Landsvirkjun

Consolidated Financial Statements 2012

Landsvirkjun
Háaleitisbraut 68
103 Reykjavík
Iceland

Reg. no. 420269-1299

Contents

Key figures

Management's presentation of the operation of Landsvirkjun

Amounts are in USD thousand

	2012	2011	2010	2009	2008
Operation					
Operating revenues	389,499	419,708	383,991	299,788	452,027
Realised aluminium hedges	18,325	16,488	(6,342)	42,526	(54,759)
Total operating revenues	407,824	436,196	377,649	342,314	397,268
Operating expenses	(88,225)	(90,993)	(79,564)	(70,655)	(100,512)
EBITDA	319,599	345,203	298,085	271,659	296,756
Depreciation and impairment loss	(112,288)	(108,200)	(107,258)	(114,321)	(105,532)
EBIT	207,311	237,003	190,827	157,338	191,224
Financial items	(103,093)	(126,877)	(99,275)	(96,102)	(142,452)
Associated companies	(2,229)	(4,014)	(1,581)	(11,193)	(4,100)
Profit before unrealised financial items	101,989	106,112	89,971	50,043	44,672
Unrealised financial items:					
Fair value changes in embedded derivatives	(3,391)	(93,197)	(55,583)	253,304	(497,167)
Fair value changes in other derivatives	13,653	6,959	(39,438)	(53,655)	186,284
Unrealised foreign exchange difference	(12,675)	22,711	87,619	(39,752)	(148,369)
	(2,413)	(63,527)	(7,402)	159,897	(459,252)
Profit (loss) before income tax	99,576	42,585	82,569	209,940	(414,580)
Income tax	(45,370)	(16,135)	(9,653)	(16,944)	70,048
Profit (loss)	54,206	26,450	72,916	192,996	(344,532)
Balance sheet					
Total assets	4,518,534	4,635,989	4,850,037	4,807,970	4,621,384
Equity	1,697,152	1,661,312	1,644,322	1,564,487	1,376,792
Liabilities	2,821,382	2,974,677	3,205,715	3,243,483	3,244,592
Net liabilities *	2,435,571	2,502,873	2,673,966	2,823,872	2,850,276
Cash flow					
Funds from operations (FFO)	241,584	255,592	218,582	202,142	207,297
Cash flow from operating activities	236,178	267,172	229,595	197,023	184,350
Investing activities	(122,979)	(107,689)	(53,517)	(120,533)	(374,797)
Financing activities	(151,670)	(185,328)	(106,294)	(4,572)	168,586
Liquidity					
Cash and cash equivalents at year end	187,916	229,942	265,532	194,248	124,993
Undrawn loans	409,979	415,767	307,676	281,600	350,000
Total liquidity	597,895	645,709	573,208	475,848	474,993
Key ratios					
Return on equity	3.3%	1.6%	4.7%	14.0%	(21.5%)
Equity ratio	37.6%	35.8%	33.9%	32.5%	29.8%
Interest cover (EBITDA/net interest expenses)	3.25x	3.06x	3.68x	3.14x	1.83x
FFO / net liabilities	9.9%	10.2%	8.2%	7.2%	7.3%
FFO / interest expenses	2.36x	2.19x	2.58x	2.19x	1.17x
Net liabilities / EBITDA	7.62x	7.25x	8.97x	10.39x	9.60x
Credit rating at year end					
Standard & Poor's	BB	BB	BB+	BB	BBB-
Moody's	Baa3	Baa3	Baa3	Baa3	Baa1

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

Quarterly statement 2012

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

	Q1	Q2	Q3	Q4	Total
Operating revenues					
Power sales	87,014	81,253	79,121	90,854	338,242
Realised aluminium hedges	1,775	7,651	6,137	2,762	18,325
Transmission	11,490	10,715	10,609	11,543	44,357
Other income	1,326	1,656	2,192	1,726	6,900
	101,605	101,275	98,059	106,885	407,824
Operating expenses					
Energy production costs	7,592	8,005	8,973	8,184	32,754
Transmission costs	4,243	4,254	4,699	9,708	22,904
Cost of general research	1,369	1,960	1,422	1,190	5,941
Other operating expenses	6,304	6,002	7,063	7,257	26,626
Depreciation and impairment loss	26,434	25,957	25,970	33,927	112,288
	45,942	46,178	48,127	60,266	200,513
Operating profit	55,663	55,097	49,932	46,619	207,311
Financial income and (expenses)					
Interest income	1,475	872	1,518	149	4,014
Interest expenses	(29,662)	(27,853)	(19,975)	(24,779)	(102,269)
Realised foreign exchange differences	(5,703)	(1,495)	(2,882)	5,242	(4,838)
	(33,890)	(28,476)	(21,339)	(19,388)	(103,093)
Associated companies	(702)	(837)	(1,042)	352	(2,229)
Profit before income tax and unrealised items	21,071	25,784	27,551	27,583	101,989
Unrealised financial items:					
Fair value changes in embedded derivatives	16,504	(83,924)	89,301	(25,272)	(3,391)
Fair value changes in other derivatives	20,002	(7,763)	(1,837)	3,251	13,653
Unrealised foreign exchange difference	(30,303)	52,321	(23,675)	(11,018)	(12,675)
	6,203	(39,366)	63,789	(33,039)	(2,413)
Profit (loss) before income tax	27,274	(13,582)	91,340	(5,456)	99,576
Income tax	(10,481)	5,298	(31,826)	(8,361)	(45,370)
Profit (loss)	16,793	(8,284)	59,514	(13,817)	54,206
Attributable to:					
Owners of the parent company	17,275	(9,427)	57,309	(13,212)	51,945
Subsidiaries minority interest	(482)	1,143	2,205	(605)	2,261
	16,793	(8,284)	59,514	(13,817)	54,206
From cash flow					
Cash flow from operating activities	57,010	61,077	46,290	71,801	236,178

Other key metrics for Landsvirkjun (parent company)	2012	2011	2010	2009	2008
Installed power at year end (MW)	1,860	1,860	1,860	1,860	1,860
Average price for industrial users (incl. transm.) USD/MWh	26.2	28.7	25.7	19.5	30.8
Average price for retail sales comp. (excl. transm.) ISK/kWh	3.9	3.6	3.4	3.2	3.0
Sales in Gwh	12,770	12,778	12,926	12,546	12,746
Research and development	32,514	17,203	19,575	23,601	48,363
Accident frequency: H200*	0.0	0.4	1.4	1.1	0.4

* 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 in accordance with decisions of the Board of Directors. 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 three subsidiaries of Landsvirkjun Power ehf. During the year Hraunaveita ehf. was sold to Landsvirkjun Power ehf. and Þeistareykir ehf. was merged with Landsvirkjun.

The financial statements of Landsvirkjun for the year 2012 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 407.8 million in the year 2012 compared to USD 436.2 million in the previous year. Income thus decreased by USD 28.4 million. The decrease is mainly explained by lower aluminium prices, despite being partly offset by power contracts linked to general price development. Revenue recognition due to realised aluminium hedges amounted to USD 18.3 million in the year 2012 compared to USD 16.5 million in the previous year. Operating expenses amounted to USD 200.5 million in the year 2012 compared to USD 199.2 million in the year 2011. The Company's operating profit thus amounted to USD 207.3 million in the year 2012 compared to USD 237.0 million in the previous year.

Financial expenses in excess of financial income amounted to USD 105.5 million in the year 2012, compared to USD 190.4 million the previous year. The change between years amounts to USD 84.9 million. The main reasons for this difference between years are fair value changes in derivative financial instruments. Fair value changes in derivative financial instruments are mostly unrealised, which must be kept in mind in the evaluation of the Company's return for the year. Profit before unrealised financial items amounted to USD 102.0 million during the year compared to USD 106.1 million in the year 2011. According to the income statement, profit of the year amounted to USD 54.2 million compared to USD 26.5 million in the previous year.

Landsvirkjun employs 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 due to portion of revenues being linked to aluminium prices. Positive fair value of aluminium hedges to ensure the Company's revenues amounted to USD 10.0 million at year end 2012. Fair value of currency and interest rate swap derivative agreements at year end 2012 was negative by USD 48.4 million. Fair value of embedded derivatives in Landsvirkjun's electric power sales agreements with aluminium companies after deducting the fair value of embedded derivatives in electric power purchase agreements is positive with a fair value of USD 270.8 million at year end 2012.

According to the balance sheet, equity at year end 2012 amounted to USD 1,697.2 million compared to USD 1,661.3 million at year end 2011. The Company's Board of Directors proposes that the profit of the year be recognised as an increase in equity. The Company's Board of Directors will propose during the Annual General Meeting 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%.

The financial position of the Company is acceptable and its liquidity position is strong due to its cash balance and access to undrawn loans. Cash and cash equivalents at year end amounted to USD 187.9 million and undrawn Revolving Credit Facilities to USD 281.6 million. Furthermore, undrawn long-term loans amount to USD 128.4 million. Liquid assets amounted thus to USD 597.9 million at year end. Cash flow from operations amounted to USD 236.2 million. Landsvirkjun borrowed USD 16.6 million in the year and paid down debt by USD 155.5 million. Cash and cash equivalents decreased by USD 42.0 million during the year. It is the opinion of Landsvirkjun's management that access to liquid assets is ensured until year end 2014. The construction of Budarhals power plant is on schedule.

Following the State's purchase of a share in Landsvirkjun held by the city of Reykjavik and the town of Akureyri, an agreement was reached stipulating that the city of Reykjavík and the town of Akureyri would provide a guarantee of collection together with the State for all of Landsvirkjun's obligations entered into before the end of 2006. From the beginning of 2007, the State and Eignarhlutir ehf. provide a guarantee of collection for all of Landsvirkjun's obligations entered into after that date in accordance with the Act on Landsvirkjun. According to the agreement, the State guarantees the city of Reykjavík and the town of Akureyri indemnity after 1 January 2012 with respect to a guarantee of obligations entered into before 1 January 2007. The Company's payments due to guarantees for long-term loans amounted to USD 9.6 million in 2012.

Endorsement by the Board of Directors and CEO, contd.:

Corporate Governance

The Board of Directors of Landsvirkjun endeavours to maintain good corporate governance in line with the Guidelines on Corporate Governance issued by the Icelandic Chambre of Commerce in collaboration with the Confederation of Icelandic Employers and Nasdaq OMX Iceland. The Board of Directors has established detailed working procedures for the Board, wherein its competence and purview with respect to the CEO is defined. The Board of Directors has appointed an Audit Committee. In the year 2012, 16 Board meetings were held and 3 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 its financial statements. Further information on the parent company's corporate governance is included in notes 47 to 55 and in an appendix to the financial statements.

Statement of 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 on 31 December, 2012 and the Company's results and changes in cash in the year 2012.

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 2012 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, 22 February 2013.

The Company's Board of Directors:

Bryndís Hlöðversdóttir

Sigurbjörg Gísladóttir

Arnar Bjarnason

Ingimundur Sigurpálsson

Stefán Arnórsson

CEO:

Hörður Arnarson

Independent Auditor's Report

To the Board of Directors and owners of Landsvirkjun

We have audited the accompanying financial statements of Landsvirkjun, which comprise the balance sheet as at 31 December, 2012, and the income statement, statement of comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management’s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted by the EU. This responsibility includes: designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, 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 Auditing Standards. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of 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 judgement, 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 principles used and the soundness 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, 2012, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Confirmation of the Endorsement by the Board of Directors and the CEO

In accordance with provisions of Article 106, Para 1, Number 5 of Act no. 3/2006 on financial statements, we confirm according to our best knowledge that the Endorsement by the Board of Directors and the CEO accompanying these financial statements include information as decreed by the Financial Statements Act.

Reykjavik, 22 February 2013.

KPMG ehf.

Árni Claessen

Auður Þórisdóttir

Income Statement for 2012

	Notes	2012	2011
Operating revenues			
Power sales		338,242	366,049
Realised aluminium hedges		18,325	16,488
Transmission		44,357	46,894
Other income		6,900	6,765
		407,824	436,196
Operating expenses			
Energy production costs		115,770	122,261
Transmission costs		41,244	39,128
Cost of general research		13,941	7,654
Other operating expenses		29,558	30,150
		200,513	199,193
Operating profit		207,311	237,003
Financial income and (financial expenses)			
Interest income		4,014	4,127
Interest expenses		(102,269)	(116,844)
Foreign exchange difference		(17,513)	8,561
Fair value changes in embedded derivatives	49	(3,391)	(93,197)
Fair value changes in other derivatives		13,653	6,959
Fair value changes in shares		0	(9)
	25	(105,506)	(190,404)
Associated companies	31	(2,229)	(4,014)
Profit before taxes		99,576	42,585
Income tax	26	(45,370)	(16,135)
Net profit for the year		54,206	26,450
Attributable to:			
Owners of the parent company		51,945	23,921
Subsidiaries minority interest		2,261	2,529
		54,206	26,450

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

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Statement of Comprehensive Income for the year 2012

	2012	2011
Profit for the year	54,206	26,450
Operating items moved to equity		
Translation difference due to functional currency	(4,145)	(9,461)
Total operating items moved to equity	(4,145)	(9,461)
Total Comprehensive Income for the year	50,061	16,989
Profit attributable to:		
Owners of the parent company	49,631	16,831
Subsidiaries minority interest	430	158
	50,061	16,989

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

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Balance Sheet as at 31 December 2012

Assets	Notes	2012	2011
Non-current assets			
Property, plant and equipment	27	3,476,284	3,585,637
Projects under construction	27	151,509	71,883
Intangible assets	28	233,563	207,415
Derivative financial instruments	30	270,076	289,569
Associated companies	31	20,103	22,406
Other non-current assets	32	3,224	106
Deferred tax asset	34	56,218	100,716
Total non-current assets		4,210,977	4,277,732
Current assets			
Inventories	35	4,186	4,096
Accounts receivables and other receivables	36	72,896	75,077
Derivative financial instruments	30	41,591	40,891
Restricted deposits	37	968	8,251
Cash and cash equivalents	37	187,916	229,942
Total current assets		307,557	358,257
Total assets		4,518,534	4,635,989
Equity and liabilities			
Equity			
Owners' contribution	38	586,512	586,512
Revaluation account	39	98,281	101,983
Translation difference	39	(37,233)	(34,919)
Other equity		1,013,216	971,791
Equity of the owners of the parent company		1,660,776	1,625,367
Minority interest		36,376	35,945
Total equity		1,697,152	1,661,312
Long-term liabilities			
Interest bearing liabilities	40	2,416,004	2,612,256
Accrued pension liabilities	42	23,228	23,238
Deferred tax liability	34	14,550	13,565
Obligation due to demolition	43	5,704	5,673
Prepaid income		2,336	1,051
Derivative financial instruments	30	60,232	86,018
		2,522,054	2,741,801
Current liabilities			
Accounts payable and other payables	44	71,845	75,388
Interest bearing liabilities	41	208,451	128,810
Derivative financial instruments	30	19,032	28,678
		299,328	232,876
Total liabilities		2,821,382	2,974,677
Total equity and liabilities		4,518,534	4,635,989

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

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Statement of Equity for the year 2012

	Owners' contribution	Revaluation account	Translation difference	Other equity	Equity attributable to the owners of the parent company	Minority interest	Total equity
Changes in equity year 2011							
Equity at 1 January 2011...	586,512	105,056	(27,829)	944,797	1,608,536	35,786	1,644,322
Translation difference			(7,090)		(7,090)	(2,371)	(9,461)
Profit for the year..............				23,921	23,921	2,529	26,450
Total profit for the year......			(7,090)	23,921	16,831	158	16,989
Revaluation transferred to other equity...................		(3,072)		3,072	0	0	0
Equity at 31 December 2011.................................	586,512	101,983	(34,919)	971,791	1,625,367	35,945	1,661,312
Changes in equity year 2012							
Equity at 1 January 2012 ..	586,512	101,983	(34,919)	971,791	1,625,367	35,945	1,661,312
Translation difference			(2,314)		(2,314)	(1,831)	(4,145)
Profit for the year				51,945	51,945	2,261	54,206
Total profit for the year			(2,314)	51,945	49,631	430	50,061
Revaluation transferred to other equity...................		(3,702)		3,702	0	0	0
Dividend paid to owners....				(14,221)	(14,221)	0	(14,221)
Equity at 31 December 2012	586,512	98,281	(37,233)	1,013,216	1,660,776	36,376	1,697,152

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

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Statement of Cash Flow for 2012

	Notes	2012	2011
Operating activities			
Operating profit		207,311	237,003
Adjusted for:			
Depreciation and impairment loss		112,288	108,200
Pension obligation, change		1,108	1,303
Obligation due to demolition, change		306	(486)
Other changes		1,359	915
Working capital from operations before financial items		322,372	346,935
Operating assets and liabilities. change		(1,605)	6,797
Cash flow from operating activities before financial items		320,767	353,732
Interest income received		4,629	4,847
Interest expenses and foreign exchange difference paid		(89,218)	(91,407)
Cash flow from operating activities	46	236,178	267,172
Investing activities			
Hydropower stations in operation		(7,217)	(6,012)
Hydropower stations in construction		(68,131)	(51,158)
Transmission		(16,005)	(5,793)
Development costs for power plants		(29,687)	(25,793)
Purchased shares		(1,740)	(6,965)
Dividend received from associated company		12	78
Other capital expenditure		(10,684)	(7,711)
Assets sold		2,090	4,857
Unpaid construction cost, change		2,432	(5,873)
Other receivables, change		5,951	(3,319)
Investing activities		(122,979)	(107,689)
Financing activities			
Dividends paid to owners		(14,221)	0
New loans		16,640	310,557
Amortisation of long-term debt		(155,516)	(483,807)
Currency swaps		0	(13,559)
Short-term loans, change		0	370
Prepaid income, change		1,427	1,111
Financing activities		(151,670)	(185,328)
Change in cash and cash equivalents		(38,471)	(25,845)
Effect of exchange difference on cash and cash equivalents		(3,555)	(9,745)
Cash and cash equivalents at the beginning of the year		229,942	265,532
Cash and cash equivalents at end of year		187,916	229,942

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 which has its place of business in Iceland and its headquarters at Háaleitisbraut 68, Reykjavik, Iceland. 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 and share in the return 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 22 February 2013.

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.

Fixed assets and asset groups available for sale are recognised at the lower value of either the book value or the net fair value. Fixed 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 effects of the changes are entered in the periods in which the changes are made and in subsequent periods if the changes also affect those periods.

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

- note 27 property, plant and equipment
- note 28 intangible assets
- note 30 derivative financial instruments
- note 34 deferred tax asset
- note 42 accrued pension liabilities
- note 49 aluminium price risk

Significant accounting methods

The accounting policies set out below have been consistently applied to all periods presented in these financial statements, and to all companies within the group. The Group's deferred tax asset is now divided into deferred tax asset on the one hand and deferred tax liability on the other. Comparative figures have been adjusted accordingly.

3. Basis of consolidation

a. Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. 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.

b. Transactions eliminated on consolidation

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.

c. Subsidiaries with another functional currency

Assets and liabilities of a subsidiary with other functional currency other 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 period. The exchange rate difference arising from the translation is entered as a specific item 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.

4. 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 income and expenses of associated companies according to the method of association, 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.

5. Operating revenues

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

6. Interest income and expenses

Interest income and expenses are recognised in the income statement as they accrue using the effective interest method. Interest income and expenses include bank rates, premium, realised interest rate swaps and other difference 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.

7. Other financial income and expenses

Other income (expenses) on financial assets and liabilities include profit and loss on current assets and liabilities and all redeemed and unredeemed fair value changes, dividends and changes in foreign exchange difference. Dividend income is recognised in the income statement when distribution of dividends has been approved.

8. Foreign currency transactions

Transactions in foreign currencies are recognised at the exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are recognised at the exchange rate ruling at the end of the year. Foreign currency gain or loss 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.

9. 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 or 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 non-financial 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. Impairment tests are carried out at least once a year on intangible assets with undetermined useful life.

Impairment loss is recognised when the book value of the asset or its cash generating unit exceeds its recoverable amount. A cash generating unit is the smallest distinguishable asset group that generates cash, which is mostly independent from other units or unit groups. Impairment loss is expensed in the income statement and later proportionally as reduction in the book value of other assets pertaining to the unit.

The recoverable amount of non-financial assets or its cash generating unit is the greater of its sales value or its value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss in respect of non-financial assets 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.

10. 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, in which case it is recognised in equity.

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.

10. Income tax, contd.:

A deferred tax asset 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 another premises 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 be utilised against future taxable profit.

11. Fixed assets

Fixed assets are initially measured at cost.

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

The Group's transmission and telecommunication systems are recognised at a revalued cost in the balance sheet, which is their fair value less depreciation from the date of revaluation. The revaluation of those assets 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.

The 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 costs.

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. When a revalued fixed asset is sold its revaluation among equity is moved to retained earnings.

Depreciation

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

11. Fixed assets, contd.:

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

Depreciation ratios and useful life are specified as follows:

	Amortisation	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
Substations	2.5%-5%	20-40 years
Power lines	2.00%	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

12. 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:

	Amortisation	Useful life
Software	25%	4 years

13. Financial instruments

a. Non-derivative financial instruments

Non-derivative financial instruments consist of investments in shares and bonds, accounts receivable, other receivables, cash and cash equivalents, borrowings, accounts payable and other short-term liabilities.

Non-derivative financial instruments are recognised at fair value at initial recognition. In case of financial instruments, not measured at fair value through income statement, all direct transaction cost is entered as increase in the fair value at their initial recognition, with the exceptions described here below. Following an initial registration non-derivative financial instruments are recognised as follows.

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13. Financial instruments, contd.,

Financial instruments are entered in the consolidated financial statements 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. Conventional purchase and sale of financial assets are recognised at the transaction date, i.e. the date the Company enters into obligation to purchase or sell the asset. Financial obligations are derecognised from the consolidated financial statements if the obligations of the Company defined in an agreement are paid, expire, disallowed, or are invalidated.

Note no. 6 includes information on accounting methods used for financial income and expenses.

Financial assets and liabilities at fair value through income statement

A financial instrument is recognised at fair value and fair value changes through income statement in case of current financial assets or financial liabilities or if it is, at the initial registration, determined as a financial instrument at fair value through the income statement. A financial instrument is denominated at fair value through the income statement if the Company manages such investments and decisions of purchase and sale on their fair value. Financial assets and liabilities at fair value through the income statement are recognised at fair value in the balance sheet and fair value changes are recognised in the income statement. Direct transaction cost is entered in the income statement as it incurs.

Other financial instruments

Other non-derivative financial instruments are recognised at amortised cost value using the effective interest method, less impairment loss, if any.

Off-setting of financial assets and liabilities

Financial assets and liabilities are set off and the net amount is recognised in the balance sheet when the legal right exists on off-setting and the Company intends to account for financial assets and liabilities by off-setting.

b. Derivative financial instruments

The Company enters into derivative financial instruments to hedge its foreign currency, interest rate and aluminium price risk exposures. 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 and 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.

Derivative financial instruments are recognised initially at fair value. Attributable transaction costs are recognised in the income statement when incurred. Subsequent to initial recognition, derivatives are measured at fair value , and changes therein are accounted for as described below.

Economic hedges

Hedge accounting is not applied to derivative instruments that economically hedge monetary assets and liabilities denominated in foreign currencies. Changes in the fair value of such derivatives are recognised in the income statement among financial income and expenses.

Separable embedded derivatives

Fair value changes of embedded derivatives separable from the host contract are recognised when the fair value changes take place, see notes on risk management.

14. Fair value measurement

Accounting standards require that the fair value be measured, both for financial assets and liabilities and other assets and liabilities. The fair value has been determined due to assessments and/or notes according to the following methods. Where applicable, further information is made available on the methods used to find the fair value of assets and liabilities in the note relevant to the asset or the liability in question.

The fair value of financial assets and liabilities listed in an active market is the same as their listed value. Evaluation methods are applied to all other financial instruments in calculating their fair value. A financial asset or liability is considered to be listed on an active market if the official price can be obtained from a stock exchange or another independent party and the price reflects real and regular market transactions between unrelated parties.

14. Fair value measurement, contd.:

Evaluation methods can involve the use of recent transaction prices between unrelated parties. The methods take note of the value of other financial instruments similar to the instrument in question, and methods are used to determine the discounted cash flow or other evaluation methods that can by applied in order to measure in a reliable way the real market value. When applying evaluation methods, all factors that market parties would use in a price assessment are used and the methods are in accordance with generally accepted methods for rating financing instruments. If market data is unavailable management's evaluation is used. The Company verifies its evaluation methods on an ongoing basis and tests them by using the prices obtained from transactions in an active market with the same instrument, without adjustments or changes, or based on information from an active market.

The most reliable verification of the initial fair value of derivative financial instruments is the purchase value, unless the fair value of the instrument can be verified by comparison with other recent listed market transactions with the same instrument, or based on an evaluation method where variables are exclusively based on market data. When such market data can be obtained, the Company recognises profit and loss at the initial recognition date of the instruments.

15. 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, bringing them on location and possible set-up costs.

16. Cash and cash equivalents

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

17. 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.

18. Employees’ benefits

a. Defined contribution plan

Cost due to a contribution to the 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, which is based on accrued benefits. Changes in the obligation are recognised in the income statement when incurred.

19. Obligations

Obligations are recognised when the Company has a legal obligation or entered into obligations due to past events, which are likely to be settled and can be reliably measured. The obligation can be assessed on the basis of estimated cash flow, discounted on the basis of interests reflecting market interests and the risk inherent with the obligation.

20. Statement of segments

A segment is a distinguishable component of the Group, which is subject to risks and returns that are different from those of other segments. In determining the distribution of resources to segments and evaluating the results, the return of the segments is reviewed 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.

21. Reporting standards

The Group has adopted all International Financial Reporting Standards, amendments thereto and interpretations confirmed by the EU at year end 2012 that apply to its operations. The Group has not adopted standards, amendments to standards or interpretations entering into effect after year end 2012, which may be adopted earlier. The effect thereof on the Group’s financial statements have not been fully determined but are considered to be insubstantial.

22. 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 electricity production segment. By law Landsvirkjun's objectives are to operate in the energy sector and other business and financial operations in accordance with decisions of the Board of Directors. Landsvirkjun's electricity production is based on hydroelectric- and geothermal power. Landsvirkjun sells its electricity production in Iceland to retail sales companies and industrial users. Furthermore, the operations of Icelandic Power Insurance Ltd. and Theistareykir ehf., falls under these segments. Þeistareykir ehf. merged with Landsvirkjun during the year. The purpose of Icelandic Power Insurance Ltd. is to manage the insurance of Landsvirkjun's power stations.

Electricity transmission

The operation of Landsnet hf. falls under the electricity transmission segment. Tthe company was established in August 2004 on the basis of the Energy Act approved by 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.

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 rent access to the system in addition to other related operations according to law. Landsvirkjun Power ehf. takes care of sales of technical and operational advisory services to third parties and general research work, harnessing research and projects for Landsvirkjun and related companies.

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

Operating segments year 2012	Electricity production	Electricity transmission	Other segments	Adjustments	Total
Income from third party	359,608	44,483	3,733	0	407,824
Income within the Group	9,676	54,234	2,932	(66,842)	0
Segment income	369,284	98,717	6,665	(66,842)	407,824
Segment operating expenses	(113,389)	(36,862)	(4,816)	66,842	(88,225)
EBITDA	255,895	61,855	1,849	0	319,599
Depreciation and impairment loss	(92,004)	(19,732)	(944)	392	(112,288)
Segment earnings, EBIT	163,891	42,123	905	392	207,311
Segment assets 2012	4,348,535	576,581	16,392	(443,076)	4,498,431
Shares in associated companies	19,734	5,001	368	(5,001)	20,103
Total assets 2012	4,368,269	581,582	16,760	(448,077)	4,518,534
Segment liabilities 2012	2,683,744	478,562	3,788	(344,712)	2,821,382
Total liabilities 2012	2,683,744	478,562	3,788	(344,712)	2,821,382
Investing activities	109,104	18,357	1,832	0	129,293

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22. Statement of segments, contd.:

Operating segments year 2011	Electricity production	Electricity transmission	Other segments	Adjustments	Total
Income from third party	385,412	47,123	3,662	0	436,196
Income within the Group	10,514	55,477	3,168	(69,159)	0
Segment income	395,926	102,600	6,830	(69,159)	436,196
Segment operating expenses	(121,970)	(33,130)	(5,053)	69,159	(90,993)
EBITDA	273,956	69,470	1,777	0	345,203
Depreciation and impairment loss	(85,883)	(22,112)	(657)	452	(108,200)
Segment earnings, EBIT	188,073	47,358	1,120	452	237,003
Segment assets 2011	4,489,237	603,064	17,979	(496,696)	4,613,583
Associated companies	21,657	5,515	349	(5,116)	22,406
Total assets 2011	4,510,894	608,579	18,328	(501,812)	4,635,989
Segment liabilities 2011	2,859,760	507,023	3,963	(396,069)	2,974,677
Total liabilities 2011	2,859,760	507,023	3,963	(396,069)	2,974,677
Investing activities	97,219	8,873	2,384	0	108,476

23. Salaries and salary related expenses

Total number of employees is specified as follows:	2012	2011
Average number of employees during the year, full-time equivalents	414	396
Full-time equivalent units at year-end	361	334

24. Total salaries of employees

Total salaries of employees are specified as follows:

Salaries	30,087	29,720
Pension premium payments	3,619	3,524
Defined pension benefit payments	1,415	1,295
Change in pension obligation	1,108	1,303
Other salary related expenses	3,219	3,461
	39,448	39,303

Salaries are divided as follows in the income statement:

Energy production cost	11,753	12,713
Transmission costs	10,653	10,629
Other operating expenses	17,042	15,961
	39,448	39,303

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	84	82
Salaries of Boards of Directors of two subsidiaries (four in 2011)	75	84
Salaries and benefits of the CEO of the parent company, Hördur Arnarson	140	179
Salaries and benefits of the former Corporate Office Director 2011	0	70
Salaries of fives Directors and the Deputy (2011: 8)	948	1,148
Salaries and benefits of the CEO and three Directors of subsidiaries (2011: 5)	467	750

During the year, the parent company's divisions of human resources and IT were transferred to the Corporate Office and therefore Directors decreased by two.

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Notes, contd.:

25. Financial income and (expenses)

Financial income and (expenses) are specified as follows:

	2012	2011
Interest income	4,014	4,127
Interest expenses	(78,338)	(90,481)
Guarantee fee	(9,587)	(7,014)
Indexation	(18,531)	(21,179)
Capitalised interest costs	4,187	1,830
Total interest expenses	(102,269)	(116,844)
Realised foreign exchange differences	(4,838)	(14,150)
Unrealised foreign exchange difference	(12,675)	22,711
Total foreign exchange difference	(17,513)	8,561
Fair value changes in embedded derivatives	(3,391)	(93,197)
Fair value changes in other derivatives	13,653	6,959
Fair value changes in shares	0	(9)
Financial income and (expenses)	(105,506)	(190,404)

Capitalised finance cost amounted to 3.5% of restricted cash in hydropower stations in construction in the year 2012 (2011: 3.1%) and 7.6% of restricted cash in transmission under construction (2011: 8.0%).

26. Income tax

Income tax is specified as follows:

	2012	2011
Change in income tax asset / liability	(45,483)	(16,990)
Current tax	(131)	(207)
Foreign exchange difference	119	1,061
Adjustment due to previous year with subsidiary	124	0
Expensed income tax	(45,370)	(16,135)

Change in income tax asset / liability is specified as follows:

	2012	2011
Change in temporary difference	(33,278)	(3,027)
Change in carry forward loss	(12,085)	(12,902)
Foreign exchange difference	(119)	(1,061)
Change in income tax asset / liability	(45,483)	(16,990)

Effective tax rate		2012		2011
Profit for the year		54,206		26,450
Income tax for the year		45,370		16,135
Profit before income tax		99,576		42,585
Income tax acc. to the parent company's curr. tax rate	36.0%	35,847	36.0%	15,331
Effect of different tax rates within the Group	(3.5%)	(3,492)	(4.5%)	(1,900)
Effect of merger of subsidiary with parent company	12.2%	12,194	0.0%	0
Non-deductible items	0.2%	152	3.6%	1,516
Other items	0.7%	669	2.8%	1,188
Effective income tax	45.6%	45,370	37.9%	16,135

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27. 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 1.1.2011	4,844,192	588,677	10,628	73,500	5,516,997
Effect of exchange rate differences	0	(36,816)	(956)	(1,689)	(39,461)
Additions during the year	6,012	1,808	8,983	3,981	20,784
Moved to assets available for sale	0	0	0	(5,690)	(5,690)
Moved from other items	0	5,756	0	0	5,756
Sold and disposed of	0	(6,315)	(3,185)	(844)	(10,344)
Total value 31.12.2011	4,850,204	553,110	15,470	69,258	5,488,042
Effect of exchange rate changes	0	(26,020)	(776)	(1,280)	(28,076)
Additions during the year	7,217	3,954	1,832	7,534	20,537
Sold and disposed of	0	0	(40)	(5,113)	(5,153)
Total value 31.12.2012	4,857,421	531,044	16,486	70,399	5,475,350
Depreciation and impairment loss					
Total value 1.1.2011	1,689,961	85,627	5,896	25,780	1,807,264
Effect of exchange rate changes	0	(6,372)	(224)	(390)	(6,986)
Depreciation of the year	84,387	19,331	645	2,475	106,838
Sold and disposed of	0	(818)	(3,315)	(579)	(4,712)
Total value 31.12.2011	1,774,348	97,768	3,002	27,286	1,902,404
Effect of exchange rate changes	0	(5,100)	(168)	(315)	(5,583)
Depreciation of the year	82,504	17,732	972	2,591	103,799
Sold and disposed of	0	0	0	(1,553)	(1,553)
Total value 31.12.2012	1,856,852	110,400	3,806	28,009	1,999,067
Book value					
1.1.2011	3,154,231	503,050	4,732	47,720	3,709,732
31.12.2011	3,075,856	455,342	12,468	41,972	3,585,637
31.12.2012	3,000,569	420,644	12,680	42,390	3,476,284

If subsidiaries had not revalued transmission and telecommunication systems, their book value would have been around USD 114 million lower at year end 2012 (2011: USD 125 million).

At year end, an impairment test was performed on the Company's assets. The result of the test did not show any indication of impairment.

Official assessment of fixed assets and insurance value

The official assessment of the Company's real estate amounted to USD 285 million at year end 2012 (2011: USD 289 million). Insurance value of the Company's assets amounts to USD 4,203 million (2011: USD 3,948 million) and emergency fund insurance amounts to USD 803 million (2011: USD 813 million).

Assets under construction

Cost value	2012	2011
Balance at 1.1.	71,883	3,699
Effect of exchange rate changes	(447)	(161)
Moved from development costs	0	18,473
Additions during the year	80,182	55,628
Moved to property, plant and equipment / development costs	(65)	(5,756)
Sold and disposed of	(44)	0
Balance at 31.12.	151,509	71,883

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28. Intangible assets

Intangible assets are specified as follows:

	Capitalised development costs	Water and geothermal rights	Software	Total
Cost value				
Total value 1.1.2011	216,571	44,827	6,527	267,925
Effect of exchange rate changes	(4,705)	0	(209)	(4,914)
Additions during the year	27,079	0	249	27,328
Moved to assets in construction	(18,957)	0	0	(18,957)
Sold and disposed of	(737)	0	0	(737)
Total value 31.12.2011	219,251	44,827	6,567	270,645
Effect of exchange rate changes	(67)	0	(150)	(217)
Additions during the year	33,160	784	720	34,664
Moved to other items	(5,235)	0	0	(5,235)
Sold and disposed of	(58)	0	0	(58)
Total value 31.12.2012	247,051	45,611	7,137	299,799
The Group's depreciation and impairment				
Total value 1.1.2011	57,729	0	4,379	62,108
Effect of exchange rate changes	(109)	0	(129)	(238)
Amortization during the year	0	0	625	625
Impairment loss during the year	736	0	0	736
Total value 31.12.2011	58,356	0	4,875	63,231
Effect of exchange rate changes	(83)	0	(101)	(184)
Amortisation during the year	0	0	425	425
Impairment loss during the year	8,065	0	0	8,065
Moved to other items	(5,300)	0	0	(5,300)
Total value 31.12.2012	61,038	0	5,199	66,237
Book value				
1.1.2011	158,842	44,827	2,148	205,819
31.12.2011	160,895	44,827	1,692	207,415
31.12.2012	186,013	45,611	1,937	233,563

At year end, an impairment test was performed on the Company's assets. The result of the test did not show any indication of impairment.

29. The Group's depreciation and impairment

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

	2012	2011
Power stations	82,504	84,387
Transmission	17,732	19,331
Telecommunication equipment	972	645
Other assets	2,591	2,475
Depreciation of assets in operation	103,799	106,838
Impairment loss on development cost	8,065	736
Amortisation of software	425	625
	112,288	108,200

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

	2012	2011
Energy production costs	83,016	84,914
Transmission costs	18,340	19,819
Cost of general research	8,000	0
Other operating expenses	2,932	3,467
	112,288	108,200

Consolidated Financial Statements of Landsvirkjun 2012 24 Amounts are in USD thousand

Notes, contd.:

30. Derivative financial instruments

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

	2012	2011
Assets:		
Embedded derivatives in electricity agreements	285,756	291,156
Aluminium hedges	13,243	36,946
Currency swaps	366	0
Other derivatives	12,302	2,358
	311,667	330,460
Derivative financial instruments are divided as follows:		
Long-term component of derivative agreements	270,076	289,569
Short-term component of derivative agreements	41,591	40,891
	311,667	330,460
Liabilities:		
Embedded derivatives in electricity agreements	14,920	16,928
Aluminium hedges	3,246	13,010
Currency swaps	11,937	17,279
Interest rate swaps	44,588	46,292
Other derivatives	4,573	21,187
	79,264	114,696
Derivative financial instruments are divided as follows:		
Long-term component of derivative agreements	60,232	86,018
Short-term component of derivative agreements	19,032	28,678
	79,264	114,696

The accounting policy for embedded derivatives is discussed in note 49.

31. Shares in associated companies

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

2012	Share	Share in return	Book value
Farice ehf., Kópavogur, Iceland	28.9%	(2,256)	19,734
Sjávarorka hf., Stykkishólmur, Iceland	30.3%	(159)	0
Netorka hf., Hafnarfjördur, Iceland	-	161	0
Hecla SAS, France	29.4%	25	369
		(2,229)	20,103

2011	Share	Share in return	Book value
Farice ehf., Kópavogur, Iceland	28.9%	(4,126)	21,640
Netorka hf., Hafnarfjördur, Iceland	42.5%	47	416
Hecla SAS, France	29.4%	64	350
		(4,014)	22,406

Consolidated Financial Statements of Landsvirkjun 2012 25 Amounts are in USD thousand

Notes, contd.:

32. Other long-term assets

	2012	2011
Other long-term assets are specified as follows:		
Shares in other companies	117	106
Long-term receivables	3,107	0
	3,224	106

33. Landsvirkjun's subsidiaries

Landsvirkjun's subsidiaries are specified as follows:

	Share	
Hraunaveita ehf., Reykjavík, Iceland	-	100.0%
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%
Þeistareykir ehf., Þingeyjarsveit, Iceland	-	96.7%

The company Þeistareykir ehf. was merged with Landsvirkjun, the sole shareholder in the company. The effective date of the merger 1 September 2012 but the merger process has not been concluded. Hraunaveita ehf. was sold to Landsvirkjun Power ehf.

34. Income tax asset / liability

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

	Deferred tax asset		Deferred tax liability	
	2012	2011	2012	2011
Balance at the beginning of the year	100,716	116,692	(13,565)	(12,551)
Adjustment due to previous year with subsidiary	0	0	(124)	0
Expensed income tax	(43,694)	(14,028)	(1,676)	(2,107)
Current tax	0	0	131	207
Exchange and translation diff. due to tax asset	(803)	(1,947)	684	886
Balance at year end	56,218	100,716	(14,550)	(13,565)

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

Carry forward taxable loss	17,618	26,567	6,610	10,950
Property, plant and equipm. and intangible assets	115,677	159,604	(23,542)	(25,682)
Derivative financial instruments	(87,948)	(84,254)	0	0
Other items	10,871	(1,201)	2,382	1,167
Balance at year end	56,218	100,716	(14,550)	(13,565)

The Group’s carry forward losses may be utilised for 10 years from when it is incurred. Carry forward loss is specified as follows:

Carry forward loss of the year 2006, usable until the year 2016	0	1,981
Carry forward loss of the year 2008, usable until the year 2018	37,786	86,439
Carry forward loss of the year 2009, usable until the year 2019	40,116	42,087
Carry forward loss of the year 2010, usable until the year 2020	871	914
Carry forward loss of the year 2011, usable until the year 2021	856	898
Carry forward loss of the year 2012, usable until the year 2022	2,357	0
Carry forward loss at year end	81,986	132,319

Deferred tax asset is calculated on all carry forward loss where 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.

35. Inventories

Inventories are specified as follows:

Oil	35	38
Spare parts and consumables	4,151	4,058
	4,186	4,096

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36. Accounts receivables and other receivables

Accounts receivables and other receivables are specified as follows:

	2012	2011
Accounts receivables	46,041	42,428
Other short term receivables	26,490	27,813
Assets available for sale	365	4,836
	72,896	75,077

At year-end 2012, 97% of accounts receivables were under 30 days old (2011: 97%).

37. Cash and cash equivalents

Cash and cash equivalents are specified as follows:

	2012	2011
Bank deposits	169,379	161,602
Market securities	18,537	68,340
	187,916	229,942

Restricted deposits in the amount of USD 1 million will be cashed out in May 2013.

38. 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 2012 was 37.6% but was 35.8% at year end 2011.

39. 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 with other functional currencies.

40. Liabilities

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

	Maturity date	2012 Average interest	2012 Remaining balance	2011 Average interest	2011 Remaining balance
Liabilities in ISK	2012-2034	4.0%	367,724	4.1%	444,948
Liabilities in CHF	2012-2022	0.4%	60,826	0.5%	64,070
Liabilities in EUR	2012-2028	1.3%	861,009	1.5%	1,027,733
Liabilities in GBP	2014-2016	11.4%	14,875	11.4%	14,202
Liabilities in JPY	2012-2033	2.5%	26,709	2.5%	38,137
Liabilities in USD	2012-2026	3.1%	1,293,312	3.0%	1,151,976
			2,624,455		2,741,066
Current maturities of long-term debt			(208,451)		(128,810)
Total long-term debt			2,416,004		2,612,256

Interest rate terms on loans are from 0.4-14.5%. Nominal interest rates for the period were on average 3.3%, compared to 3.5% the previous year.

Following the purchase by the State of shares in Landsvirkjun held by the city of Reykjavik and the town of Akureyri an agreement was reached stipulating that the city of Reykjavík and the town of Akureyri would provide a guarantee of collection together with the State for all of Landsvirkjun's obligations entered into before the end of year 2006. From the beginning of year 2007, the State and Eignarhlutir ehf. provide a guarantee of collection for all of Landsvirkjun's obligations entered into after that date in accordance with the Act on Landsvirkjun. According to the agreement, the State guarantees the city of Reykjavík and the town of Akureyri indemnity after 1 January 2012 with respect to a guarantee of obligations entered into before 1 January 2007. The Company's payments due to guarantees for long term loans are calculated according to Regulation no. 121/1997.

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Notes, contd.:

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

	2012	2011
2012	-	128,810
2013	208,451	141,589
2014	168,817	163,324
2015	188,159	187,858
2016	254,106	251,023
2017	333,014	-
Later	1,471,908	1,868,462
	2,624,455	2,741,066

42. 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 23.2 million at year end 2012 according to an actuary's evaluation, which is based on estimated future changes in salaries and prices. Interest in excess of price increases are assessed at 3.5% and salary increases in excess of price increases are 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:	2012	2011
Balance at 1.1.	23,238	23,442
Expensed during the year	2,286	2,462
Payments during the year	(1,178)	(1,159)
Effect of foreign exchange rate differences	(1,118)	(1,507)
Balance at 31.12.	23,228	23,238

Pension fund obligation, 5 year statem:	2012	2011	2010	2009	2008
Present value of the obligation	23,228	23,238	23,442	21,978	22,118

43. Obligation due to demolition

Change in the obligation due to demolition is specified as follows:	2012	2011
Balance at 1.1.	5,673	6,541
Change in the obligation	306	(486)
Effect of foreign exchange rate differences	(275)	(382)
Balance at 31.12.	5,704	5,673

In accordance with IFRS, the initial value of fixed operating assets shall include an estimated cost of their demolition after their use. An estimated demolition cost of power lines has been assessed and discounted on the basis of 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.

44. Accounts payable and other payables

Accounts payable and other payables are specified as follows:

Accounts payable	32,269	27,648
Accrued interests	23,647	26,952
Other short term liabilities	15,929	20,788
	71,845	75,388

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45. Related parties

Definition of related parties

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

Transactions with related parties	**2012**	**2011**
Interest income		
Associated companies	50	0
Expenses		
Associated companies	8	7
Receivable		
Associated companies	1,773	0

Transactions with the State or companies and institutions owned by the State are not specified as a separate item, but are as transactions with non-related parties.

46. Cash flow

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

Operating activities		
Cash received from customers	408,240	441,595
Cash expenses	(87,473)	(87,863)
Cash flow from operations excluding interest	320,767	353,732
Interest income received	4,629	4,847
Interest expenses and foreign exchange difference paid	(89,218)	(91,407)
Cash flow from operating activities	236,178	267,172

47. Risk management

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

- 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
- 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 is 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. The Head of Risk Management is responsible for risk management on a daily basis.

The objective of risk management is to analyse, manage, and monitor Landsvirkjun's risk in order to reduce 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:

- 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

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48. Financial risk

During the year, Landsvirkjun entered into agreements in order to hedge against currency, interest and aluminium price risk. The Company made an agreement with the Nordic Investment Bank to convert loans in the amount of EUR 140 million to USD. The loans were on floating interests in EUR but following the conversion they are on fixed interests in USD. The Company also entered into a currency swap agreement against an underlying loan where EUR 60 million, previously on floating interest, were converted to USD on fixed interest.

At year end 2012, the Company had access to undrawn Revolving Credit Facilities in the amount of USD 200 million and ISK 10,500 million. Both Revolving Credit Facilities have a three year term with the possibility of extending the term for one year. Furthermore, undrawn long-term loans amount to USD 128 million. The maturity profile, strong liquidity, and access to loans secures the Company's liquidity until year end 2014.

49. Aluminium price risk

The Company is exposed to substantial risk due to possible aluminium price fluctuations as just under half of its income from energy sales is linked to aluminium price. The Company has thus entered into derivative agreements in order to secure its income base and reduce fluctuations. Generally such agreements consist of fixing an aluminium price at a certain level. The Company can, therefore, lose income if the aluminium price increases considerably, but at the same time guarantees improved cash flow should the market price of aluminium decrease. Risk management may hedge up to 100% of aluminium price risk for next year and proportionally less over the next 10 years but minimum hedges are not required. At year end 2012, 29% of 2013 estimated cash flow has been hedged but for the year 2014 there are minor hedges. At year end 2012, fair value of the hedges was positive by USD 10 million (2011: USD 23.9 million) but the agreements are effective over the next two years.

The accompanying tables show fair value changes of aluminium hedges due to changes in aluminium prices and/or interest rates. The amounts are in USD thousand before taxes.

2012

		Aluminium Price		
		-10%	0%	10%
Interest rates	-1%	5,901	59	(6,583)
	0%	5,789	-	(6,580)
	1%	5,679	(59)	(6,578)

2011

		Aluminium Price		
		-10%	0%	10%
Interest rates	-1%	6,737	136	(7,252)
	0%	6,553	-	(7,332)
	1%	6,372	(134)	(7,410)

Embedded derivatives

Landsvirkjun has defined the part of electric power sales and purchase agreements related to aluminium price as embedded derivatives, which are recognised in the Company's financial statements. Embedded derivatives in electric power sales agreements are capitalised in the balance sheet at fair value on the reporting date and in a comparable way electric power purchase agreements are charged. Fair value changes of the agreements during the year are recognised in the Company's income statement among financial income and expenses.

	2012	2011
The fair value of embedded derivatives is specified as follows:		
Fair value of embedded derivatives at the beginning of the year	274,227	367,424
Fair value changes during the year	(3,391)	(93,197)
Fair value of embedded derivatives at year end	270,836	274,227
Division of embedded derivatives is specified as follows:		
Long term component of embedded derivatives	253,322	258,107
Short term component of embedded derivatives	17,514	16,120
Total embedded derivatives	270,836	274,227

49. Aluminium price risk, contd.:

The following tables show fair value changes of embedded derivatives in the case of changes in aluminium prices and/or interest rates. The amounts are in USD thousand before taxes.

2012

Interest rates	Aluminium Price -10%	Aluminium Price 0%	Aluminium Price 10%
-1%	(120,802)	14,703	150,207
0%	(128,910)	-	128,910
1%	(136,952)	(14,406)	108,141

2011

Interest rates	Aluminium Price -10%	Aluminium Price 0%	Aluminium Price 10%
-1%	(119,043)	15,770	151,001
0%	(128,037)	-	128,515
1%	(136,522)	(14,868)	107,325

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

Fair value of the agreements is calculated on the basis of forward price of aluminium, as disclosed in the LME, discounted at USD zero-coupon rates according to Bloomberg, no spread added.

Calculations are based on the maximum time length of official information on aluminium prices, or 123 months. The management's opinion is that aluminium price expectations in ten years will reflect the evaluation of Landsvirkjun's management as when the agreements were made and therefore fair value changes will not arise for that period.

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

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

50. 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 payment flow, assets and liabilities in addition to all general transactions in other currencies than the functional currency.

The Company's functional currency is the USD and therefore a foreign exchange risk arises from the net cash flow and opening balance in currencies other than the USD. The Company's income flow 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 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. Risk management 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.

The Company's reporting risk related to exchange rate changes arises mainly due to its debts in EUR, which are mainly long-term loans. There is also limited risk related to the JPY, CHF, and GBP due to outstanding loans. The open balance in the loan portfolio against the USD is around 21% of assets. 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:

2012	EUR	ISK	JPY	Other currencies
Long-term receivables	0	3,107	0	0
Accounts receivables and other receivables	640	15,574	0	2,962
Cash	7,216	27,170	96	5,693
Derivatives	395,517	0	(44,932)	0
Interest bearing liabilities	(861,009)	(367,724)	(26,709)	(75,701)
Accounts payable and other payables	(1,868)	(51,500)	(550)	(1,546)
Risk in balance sheet	(459,504)	(373,373)	(72,095)	(68,592)

50. Foreign exchange risk, contd.:

2011	EUR	ISK	JPY	Other currencies
Accounts receivables and other receivables	491	14,009	0	2,470
Restricted deposits	0	8,251	0	0
Cash	2,957	93,447	438	6,781
Derivatives	518,361	0	(49,981)	0
Interest bearing liabilities	(1,027,733)	(444,948)	(38,137)	(78,272)
Accounts payable and other payables	(4,979)	(51,842)	(803)	(1,509)
Risk in balance sheet	(510,903)	(381,083)	(88,483)	(70,530)

Exchange rates of the main currencies against the USD, (USD/currency) for the years 2012 and 2011 are specified as follows:

	Average rate		Rate at year end	
	2012	2011	2012	2011
EUR	0.78	0.72	0.76	0.77
GBP	0.63	0.62	0.62	0.65
CHF	0.94	0.88	0.92	0.94
JPY	79.70	79.59	86.10	77.40
NOK	5.82	5.61	5.59	6.01
ISK	125.05	116.07	128.74	122.71

Sensitivity analysis

Changes to the USD exchange rate by 10% against the following currencies, would have affected the Group's profit and equity by the following amounts after 36% income tax. The analysis is based on all variables, especially interest rates, remaining unchanged.

	Profit (loss) after tax			
	2012		2011	
	Strengthening	Weakening	Strengthening	Weakening
EUR	35,455	(44,864)	24,549	(47,803)
ISK	2,880	(2,880)	(1,402)	1,402
JPY	4,614	(4,614)	5,663	(5,663)

The fair value of currency swaps was negative by USD 11.6 million at the end of December 2012. The underlying principal amount is USD 123.2 million. The fair value of currency options was positive by USD 7.7 million and the underlying principal amount was USD 418.3 million.

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51. 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 hedge against risk. Interest bearing financial liabilities are considerably higher than interest bearing financial assets and the Company's risk therefore consists of possible increase in interest and increased interest expenses.

At year end 2012, the proportion of loans with floating interest rates was 64% compared to 73% at year end 2011. Changes in interest rates by one percent would have led to a change in interest expenses by USD 17 million in the year 2012 (USD 20 million in the year 2011). The Company's financial instruments with fixed interests are not sensitive to interest rate changes. At year end 2012, the estimated market value of the Company's long-term liabilities was USD 112 million higher than their book value (USD 122 million higher in the year 2011) discounted by the underlying currencies yield curve without spread. The following table shows the division of financial assets and liabilities between floating and fixed interest.

	2012	2011
Financial instruments with fixed interest		
Financial assets	3,107	0
Financial liabilities	(944,804)	(751,052)
	(941,697)	(751,052)
Financial instruments with floating interest		
Financial assets	188,884	238,193
Financial liabilities	(1,679,651)	(1,990,014)
	(1,490,767)	(1,751,821)
Derivatives		
Embedded derivatives	270,836	274,227
Other derivatives	(38,433)	(58,463)
	232,403	215,764

Interest rate swaps are not hedge accounted and fair value changes of these agreements are recognised in the income statement. At year end 2012, the fair value of interest rate swaps was negative by USD 44.6 million and the underlying principle amounted to USD 185 million. The following tables show the effect of changes in interest rates on fair value of the derivatives in USD thousand before tax.

2012

Interest Rates			
-0.2%	0%	1.0%	2.0%
(1,201)	-	5,325	9,531

2011

Interest Rates			
-0.2%	0%	1.0%	2.0%
(1,306)	-	5,717	10,171

Interest rate changes in the US have considerable effect on the value of embedded derivatives held by Landsvirkjun and the effect increases with higher aluminium prices. Note 49 includes sensitivity analysis on the fair value of embedded derivatives and shows the effect of the change on interest rates and the price of aluminium.

52. 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 ensuring that there is sufficient cash at each time in order to be able to meet the company's obligations. In order to limit such risk, the Company's liquidity balance is monitored and emphasis is placed on having a sufficient cash position and access to Revolving Credit Facilities. The Company's cash and cash equivalents amounted to USD 188 million at year end 2012 but when taken into account undrawn credit facilities (USD 200 million and ISK 10,500 million) and undrawn long-term loans in the amount of USD 128 million the company has access to a total of approx. USD 598 million. Taken into consideration cash flow from operation the Company believes that access to liquid assets is ensured until year end 2014.

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 Euro Medium Term Note Programme (EMTN). At year end 2012, the balance of loans under the EMTN was USD 1.83 billion but the total amount that the Company can borrow under the programme is USD 2.5 billion.

The Company's risk related to refinancing is reduced with an evenly distributed and long dated maturity profile. Weighted average of loan maturity was 6.5 years and the proportion of loans with maturity within 12 months was 7.9%.

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

2012	**Book value**	**Contractual cash flow**	**Within 1 year**	**1 - 2 years**	**2 - 5 years**	**More than 5 years**
Non-derivative financial instruments						
Long-term receivabl.	3,107	3,577	217	217	3,143	0
Cash	187,916	187,916	187,916	0	0	0
Restricted deposits	968	968	968	0	0	0
Short term receivabl.	72,896	72,896	72,896	0	0	0
Interest bearing liab.	(2,624,455)	(3,168,729)	(241,475)	(231,700)	(894,600)	(1,800,954)
Current liabilities	(71,845)	(71,845)	(71,845)	0	0	0
	(2,431,413)	(2,975,217)	(51,323)	(231,483)	(891,457)	(1,800,954)
Derivative financial instruments						
Currency swaps	(3,841)	(3,359)	(3,197)	(609)	447	0
Interest rate swaps	(44,588)	(42,655)	(4,213)	(4,848)	(33,002)	(592)
Aluminium derivatives ...	9,997	12,032	8,726	3,306	0	0
Embedded derivatives in electricity sales agr ...	270,836	290,999	17,549	20,987	85,318	167,145
	232,403	257,017	18,865	18,836	52,763	166,553

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52. Liquidity risk, contd.:

2011	Book value	Contractual cash flow	Within 1 year	1 - 2 years	2 - 5 years	More than 5 years
Non-derivative financial instruments						
Cash	229,942	229,942	229,942	0	0	0
Restricted deposits	8,251	8,251	8,251	0	0	0
Short term receivabl.	75,077	75,077	75,077	0	0	0
Interest bearing liab.	(2,741,066)	(3,384,434)	(173,087)	(200,559)	(808,248)	(2,202,540)
Current liabilities	(75,388)	(75,388)	(75,388)	0	0	0
	(2,503,184)	(3,146,552)	64,795	(200,559)	(808,248)	(2,202,540)
Derivative financial instruments						
Currency swaps	(36,107)	(23,946)	(6,348)	(17,598)	0	0
Interest rate swaps	(46,292)	(45,712)	(3,904)	(4,390)	(35,536)	(1,882)
Aluminium derivatives ...	23,936	28,910	15,801	7,483	5,626	0
Embedded derivatives in electricity sales agr. ..	274,227	300,680	16,187	20,666	83,799	180,028
	215,764	259,932	21,736	6,161	53,889	178,146

53. Counterparty risk

Counterparty risk is the risk that a counterparty to an agreement does not comply with provisions of the agreement. Landsvirkjun's counterparty risk arises first and foremost due to the Company's energy contracts and derivatives entered into for hedging purposes. Though the amounts involved can be considerably high, the risk is limited with the Company´s requirements for counterparty quality. Landsvirkjun has set a benchmark for the trading of derivatives that no derivative agreements are made with financial counterparties 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, when applicable, are thoroughly reviewed.

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

	2012	2011
Derivative financial instruments	311,667	330,460
Restricted deposits	968	8,251
Long-term receivables	3,107	0
Accounts receivables and other receivables	72,896	75,077
Cash and cash equivalents	187,916	229,942
	576,554	643,730

54. Fair value

Comparison of fair value and book value

The fair value and book value of financial assets and liabilities in the balance sheet is specified as follows:

	2012 Book value	2012 Fair value	2011 Book value	2011 Fair value
Derivative financial instruments	232,403	232,403	215,764	215,764
Other long-term assets	3,224	3,330	106	106
Accounts receivables and other short term receivables ..	72,896	72,896	75,077	75,077
Restricted deposits	968	968	8,251	8,251
Cash and cash equivalents	187,916	187,916	229,942	229,942
Interest bearing liabilities	(2,624,455)	(2,736,455)	(2,741,066)	(2,863,013)
Accounts payable and other short term payables	(71,845)	(71,845)	(75,388)	(75,388)
	(2,198,893)	(2,310,787)	(2,287,314)	(2,409,261)

Note 14 includes further information on measurement of fair value.

Consolidated Financial Statements of Landsvirkjun 2012 35 Amounts are in USD thousand

54. Fair value, contd.:

Interest rates in the evaluation of fair value

Inter bank rates and swap rates were used without spread for the relevant currencies at the reporting date when discounting the expected cash flow.

Interest rates are specified as follows:	2012	2011
Embedded derivatives in electric power agreements	0.3-1.9%	0.6-2.1%
Interest bearing liabilities in ISK	5.5-6.4%	4.6-5.1%
Interest bearing liabilities other than in ISK	0.0-2.7%	0.1-2.8%

Fair value classification:

The table below shows financial instruments recognised at fair value according to the relevant price evaluation method. The methods are defined as follows:

Level 1: Prices are available in an active market for the same type of assets and liabilities.

Level 2: Assumptions based on other variables than available price in an active market (level 1) that can be obtained for assets and liabilities, directly (for example price) or indirectly (derived from prices).

Level 3: Assumptions for fair value of assets and liabilities are based on data that is not available in markets.

	Level 2	Level 3	Total
2012			
Embedded derivatives		270,836	270,836
Other derivatives	(38,433)		(38,433)
Shares in other companies		117	117
	(38,433)	270,953	232,520
2011			
Embedded derivatives		274,227	274,227
Other derivatives	(58,463)		(58,463)
Shares in other companies		106	106
	(58,463)	274,333	215,870

Classification of financial assets between the levels remains unchanged from the previous year. Fair value changes of financial assets at level 3 amounted to USD 3.4 million expensed in the year 2012 (USD 93.2 million in the year 2011) and is recognised among financial income and expenses.

55. 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:

- Trading assets and liabilities - 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.

Consolidated Financial Statements of Landsvirkjun 2012 36 Amounts are in USD thousand

55. Classification of financial instruments, contd.:

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

	Trading assets and liabilities	Financial assets and liabilities at fair value through p&l	Loans and receivables	Financial liabilities recognised at amortised cost	Book value
2012					
Derivatives	311,667				311,667
Shares in other companies		117			117
Long-term receivables		3,107			3,107
Accounts receivables and other receivables			72,896		72,896
Restricted deposits			968		968
Cash			187,916		187,916
Total assets	311,667	3,224	261,780	0	576,671
Interest bearing liabilities				2,624,455	2,624,455
Derivatives	79,264				79,264
Accounts payable and other payables				71,845	71,845
Total liabilities	79,264	0	0	2,696,300	2,775,564
2011					
Derivatives	330,460				330,460
Shares in other companies		106			106
Accounts receivables and other receivables			75,077		75,077
Restricted deposits			8,251		8,251
Cash			229,942		229,942
Total assets	330,460	106	313,270	0	643,836
Interest bearing liabilities				2,741,066	2,741,066
Derivatives	114,696				114,696
Accounts payable and other payables				75,388	75,388
Total liabilities	114,696	0	0	2,816,454	2,931,150

Consolidated Financial Statements of Landsvirkjun 2012 37 Amounts are in USD thousand

56. Other issue

The Company has capitalised water rights amounting to USD 45.6 million, whereof water rights related to Kárahnjúkar weigh the most. With Law Amendment Act no. 58/2008 on the resource and energy sector, which entered into effect on 1 July 2009, restrictions are set for the State, municipalities, and government owned Companies on the endorsement of the ownership of water rights containing harnessable power in excess of 10 MW. The State and municipalities are allowed, however, to entitle companies in their posession the right of using the resources for up to 65 years at a time. The State has yet to decide how these issues will be managed in the future with respect to Landsvirkjun.

57. Subsequent events

No subsequent events have taken place after the balance sheet date, which would require adjustments or changes to the financial statement for the year 2012.

Statement of Corporate Governance

Corporate Governance

Organisation

Landsvirkjun's operations are subject to Act no. 42/1983, with later 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 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 for Landsvirkjun to take note of the economy, environment, and community in its operations.

The Board of Directors

According to law, the Board of Directors of Landsvirkjun is responsible for the financial matters and operations of the Company and is appointed by the Minister of Finance for a one year term. The Board of Directors of Landsvirkjun consists of the following Directors: Bryndís Hlödversdóttir, President of the University of Bifröst, who is also the Chairman of the Board, Sigurbjörg Gísladóttir, chemist at the Environment Agency of Iceland and vice Chairman of the Board, Ingimundur Sigurpálsson, CEO of Íslandspóstur, Arnar Bjarnason, Managing Director of Reykjavík Capital and Stefán Arnórsson, Professor at the University of Iceland.

Audit committee

Chapter IX of 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, Ingimundur Sigurpálsson and Sigurbjörg Gísladóttir. Stefán Svavarsson, Professor at the University of Bifröst is the Chairman of the committee.

CEO, Deputy and Executive Directors

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

Project planning division. The Head of project planning division is Pálmar Óli Magnússon. 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 Magnús Bjarnason. The role of the division is to maximise the Company's revenue with the analysis of different business opportunities, product development, promotion, and sales of products and services, and negotiations of new power contracts and follow up on the execution of existing contracts.

Energy division. Director 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.