquidity, and access to credit facilities secure the Company's liquidity at least throughout the year 2016.

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 a state guaranteed Euro Medium Term Note Programme (EMTN).

- At year end 2014, the balance of loans under the EMTN with state guarantee was USD 1.6 billion (2013: USD 1.8 billion). The total amount the Company can borrow under the programme is USD 2.5 billion.
- At year end 2014, the balance of loans under the EMTN without state guarantee was USD 30 million (2013: USD 30 million). The total amount the Company can borrow under the programme is USD 1.0 billion.

The Company's risk related to refinancing is reduced with an even maturity profile and long loan terms of outstanding loans. Weighted average life of the loan portfolio is 5.4 years and the proportion of loans with maturity within 12 months is 11.4%.

Notes, contd.:

33. Liquidity risk, contd.:

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

2014	Book value	Contractual cash flow	Within one year	1 - 2 years	2 - 5 years	More than 5 years
Non-derivative financial instruments						
Long term receivables .	11,334	11,334	0	5,666	5,668	0
Cash and cash equiv. ...	207,070	207,070	207,070	0	0	0
Short term receiv.	73,368	73,368	73,368	0	0	0
Interest bearing liab. ...	(2,397,529)	(2,758,841)	(310,905)	(287,554)	(900,961)	(1,259,421)
Current liabilities	(57,688)	(57,688)	(57,688)	0	0	0
	(2,163,445)	(2,524,757)	(88,155)	(281,888)	(895,293)	(1,259,421)
Derivative financial instruments						
Currency swaps	(9,861)	(10,862)	(3,777)	(726)	(6,359)	0
Interest rate swaps	(33,630)	(33,816)	(27,606)	(3,716)	(2,494)	0
Aluminium derivatives .	7,499	10,244	7,027	3,217	0	0
Embedded derivatives in electr. sales agr.	7,711	9,030	(17)	154	1,924	6,969
	(28,281)	(25,404)	(24,373)	(1,071)	(6,929)	6,969
2013						
Non-derivative financial instruments						
Long term receivables .	3,477	3,761	243	3,518	0	0
Cash and cash equiv. ...	287,987	287,987	287,987	0	0	0
Short term receiv.	67,630	67,630	67,630	0	0	0
Interest bearing liab. ...	(2,717,163)	(3,280,119)	(219,297)	(253,453)	(1,016,325)	(1,791,044)
Current liabilities	(75,701)	(75,701)	(75,701)	0	0	0
	(2,433,770)	(2,996,442)	60,862	(249,935)	(1,016,325)	(1,791,044)
Derivative financial instruments						
Currency swaps	10,137	11,759	7,486	(418)	4,691	0
Interest rate swaps	(38,124)	(38,776)	(4,496)	(29,214)	(5,066)	0
Aluminium derivatives .	10,047	12,265	9,768	1,955	542	0
Embedded derivatives in electr. sales agr.	96,195	113,116	487	4,011	31,062	77,556
	78,254	98,364	13,245	(23,666)	31,229	77,556

34. Credit risk

Credit 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 due to the Company's energy contracts, derivatives contracts and cash and cash equivalent. Though the amounts involved are considerably high, the risk is limited with the Company´s requirements for counterparty quality. Landsvirkjun has set a benchmark for derivatives which involves that no derivative agreements are made with financial companies that have a lower rating than A- from Standard and Poor's or a comparable rating from other recognised credit rating agencies. Before entering into energy contracts the financial standing of the relevant companies and their parent companies is thoroughly reviewed, if applicable.

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Notes, contd.:

34. Credit risk, contd.:

The Company's credit risk is specified as follows at year end:

	2014	2013
Derivative financial instruments	24,306	138,189
Long term receivables	11,334	3,477
Accounts receivables and other receivables	73,368	67,630
Cash and cash equivalents	207,070	287,987
	316,078	497,283

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

	2014		2013	
	Book value	Fair value	Book value	Fair value
Interest bearing long term liabilities	2,397,529	2,548,996	2,717,163	2,904,201

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

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

Interest rates are specified as follows:

	2014	2013
Interest bearing liabilities in ISK	3,1%-4,7%	2,2-3,0%
Interest bearing liabilities other than in ISK	0,0-2,6%	0,0-4,0%

36. Fair value classification

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

2014	Level 2	Level 3	Total
Embedded derivatives		7,711	7,711
Other derivatives	(35,992)		(35,992)
Shares in other companies		120	120
	(35,992)	7,831	(28,161)

2013	Level 2	Level 3	Total
Embedded derivatives		96,195	96,195
Other derivatives	(17,940)		(17,940)
Shares in other companies		133	133
	(17,940)	96,328	78,388

Classification of financial assets between levels remains unchanged from the previous year. Fair value changes of financial assets at level 3 amounted to USD 88.5 million expensed in the year 2014 (USD 174.6 million expensed in the year 2013) and is recognised among financial income and expenses.

Consolidated Financial Statements of Landsvirkjun 2014 31 Amounts are in USD thousand

Notes, contd.:

37. Classification of financial instruments

According to the International Financial Reporting Standard *IAS 39 Financial instruments: recognition and measurement,* financial assets and liabilities are divided into defined groups. The classification affects how the 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 receivables	Financial liabilities recognised at amortised cost	Book value
2014					
Derivative financial instruments	24,306				24,306
Shares in other companies		120			120
Long-term receivables			11,334		11,334
Accounts receivables and					
other receivables			73,368		73,368
Cash and cash equivalents			207,070		207,070
Total assets	24,306	120	291,772	0	316,198
Interest bearing long term liabilities				2,397,529	2,397,529
Derivative financial instruments	52,587				52,587
Accounts payable and					
other payables				57,688	57,688
Total liabilities	52,587	0	0	2,455,217	2,507,804
2013					
Derivative financial instruments	138,189				138,189
Shares in other companies		133			133
Long-term receivables		3,477			3,477
Accounts receivables and					
other receivables			67,630		67,630
Cash and cash equivalents			287,987		287,987
Total assets	138,189	3,610	355,617	0	497,416
Interest bearing long term liabilities				2,717,163	2,717,163
Derivative financial instruments	59,935				59,935
Accounts payable and					
other payables				75,701	75,701
Total liabilities	59,935	0	0	2,792,864	2,852,799

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 statement for the year 2014.

Consolidated Financial Statements of Landsvirkjun 2014 32 Amounts are in USD thousand

Notes, contd.:

40. Significant accounting policies

The Group has adopted all International Financial Reporting Standards, amendments thereto and interpretations confirmed by the EU at year end 2014 and apply to its operation. The Group has not adopted standards, amendments to standards or interpretations entering into effect after year end 2014, which may be adopted earlier.

The Group has implemented the following accounting principles and changes in accounting standards as of 1 January 2014.

- IFRS 10, Consolidated financial statements
- IFRS 11, Joint arrangements
- IFRS 12 Disclosure of interests in other entities

The effect of these changes is explained as follows.
IFRS 10 assumes a single model for consolidation which is based on control irrespective of the nature of the investor. According to the standard, control is based upon whether the investor has the power over the investee, exposure and rights to variable returns by participating in the investee and can by the power to govern influence his returns of the investee.

IFRS 11 provides principles for accounting for interests in joint arrangements. The definition of joint arrangements is when two or more parties share control. The standard applies to all companies that participate in joint arrangements.

IFRS 12 requires that information is provided in notes which enables the users of financial information to assess the nature and the risk of owning interests in other entities and the effects on operations, statement of financial position and cash flow. Significant disclosure requirements are made in connection with significant judgments and assumptions such as how control, joint control and significant influences are assessed.

It is the opinion of management that the implementation of those standards did not have significant effects on the valuation of assets or liabilities of the Group. It is also the management's opinion that changes to other standards and interpretations than those described above and apply to accounting periods from 1 January 2014 has no effects on the financial statements of the Group.

41. Basis of consolidation

Subsidiaries are entities controlled by the Company. The Group controls an entity when it has the power to govern over 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 statements 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 a subsequent period, a share in their profit is not recognised until a share in a loss has been fully set off.

Notes, contd.:

41. Basis of consolidation, contd.:

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 a subsidiary 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 flows 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 flows.

42. Associated companies

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

The financial statements include the Group's 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.

43. Operating revenues

Revenues from sales and transmission of electricity consists of sales supplied to power intensive industries and public utilities based on the delivery of electricity during the period. Other service income is recognised when earned or upon delivery. Other revenues increased by USD 17 million due to an agreement with Rio Tinto Alcan in Iceland.

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 (expenses) include profit and 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 period. The foreign currency gain or loss thereon 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 an available-for-sale financial asset is calculated by reference to its fair value.

Impairment loss on financial assets is recognised in the income statement. Accumulated loss on available for sale financial assets, previously recognised among equity, is recognised in the income statement when the impairment loss has been 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 available-for-sale financial assets that are debt securities, the reversal is recognised in the income statement. For available-for-sale financial assets that are equity securities, the reversal is recognised in the statement of comprehensive income.

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, if no impairment loss had been recognised.

Notes, contd.:

48. Income tax

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

Current 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 tax of previous years.

A deferred 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.

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 in the year 2008. The revaluation of those assets will be 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.

49. Property, plant and equipment, contd.:

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 reassessed 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
Thermal stations	1.67-6.67%	15-60 years
Windmills	5.00%	20 years
Substations	2.5%-5%	20-40 years
Power lines	2-5%	20-50 years
Optical fibre	5.00%	20 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

50. Intangible assets

Intangible assets are recognised at cost value, less 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. The 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 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.

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

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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 available-for-sale financial assets.

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.

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.

Notes, contd.:

51. Financial instruments, contd.:

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 reconised 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.

54. Equity

The Group’s equity is divided into owners’ contribution, revaluation account, translation difference, 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 a contribution to defined benefit plans is expensed in the income statement 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, 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 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 cash flow, discounted on the basis of interests reflecting market interests and the risk inherent with the obligation.

Notes, contd.:

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 the 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.

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.

Values and social responsibility

Landsvirkjun's employees hold progress, prudence and trust as their guiding principles. Landsvirkjun's policy on social responsibility was approved and presented in November 2011. The policy aims at increasing the Company's positive effect on stakeholders and minimise the negative effect on the environment and community. The policy sets the basis for the Company to obtain its goal of becoming a leading energy company in the field of renewable energy and aims at Landsvirkjun taking note of the economy, environment and community in its operation.

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 the Company. 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, CEO of Samfylkingin, and Álfheiður Ingadóttir, biologist.

Audit committee

Chapter IX of the Act No. 3/2006 on financial statements, 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 Þórunn Sveinbjarnardóttir, and Heimir Haraldsson, auditor and chairman of the committee.

CEO, Deputy and Executive Directors

The Board of Directors of Landsvirkjun hires a CEO. The CEO of the Company is Hörður Arnarson. The Board of Directors and the CEO exercise executive power in the Company. Landsvirkjun's Deputy CEO is Ragna Árnadóttir. The Deputy'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 basis for profitable operation and contribute to maximum results in all units of the Group.

Project planning division. The Head of project planning division is Gunnar Guðni Tómasson. The role of the division is to manage Landsvirkjun's power plant constructions from development to fully operative power plants. The division monitors costs, quality and work progress and ensures that projects are delivered fully operative in accordance with the Company's presumptions, estimates and needs.

Marketing and business development division. Head of marketing and business development is Björgvin S. Sigurðsson. The role of the division is to maximise the Company's revenue by analysing different business opportunities, product development, promotion, and sales of products and services, and negotiating new power contracts and follow up on the execution of existing contracts.

Energy division. Head of the energy division is Einar Mathiesen. The role of the division is to guarantee that energy production and distribution is in accordance with agreements with customers in a safe and an efficient way.

Research and development division. Head of research and development is Óli Grétar Blöndal Sveinsson. The role of the division is to manage the preparation of new power projects and to conduct research and monitoring of the existing power system. The division shall ensure the economic implementation of new power projects, increase flexibility and manage innovation, and to have a long-term vision of utilisation of energy resources.