Landsvirkjun

Group

Consolidated Financial Statements 2013

Landsvirkjun
Háaleitisbraut 68
103 Reykjavík

Id.no. 420269-1299

Contents

Key figures

Management's presentation of the operation of Landsvirkjun

Amounts are in USD thousand

	2013	2012	2011	2010	2009
Operation					
Operating revenues	407,676	389,499	419,708	383,991	299,788
Realised aluminium hedges	15,228	18,325	16,488	(6,342)	42,526
Total operating revenues	422,904	407,824	436,196	377,649	342,314
Operating expenses	(93,768)	(86,488)	(90,993)	(79,564)	(70,655)
EBITDA	329,136	321,336	345,203	298,085	271,659
Depreciation and impairment loss	(117,670)	(112,288)	(108,200)	(107,258)	(114,321)
EBIT	211,466	209,048	237,003	190,827	157,338
Financial items	(86,988)	(103,093)	(126,877)	(99,275)	(96,102)
Associated companies	(2,647)	(2,229)	(4,014)	(1,581)	(11,193)
Profit before unrealised financial items	121,831	103,726	106,112	89,971	50,043
Unrealised financial items:					
Fair value changes in embedded derivatives	(174,641)	(3,391)	(93,197)	(55,583)	253,304
Fair value changes in other derivatives	5,014	13,653	6,959	(39,438)	(53,655)
Unrealised foreign exchange difference	(16,658)	(12,675)	22,711	87,619	(39,752)
	(186,285)	(2,413)	(63,527)	(7,402)	159,897
Profit (loss) before income tax	(64,454)	101,313	42,585	82,569	209,940
Income tax	25,913	(45,995)	(16,135)	(9,653)	(16,944)
Profit (loss)	(38,541)	55,318	26,450	72,916	192,996
Balance sheet					
Total assets	4,568,965	4,518,534	4,635,989	4,850,037	4,807,970
Equity	1,658,134	1,697,152	1,661,312	1,644,322	1,564,487
Liabilities	2,910,831	2,821,382	2,974,677	3,205,715	3,243,483
Net liabilities *	2,429,176	2,435,571	2,502,873	2,673,966	2,823,872
Cash flow					
Funds from operations (FFO)	257,704	241,584	255,592	218,582	202,142
Cash flow from operating activities	258,485	236,178	267,172	229,595	197,023
Investing activities	(149,455)	(122,979)	(107,689)	(53,517)	(120,533)
Financing activities	(12,893)	(151,670)	(185,328)	(106,294)	(4,572)
Liquidity					
Cash and cash equivalents at year end	287,987	187,916	229,942	265,532	194,248
Undrawn loans	301,947	409,979	415,767	307,676	281,600
Total liquidity	589,934	597,895	645,709	573,208	475,848
Key ratios					
Return on equity	(2.3%)	3.3%	1.6%	4.7%	14.0%
Equity ratio	36.3%	37.6%	35.8%	33.9%	32.5%
Interest cover (EBITDA/net interest expenses)	3.51x	3.27x	3.06x	3.68x	3.14x
FFO / net liabilities	10.6%	9.9%	10.2%	8.2%	7.2%
FFO / interest expenses	2.66x	2.36x	2.19x	2.58x	2.19x
Net liabilities / EBITDA	7.38x	7.58x	7.25x	8.97x	10.39x
Credit rating at year end					
Standard & Poor's	BB	BB	BB	BB+	BB
Moody's	Baa3	Baa3	Baa3	Baa3	Baa3

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

Quarterly statement 2013

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

	Q1	Q2	Q3	Q4	Total
Operating revenues					
Power sales	91,104	81,618	81,642	92,116	346,480
Realised aluminium hedges	3,106	4,341	3,792	3,989	15,228
Transmission	12,150	12,546	12,723	19,112	56,531
Other income	697	1,151	1,028	1,789	4,665
	107,057	99,656	99,185	117,006	422,904
Operating expenses					
Energy production costs	7,660	8,679	8,489	9,514	34,342
Transmission costs	3,410	4,761	4,209	8,091	20,471
Cost of general research	1,495	1,601	1,808	2,041	6,945
Other operating expenses	7,191	6,663	6,688	11,468	32,010
Depreciation and impairment loss	25,871	34,732	26,209	30,858	117,670
	45,627	56,436	47,403	61,972	211,438
Operating profit	61,430	43,220	51,782	55,034	211,466
Financial income and (expenses)					
Interest income	1,381	568	540	542	3,031
Interest expenses	(26,910)	(21,020)	(23,041)	(25,789)	(96,760)
Realised foreign exchange difference	3,521	6,692	(2,403)	(1,069)	6,741
	(22,008)	(13,760)	(24,904)	(26,316)	(86,988)
Associated companies	(1,969)	160	(223)	(615)	(2,647)
Profit before income tax and unrealised items	37,453	29,620	26,655	28,103	121,831
Unrealised financial items:					
Fair value changes in embedded derivatives	(114,681)	(54,778)	45,522	(50,704)	(174,641)
Fair value changes in other derivatives	(5,798)	6,362	464	3,986	5,014
Unrealised foreign exchange difference	34,349	(17,839)	(22,823)	(10,345)	(16,658)
	(86,130)	(66,255)	23,163	(57,063)	(186,285)
Profit (loss) before income tax	(48,677)	(36,635)	49,818	(28,960)	(64,454)
Income tax	18,132	14,957	(17,119)	9,943	25,913
Profit (loss)	(30,545)	(21,678)	32,699	(19,017)	(38,541)
Attributable to:					
Owners of the parent company	(32,399)	(24,059)	30,771	(19,157)	(44,844)
Subsidiaries minority interest	1,854	2,381	1,928	140	6,303
	(30,545)	(21,678)	32,699	(19,017)	(38,541)
From cash flow					
Cash flow from operating activities	74,885	59,545	57,606	66,449	258,485

Other key metrics for Landsvirkjun (parent company)	**2013**	**2012**	**2011**	**2010**	**2009**
Installed power at year end (MW)	1,862	1,860	1,860	1,860	1,860
Average price for industrial users (incl. transm.) USD/MWh	25.8	26.2	28.7	25.7	19.5
Average price for retail sales comp.(excl. transm.) ISK/kWh	4.0	3.9	3.6	3.4	3.2
Sales in Gwh	13,186	12,770	12,778	12,926	12,546
Research and development	26,799	32,514	17,203	19,575	23,601
Accident frequency: H200*	0.7	0.0	0.4	1.4	1.1

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

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Endorsement by the Board of Directors and CEO

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

The financial statements of Landsvirkjun for the year 2013 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 422.9 million in the year 2013 compared to USD 407.8 million in the previous year. Income thus increased by USD 15.1 million. The increase is mainly explained by the increase in sold volume and higher transmission income. Revenue recognition due to realised aluminium hedges amounted to USD 15.2 million in the year 2013 compared to USD 18.3 million in the previous year. Operating expenses amounted to USD 211.4 million in the year 2013 compared to USD 198.8 million in the year 2012. The Company's operating profit thus amounted to USD 211.5 million in the year 2013 compared to USD 209.0 million in the previous year.

Financial expenses in excess of financial income amounted to USD 273.3 million in the year 2013, compared to USD 105.5 million the previous year. The change between years amounts to USD 167.8 million. The main reason for this difference between years is fair value changes in embedded derivatives. Fair value changes in derivative financial instruments are mostly unrealised, which must be kept in mind in the evaluation of the Company's results for the year. Profit before unrealised financial items amounted to USD 121.8 million during the year compared to USD 103.7 million in the year 2012. According to the income statement the loss of the year amounted to USD 38.5 million compared to a profit of USD 55.3 million in the previous year.

Landsvirkjun has entered into derivative agreements in order to manage risk. Agreements have been made due to interest rate risk and foreign currency risk. In addition, derivative agreements have been made in order to hedge risk due to fluctuations of aluminium prices in the global market as a part of revenues is based thereon. Positive fair value of aluminium hedges, which ensure the Company's revenue, amounted to USD 10.0 million at year end 2013. Fair value of currency and interest rate swap derivative agreements at year end 2013 was negative by USD 28.0 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 and the fair value is measured at USD 96.2 million at year end 2013.

Equity at year end 2013 amounted to USD 1,658.1 million compared to USD 1,697.2 million at year end 2012 according to the balance sheet and the Company's Board of Directors proposes that the loss of the year be recognised as a decrease in equity. The Company's Board of Directors will during the Annual General Meeting propose a dividend payment to the owners of the company but otherwise refer to the notes to the financial statements and statement of equity for further changes in equity. Landsvirkjun is a partnership owned by the 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 solid due to a cash balance and undrawn loans. Cash and cash equivalents at year end amounted to USD 288.0 million and undrawn Revolving Credit Facilities to USD 291.3 million. Furthermore, undrawn long-term loans amount to USD 10.7 million. Liquid assets amounted thus to USD 590.0 million at year end. Cash flow from operations amounted to USD 258.5 million. Landsvirkjun borrowed USD 158.1 million in the year and paid down debt and currency swaps by USD 158.9 million. Cash and cash equivalents increased by USD 100.1 million during the year. It is the evaluation of the management of Landsvirkjun that access to liquid assets is ensured until year end 2015. The construction of Budarhals power plant is on schedule and the power station will be taken into operation in the year 2014.

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

Corporate Governance

The Board of Directors of Landsvirkjun endeavours to maintain good corporate governance having regard to the Guidelines on Corporate Governance issued by the Iceland Chamber of Commerce in collaboration with the Confederation of Icelandic Employers and Nasdaq OMX Iceland. The Board of Directors has laid down comprehensive guidelines wherein the competences of the Board is defined and its scope of work vis-à-vis the CEO. The Board of Directors has appointed an Audit Committee. In the year 2013, 13 Board meetings were held and 4 meetings in the Audit Committee. Meetings have been attended by the majority of the Board of Directors and the majority of the Audit Committee. Landsnet hf. has disclosed information on corporate governance in an appendix in its financial statements. Further information on the parent company's corporate governance is included in notes 28 to 37 and appendix to the financial statements.

Statement by the Board of Directors and the CEO

According to the best knowledge of the Board of Directors' and the CEO, the financial statements are in accordance with International Financial Reporting Standards as adopted by the EU and it is the opinion of the Board of Directors and the CEO that the financial statements give a fair view of the Company's assets, liabilities and financial position as at 31 December, 2013 and the Company's results and changes in cash in the year 2013.

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 2013 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, 21 February 2014.

The Board of Directors:

Bryndís Hlödversdóttir

Sigurbjörg Gísladóttir

Arnar Bjarnason

Ingimundur Sigurpálsson

Stefán Arnórsson

The CEO:
Hördur 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, 2013, 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 reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of Landsvirkjun as at 31 December, 2013, 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 Paragraph 2 of Article 104 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 the information that according to the Financial Statements Act shall be provided and are not stated in the notes to the financial statements.

Reykjavik, 21 February 2014.

KPMG ehf.

Árni Claessen

Auður Þórisdóttir

Income Statement for 2013

	Notes	2013	2012
Operating revenues			
Power sales		346,480	338,242
Realised aluminium hedges		15,228	18,325
Transmission		56,531	44,357
Other income		4,665	6,900
		422,904	407,824
Operating expenses			
Energy production costs		116,936	115,770
Transmission costs		39,850	41,244
Cost of general research		19,007	13,941
Other operating expenses		35,645	27,821
		211,438	198,776
Operating profit	3	211,466	209,048
Financial income and (financial expenses)			
Interest income		3,031	4,014
Interest expenses		(96,760)	(102,269)
Foreign exchange difference		(9,917)	(17,513)
Fair value changes in embedded derivatives	30	(174,641)	(3,391)
Fair value changes in other derivatives		5,014	13,653
	6	(273,273)	(105,506)
Associated companies	13	(2,647)	(2,229)
Profit (loss) before income tax		(64,454)	101,313
Income tax	7	25,913	(45,995)
Net profit (loss) for the year		(38,541)	55,318
Attributable to:			
Owners of the parent company		(44,844)	53,057
Subsidiaries minority interest		6,303	2,261
		(38,541)	55,318

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

Consolidated Financial Statements of Landsvirkjun 2013 8 Amounts are in USD thousand

Statement of Comprehensive Income for the year 2013

	2013	2012
Profit (loss) for the year	(38,541)	55,318
Operating items moved to equity:		
Translation difference due to subsidiaries and associated companies	13,432	(4,145)
Pension obligation after income tax, change	(1,088)	(1,112)
Total operating items moved to equity	12,344	(5,257)
Total comprehensive income (loss) for the year	(26,197)	50,061
Profit (loss) attributable to:		
Owners of the parent company	(37,230)	49,631
Subsidiaries minority interest	11,033	430
	(26,197)	50,061

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

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Balance Sheet as at 31 December 2013

Assets	Notes	2013	2012
Non-current assets			
Property, plant and equipment	8	3,495,611	3,476,284
Projects under construction	9	221,820	151,509
Intangible assets	10	239,038	233,563
Derivative financial instruments	12	112,451	270,076
Associated companies	13	20,717	20,103
Other non-current assets	14	3,610	3,224
Deferred tax asset	7	89,536	56,218
Total non-current assets		4,182,783	4,210,977
Current assets			
Inventories	16	4,827	4,186
Accounts receivables and other receivables	17	67,630	72,896
Derivative financial instruments	12	25,738	41,591
Restricted deposits		0	968
Cash and cash equivalents	18	287,987	187,916
Total current assets		386,182	307,557
Total assets		4,568,965	4,518,534
Equity and liabilities			
Equity			
Owners' contributions	19	586,512	586,512
Revaluation account	20	94,898	98,281
Translation difference	20	(28,531)	(37,233)
Other equity		957,845	1,013,216
Equity of the owners of the parent company		1,610,724	1,660,776
Minority interest		47,410	36,376
Total equity		1,658,134	1,697,152
Long-term liabilities			
Interest bearing liabilities	21	2,541,806	2,416,004
Accrued pension liabilities	23	27,007	23,228
Deferred income tax liability	7	21,076	14,550
Obligation due to demolition	24	6,739	5,704
Prepaid income		3,210	2,336
Derivative financial instruments	12	50,029	60,232
		2,649,867	2,522,054
Current liabilities			
Accounts payable and other payables	25	75,701	71,845
Interest bearing liabilities	22	175,357	208,451
Derivative financial instruments	12	9,906	19,032
		260,964	299,328
Total liabilities		2,910,831	2,821,382
Total equity and liabilities		4,568,965	4,518,534

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

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Statement of Equity for the year 2013

	Owners' contribution	Revaluation account	Translation difference	Other equity	Equity attrib-utable to the owners of the parent company	Minority interest	Total equity
Changes in equity year 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)
Pension obligation, change				(1,112)	(1,112)		(1,112)
Profit for the year.............				53,057	53,057	2,261	55,318
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
Changes in equity year 2013							
Equity at 1 January, 2013 ..	586,512	98,281	(37,233)	1,013,216	1,660,776	36,376	1,697,152
Translation difference			8,702		8,702	4,730	13,432
Pension obligation, change				(1,088)	(1,088)		(1,088)
Loss for the year				(44,844)	(44,844)	6,303	(38,541)
Total loss for the year			8,702	(45,932)	(37,230)	11,033	(26,197)
Revaluation transferred to other equity..................		(3,383)		3,383	0	0	0
Dividend paid to owners....				(12,822)	(12,822)	0	(12,822)
Equity at 31 December 2013	586,512	94,898	(28,531)	957,845	1,610,724	47,410	1,658,134

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

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Statement of Cash Flow for 2013

	Notes	2013	2012
Operating activities			
Operating profit		211,466	209,048
Adjustments for:			
Depreciation and impairment loss		117,670	112,288
Pension obligation, change		(748)	(629)
Obligation due to demolition, change		334	306
Other changes		466	1,359
Working capital from operation before financial items		329,188	322,372
Operating assets and liabilities, change		975	(1,605)
Cash flow from operating activities before financial items		330,163	320,767
Interest income received		2,183	4,629
Interest expenses and foreign exchange difference paid		(73,757)	(89,150)
Taxes paid		(104)	(68)
Cash flow from operating activities	27	258,485	236,178
Investing activities			
Hydropower stations in operation		(4,719)	(7,217)
Hydropower stations in construction		(74,680)	(68,131)
Transmission		(49,417)	(16,005)
Development costs for power plants		(19,777)	(29,687)
Purchased shares		0	(1,740)
Dividend received from associated company		0	12
Other capital expenditure		(8,354)	(10,684)
Assets sold		2,188	2,090
Unpaid construction cost, change		(861)	2,432
Other receivables, change		6,165	5,951
Investing activities		(149,455)	(122,979)
Financing activities			
Dividend paid to owners		(12,822)	(14,221)
New loans		158,105	16,640
Amortisation of long-term debt		(155,299)	(155,516)
Currency swaps		(3,601)	0
Prepaid income, change		724	1,427
Financing activities		(12,893)	(151,670)
Change in cash and cash equivalents		96,137	(38,471)
Effect of exchange difference on cash and cash equivalents		3,934	(3,555)
Cash and cash equivalents at the beginning of the year		187,916	229,942
Cash and cash equivalents at end of year		287,987	187,916

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

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Notes

Reporting entity

1. Landsvirkjun

Landsvirkjun is a partnership having its place of business in Iceland and its headquarters at Háaleitisbraut 68, Reykjavik. Landsvirkjun operates on the basis of the Act on Landsvirkjun no. 42/1983. The Company's main objective is to engage in operations in the energy sector. The financial statements include the consolidated financial statements of the Company and its subsidiaries (referred to as "the Group") and the 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 21 February 2014.

Note no. 40 includes information on the Group's accounting policies and changes therein in the year.

b. Basis of measurement

The financial statements have been prepared on the historical cost basis except for the following assets and liabilities, which have been measured at fair value: derivative financial instruments, trading financial assets and shares in other companies. 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 value.

c. Presentation and functional currency

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

d. Use of estimates and judgements

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

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

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

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

Notes, contd.:

2. Basis of preparation, contd.:

e. Determination of fair value

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

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

For derivatives, other than embedded derivatives, counterparty information is used to measure fair values. Then risk management assesses the evidence obtained from the third parties to support the conclusion that such valuations meet the requirements of IFRS, including the level in the fair value hierarchy in which such valuations should be classified.

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

· Level 1: quoted prices in active markets for identical assets or liabilities.

· Level 2: inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

· Level 3: inputs for the asset or liability that are not based on observable market data.

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

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

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

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

3. Statement of segments

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

Landsvirkjun Group's operating segments are specified as follows:

Electricity production

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

Electricity transmission

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

Notes, contd.:

3. Statement of segments, contd.:

Other segments

Other segments include the operation of the companies Orkufjarskipti hf. and Landsvirkjun Power ehf. together with Landsvirkjun Power ehf.'s subsidiaries. The purpose of Orkufjarskipti hf. is to own and operate a telecommunications system throughout the country and to rent access thereto. Landsvirkjun Power ehf. takes care of sales of technical and operational advisory services to third parties and general research work, harnessing researches and projects for Landsvirkjun and related companies.

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

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

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	(111,652)	(36,862)	(4,816)	66,842	(86,488)
EBITDA	257,632	61,855	1,849	0	321,336
Depreciation and impairment loss	(92,004)	(19,732)	(944)	392	(112,288)
Segment earnings, EBIT	165,628	42,123	905	392	209,048
Segment assets 2012	4,348,535	576,581	16,392	(443,076)	4,498,431
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

4. Total number of employees

Total number of employees is specified as follows:

	2013	2012
Average number of employees during the year, full-time equivalents	430	414
Full-time equivalent units at year-end	381	361

Consolidated Financial Statements of Landsvirkjun 2013 15 Amounts are in USD thousand

Notes, contd.:

5. Total salaries of employees

Total salaries of employees are specified as follows:

	2013	2012
Salaries	33,791	30,087
Pension premium payments	4,134	3,619
Defined pension benefit payments	1,397	1,415
Other change in pension obligation	(748)	(629)
Other salary related expenses	3,647	3,219
	42,221	37,711

Salaries are divided as follows in the income statement:

	2013	2012
Energy production costs	12,781	11,753
Transmission costs	8,970	8,176
Other operating expenses	20,470	17,782
	42,221	37,711

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

	2013	2012
Salaries of the Board of Directors of the parent company	95	84
Salaries of Boards of Directors of two subsidiaries (same as in 2012)	82	75
Salaries and benefits of the CEO of the parent company, Hördur Arnarson	168	140
Salaries of fives Directors and the Deputy (same as in 2012)	991	948
Salaries and benefits of the CEO and three Man. Dir. of subsid. (same as in 2012)	552	467

The Director of the Marketing and Business Development Division resigned at the beginning of the year 2013 and another person was hired to fill that position later in the year.

6. Financial income and (expenses)

Financial income and (expenses) are specified as follows:

	2013	2012
Interest income	3,031	4,014
Interest expenses	(78,826)	(78,338)
Guarantee fee	(12,422)	(9,587)
Indexation	(13,793)	(18,531)
Capitalised interest costs	8,281	4,187
Total interest expenses	(96,760)	(102,269)
Realised foreign exchange difference	6,741	(4,838)
Unrealised foreign exchange difference	(16,658)	(12,675)
Total foreign exchange difference	(9,917)	(17,513)
Fair value changes in embedded derivatives	(174,641)	(3,391)
Fair value changes in other derivatives	5,014	13,653
Financial income and (expenses)	(273,273)	(105,506)

Capitalised finance cost amounted to 3.5% of restricted cash in hydropower stations in construction in the year 2013 (2012: 3.5%) and 7.0% of restricted cash in transmission under construction (2012: 7.6%).

Consolidated Financial Statements of Landsvirkjun 2013 16 Amounts are in USD thousand

Notes, contd.:

7. Income tax

Income tax is specified as follows:	2013	2012
Change in income tax asset / liability	26,792	(45,483)
Current tax	(37)	(131)
Income tax due to pension liability recognised among comprehensive income	(612)	(625)
Foreign exchange difference	(230)	119
Adjustment due to previous year with subsidiary	0	124
Income tax recognised as income (expensed)	25,913	(45,995)

Effective tax rate		2013		2012
Profit (loss) for the year		(38,541)		55,318
Income tax for the year		(25,913)		45,995
Profit (loss) before income tax		(64,454)		101,313
Income tax acc. to the parent company's curr. tax rate	36.0%	(23,203)	36.0%	36,473
Effect of different tax rates within the Group	6.2%	(4,002)	(3.5%)	(3,492)
Effect of merger of subsidiary with parent company	(0.2%)	97	12.2%	12,194
Non-deductible items	(0.6%)	358	0.2%	152
Other items	(1.3%)	837	0.7%	669
Effective income tax	40.2%	(25,913)	45.6%	45,995

Income tax due to items recognised among other comprehensive income is specified as follows:	2013	2012
Income tax due to pension liability recognised among comprehensive income	(612)	(625)

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

	Deferred tax asset		Deferred income tax liability	
	2013	2012	2013	2012
Balance at the beginning of the year	56,218	100,716	(14,550)	(13,565)
Change from asset to liability between years	(20)	0	20	0
Change in temporary difference	32,945	(35,551)	863	2,272
Change in carry forward loss	(1,852)	(8,144)	(5,394)	(3,941)
Foreign exchange difference	2,245	(803)	(2,015)	684
Balance at year end	89,536	56,218	(21,076)	(14,550)

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

Carry forward taxable loss	19,289	17,618	1,665	6,610
Non-current assets and intangible assets	83,303	115,677	(25,315)	(23,542)
Derivative financial instruments	(26,883)	(87,948)	0	0
Other items	13,827	10,871	2,574	2,382
Balance at year end	89,536	56,218	(21,076)	(14,550)

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

Carry forward loss of the year 2008, usable until the year 2018	9,317	37,786
Carry forward loss of the year 2009, usable until the year 2019	40,733	40,116
Carry forward loss of the year 2010, usable until the year 2020	975	871
Carry forward loss of the year 2011, usable until the year 2021	958	856
Carry forward loss of the year 2012, usable until the year 2022	9,908	2,357
Carry forward loss of the year 2013, usable until the year 2023	17	0
Carry forward loss at year end	61,909	81,986

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 carry forward loss at each year end.

Consolidated Financial Statements of Landsvirkjun 2013 17 Amounts are in USD thousand

Notes, contd.:

8. Property, plant and equipment

Property, plant and equipment is specified as follows:

Cost value	Power stations	Trans-mission	Communicat. equipment	Other assets	Total
Total value at 1.1.2012	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 at 31.12.2012	4,857,421	531,044	16,486	70,399	5,475,350
Effect of exchange rate changes	0	66,761	2,031	3,411	72,203
Additions during the year	4,719	5,527	1,050	5,320	16,616
Moved from development costs	4,065	0	0	0	4,065
Moved from transm. under constr.	0	49,882	0	0	49,882
Sold and disposed of	0	0	0	(7,642)	(7,642)
Total value at 31.12.2013	4,866,205	653,214	19,567	71,488	5,610,474
Depreciation and impairment loss					
Total value at 1.1.2012	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 at 31.12.2012	1,856,852	110,400	3,806	28,009	1,999,067
Effect of exchange rate changes	0	14,351	519	913	15,783
Depreciation of the year	81,974	18,587	1,058	2,953	104,572
Sold and disposed of	0	0	0	(4,559)	(4,559)
Total value at 31.12.2013	1,938,826	143,338	5,383	27,316	2,114,863
Book value					
1.1.2012	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
31.12.2013	2,927,379	509,876	14,184	44,172	3,495,611
Book value without revaluation					
1.1.2012	3,075,856	331,444	11,029	41,972	3,460,301
31.12.2012	3,000,569	308,080	11,534	42,390	3,362,573
31.12.2013	2,927,379	390,038	13,155	44,172	3,374,744

Official assessment of fixed assets and insurance value

The official assessment of the Company’s real estates amounted to USD 329 million at year end 2013 (2012: USD 285 million). Insurance value of the Company’s assets amounts to USD 4,154 million (2012: USD 4,203 million) and emergency fund amounts to USD 955 million (2012: USD 803 million).

Consolidated Financial Statements of Landsvirkjun 2013 18 Amounts are in USD thousand

Notes, contd.:

9. Projects under construction

Projects under construction are specified as follows:

	2013	2012
Balance at 1.1.	151,509	71,883
Effect of exchange rate changes	1,289	(447)
Moved from/to development costs	403	(65)
Additions during the year	118,501	80,182
Moved to property, plant and equipment	(49,882)	0
Sold and disposed of	0	(44)
Balance at 31.12.	221,820	151,509

10. Intangible assets

Intangible assets are specified as follows:

	Capitalised development costs	Water and geothermal rights	Software	Total
Cost value				
Total value at 1.1.2012	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 at 31.12.2012	247,051	45,611	7,137	299,799
Effect of exchange rate changes	1,408	0	381	1,789
Additions during the year	20,747	0	1,012	21,759
Moved to transm. under constr. / power stations	(4,468)	0	0	(4,468)
Total value at 31.12.2013	264,738	45,611	8,530	318,879
Depreciation and impairment loss				
Total value at 1.1.2012	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 at 31.12.2012	61,038	0	5,199	66,237
Effect of exchange rate changes	243	0	263	506
Amortisation during the year	0	0	421	421
Impairment loss during the year	12,678	0	0	12,678
Total value at 31.12.2013	73,959	0	5,883	79,842
Book value				
1.1.2012	160,895	44,827	1,692	207,415
31.12.2012	186,013	45,611	1,938	233,563
31.12.2013	190,779	45,611	2,646	239,038

A part of capitalised water rights is within public land and is therefore the property of the Icelandic State in accordance with Act no. 58/1998 on Public Land and determination of the confines of private property, public land and highland pasture. Landsvirkjun however holds the disposition right to the water rights under long-term agreement with the State in accordance with law at each time, and based thereon the rights are capitalised in the balance sheet.

Consolidated Financial Statements of Landsvirkjun 2013 19 Amounts are in USD thousand

Notes, contd.:

10. Intangible assets, contd.:

At year end, an impairment test was performed on the Company's intangible assets. In testing for possible impairment the parent company's forecast on expected cash flow over the useful life of the assets was used. In the evaluation expected cash flow was discounted with the rate 5.5% of weighted average required rate of return. The result of the test did not show any indication of impairment but during the year impairment had been recorded due to individual projects.

11. Depreciation and impairment loss

The Group's depreciation and impairment is specified as follows:	2013	2012
Power stations	81,974	82,504
Transmission	18,587	17,732
Telecommunication equipment	1,058	972
Other assets	2,953	2,591
Depreciation of assets in operation	104,572	103,799
Impairment loss on development cost	12,678	8,065
Amortisation of software	421	425
	117,670	112,288

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

Energy production costs	82,594	83,016
Transmission costs	19,379	18,340
Cost of general research	12,062	8,000
Other operating expenses	3,635	2,932
	117,670	112,288

12. Derivative financial instruments

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

Assets:		
Embedded derivatives in electricity sales agreements	109,465	285,756
Aluminium hedges	14,833	13,243
Currency swaps	4,303	366
Other derivatives	9,588	12,302
	138,189	311,667
Derivative financial instruments are divided as follows:		
Long-term component of derivative agreements	112,451	270,076
Short-term component of derivative agreements	25,738	41,591
	138,189	311,667
Liabilities:		
Embedded derivatives in electricity sales agreements	13,271	14,920
Aluminium hedges	4,786	3,246
Currency swaps	0	11,937
Interest rate swaps	38,124	44,588
Other derivatives	3,754	4,573
	59,935	79,264
Derivative financial instruments are divided as follows:		
Long-term component of derivative agreements	50,029	60,232
Short-term component of derivative agreements	9,906	19,032
	59,935	79,264

The accounting policy for embedded derivatives is discussed in note 30.

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

Consolidated Financial Statements of Landsvirkjun 2013 20 Amounts are in USD thousand

Notes, contd.:

13. Associated companies

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

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

		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

14. Other non-current assets

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

	2013	2012
Shares in other companies	133	117
Long-term receivables	3,477	3,107
	3,610	3,224

15. Landsvirkjun's subsidiaries

Landsvirkjun's subsidiaries are specified as follows:

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

In the year 2012, the Boards of Directors of Landsvirkjun and Þeistareykir ehf. decided to merge the companies and the effective date of the merger was 1 September 2012. Following the Company Registry's observations regarding the merger it was decided that the effective date of the merger should be 1 July 2013, but the merger had been taken into account in the financial statements of Landsvirkjun for the year 2012. The Icelandic parliament approved the merger with amendments to the Act on Landsvirkjun in December 2013. A formal merger procedure in accordance with law will be finalized in the first half of the year 2014.

16. Inventories

Inventories are specified as follows:

Oil	39	35
Spare parts and consumables	4,788	4,151
	4,827	4,186

Consolidated Financial Statements of Landsvirkjun 2013 21 Amounts are in USD thousand

Notes, contd.:

17. Accounts receivables and other receivables

Accounts receivables and other receivables are specified as follows:

	2013	2012
Accounts receivables	48,393	46,041
Other short term receivables	18,960	26,490
Assets available for sale	277	365
	67,630	72,896

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

18. Cash and cash equivalents

Cash and cash equivalents are specified as follows:

	2013	2012
Bank deposits	202,447	169,379
Market securities	85,540	18,537
	287,987	187,916

19. Equity

The parent company is a partnership owned by the State and Eignarhlutir ehf. The State owns 99.9% in the Company and Eignarhlutir ehf. 0.1%. Eignarhlutir ehf. is owned by the State. The Company is an independent taxable entity. The Group's equity ratio at year end 2013 was 36.3% but was 37.6% at year end 2012.

20. Revaluation account and translation difference

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

21. Liabilities

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

		2013		2012	
	Maturity date	Average interest	Remaining balance	Average interest	Remaining balance
Liabilities in ISK	2013-2034	3.8%	380,002	4.0%	367,724
Liabilities in CHF	2013-2022	0.3%	55,951	0.4%	60,826
Liabilities in EUR	2013-2028	1.1%	796,182	1.3%	861,009
Liabilities in GBP	2013-2016	10.4%	4,961	11.4%	14,875
Liabilities in JPY	2013-2033	4.0%	12,380	2.5%	26,709
Liabilities in USD	2013-2026	3.0%	1,467,687	3.1%	1,293,312
			2,717,163		2,624,455
Current maturities of long-term debt			(175,357)		(208,451)
Total long-term debt			2,541,806		2,416,004

Interest rate terms on loans at year end are from 0.3-7.9%. Nominal interest rates for the period were on average 3.5%, compared to 3.3% the previous year.

The Company's payments due to guarantees for long-term loans are calculated according to Regulation no. 121/1997.

Consolidated Financial Statements of Landsvirkjun 2013 22 Amounts are in USD thousand

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

	2013	2012
2013	-	208,451
2014	175,357	168,817
2015	189,966	188,159
2016	250,225	254,106
2017	264,243	254,750
2018	328,315	-
Later	1,509,057	1,550,172
	2,717,163	2,624,455

23. Pension fund obligation

The Company's obligation to refund the indexation charges on retirement payments to current and former employees, which hold pension rights with state and communal pension funds amounted to USD 27.0 million at year end 2013 according to an actuary's evaluation, which is based on estimated future changes in salaries and prices. Interest rates 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:

	2013	2012
Balance at 1.1.	23,228	23,238
Expensed during the year	583	549
Payments during the year	(1,331)	(1,178)
Actuarial change	1,700	1,737
Effect of foreign exchange rate differences	2,827	(1,118)
Balance at 31.12.	27,007	23,228

Pension fund obligation, 5 year statem:	2013	2012	2011	2010	2009
Present value of the obligation	27,007	23,228	23,238	23,442	21,978

24. Obligation due to demolition

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

	2013	2012
Balance at 1.1.	5,704	5,673
Reversed discounting in the year	334	306
Effect of foreign exchange rate differences	701	(275)
Balance at 31.12.	6,739	5,704

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

25. Accounts payable and other payables

Accounts and other payables are specified as follows:

	2013	2012
Accounts payable	30,620	32,269
Accrued interests	24,882	23,647
Other short term liabilities	20,199	15,929
	75,701	71,845

Consolidated Financial Statements of Landsvirkjun 2013 23 Amounts are in USD thousand

26. 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	**2013**	**2012**
Interest income		
Associated companies	12	50
Expenses		
Associated companies	5	8
Receivable		
Associated companies	0	1,773

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

27. Cash flow

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

Operating activities	**2013**	**2012**
Cash received from customers	427,712	408,240
Cash expenses	(97,549)	(87,473)
Cash flow from operation excluding interest	330,163	320,767
Interest income received	2,183	4,629
Interest expenses and foreign exchange difference paid	(73,757)	(89,150)
Taxes paid	(104)	(68)
Cash flow from operating activities	258,485	236,178

28. Risk management

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

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

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

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28. Risk management, contd.:

The objectives of risk management are to analyse, manage, and monitor Landsvirkjun's risks 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:

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

29. Financial risk

Landsvirkjun aims at reducing market risk related to foreign currencies by increasing the weight of USD in the Company's loan portfolio. In the past two years, Landsvirkjun has for that purpose entered into agreements to change the terms of loans from EUR to USD in the amount of EUR 190 million. Landsvirkjun will continue to work on comparable changes in loans in the year 2014.

In the year 2013, an agreement was reached with the holder of a bond to abolish a provision which granted the holder an annual right to call in the bond. Landsvirkjun had up until then defined the bond as a short term loan due to the provision but following the change it will be recognised among long term debt. The bond amounts to EUR 50 million and it matures in March 2020.

At year end 2013, the Company had access to undrawn Revolving Credit Facilities in the amount of USD 200 million and ISK 10,500 million. The maturity profile, strong liquidity, and access to loans secures the Company's liquidity until year end 2015.

30. Aluminium price risk

The Company is exposed to substantial risk due to possible aluminium price fluctuations as around 40% of its income is linked to the price of aluminium. The Company has thus entered into derivative agreements in order to secure its income base and reduce fluctuations. Such agreements consist in most cases of fixing aluminium price at a certain level. The Company, therefore, can lose income if aluminium prices increase considerably, but at the same time guarantees better cash flow should the price of aluminium decrease in the markets. Risk management may hedge up to 100% of aluminium price risk for next year and proportionally less over the next years but is not required to place minimum hedges. Around 50% of 2014 estimated cash flow and 25% of 2015 estimated cash flow has been hedged. At year end 2013, fair value of the hedges was positive by USD 10 million (2012: USD 10 million), with the agreements being effective over the next three 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.

2013

	Aluminium Price		
Interest Rates	-10%	0%	10%
-1%	7,806	55	(8,793)
0%	7,676	-	(8,760)
1%	7,547	(54)	(8,728)

2012

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

30. Aluminium price risk, contd.:

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. Net fair value changes of the agreements during the year are recognised in the Company's income statement among financial income and expenses.

	2013	2012
The fair value of embedded derivatives is specified as follows:		
Fair value of embedded derivatives at the beginning of the year	270,836	274,227
Fair value changes during the year	(174,641)	(3,391)
Fair value of embedded derivatives at year end	96,195	270,836
Division of embedded derivatives is specified as follows:		
Long term component of embedded derivative	95,711	253,322
Short term component of embedded derivative	485	17,514
Total embedded derivatives	96,195	270,836

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.

2013

Interest Rates	Aluminium Price -10%	0%	10%
-1%	(105,015)	6,114	117,243
0%	(105,777)	-	105,777
1%	(106,532)	(5,828)	94,876

2012

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

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

Calculations are based on the forward price of aluminium, as disclosed by the LME.

Calculations are based on the maximum time length of official information on aluminium prices, or 123 months. 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 the revision time of electric power sales agreements. The time length can though never be more than the aforementioned 123 months.

According to provisions on energy buyers' purchase obligation the calculations are based on a secured minimum purchase.

Expected cash flow of contracts is discounted at USD rates according to Bloomberg, no spread added. At year end 2013, the interest rate profile for discounting was in the range 0.3 - 3.3% (2012: 0.3 - 1.9%).

31. Foreign exchange risk

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

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

2013	**EUR**	**ISK**	**JPY**	**Other currencies**
Long-term receivables	0	3,477	0	0
Accounts receivables and other receivables	571	15,179	0	3,564
Cash	3,745	33,624	159	11,533
Derivatives	261,801	0	0	0
Interest bearing liabilities	(796,182)	(380,002)	(12,380)	(60,912)
Accounts payable and other payables	(2,635)	(50,619)	(386)	(4,847)
Risk in balance sheet	(532,700)	(378,341)	(12,607)	(50,662)

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)

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Notes, contd.:

31. Foreign exchange risk, contd.:

Exchange rate of the main currencies against the USD, (USD/currency) for the years 2013 and 2012 is specified as follows:

	Average rate		Rate at year end	
	2013	**2012**	**2013**	**2012**
EUR	0.75	0.78	0.73	0.76
GBP	0.64	0.63	0.60	0.62
CHF	0.93	0.94	0.89	0.92
JPY	97.55	79.70	105.00	86.10
NOK	5.88	5.82	6.08	5.59
ISK	122.23	125.05	115.03	128.74

Sensitivity analysis

A change of the USD by 10% against the following currencies, would have affected the Group's results and equity by the following amounts after tax. The analysis is based on all variables, especially interest rates, remaining unchanged.

	Profit (loss) after tax			
	2013		**2012**	
	Strengthening	Weakening	Strengthening	Weakening
EUR	39,134	(43,506)	35,455	(44,864)
ISK	(3,619)	3,619	2,880	(2,880)
JPY	807	(807)	4,614	(4,614)

The fair value of currency swaps was positive by USD 4.3 million at year end 2013. The underlying principal amount is USD 78.3 million. The fair value of currency options was positive by USD 5.8 million and the underlying principal amount was USD 245.2 million.

32. Interest rate risk

Landsvirkjun faces interest rate risk as the Company has interest bearing assets and liabilities. The Company's liabilities carry both fixed and floating interest rates and interest rate derivatives are used in order to hedge against interest rate risk. Interest bearing financial liabilities are higher than interest bearing financial assets and the Company's risk consists, therefore, of possible increases in interest rates and higher interest expenses.

At year end 2013, the proportion of loans with floating interest rates was 59% compared to 64% at year end 2012. Changes in interest rates by one percent would have led to a change in interest expenses by USD 16 million in the year 2013 (USD 17 million in the year 2012). The Company's financial instruments with fixed interests are not sensitive to interest rate changes. At year end 2013, the estimated market value of the Company's long-term liabilities was USD 187 million higher than their book value (USD 207 million higher in the year 2012) discounted by the underlying currencies yield curve without spread. The following table shows the division of financial assets and liabilities between floating and fixed interests.

Financial instruments with fixed interest other than derivatives	**2013**	**2012**
Financial assets	3,477	3,107
Financial liabilities	(1,114,037)	(944,804)
	(1,110,560)	(941,697)

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Notes, contd.:

32. Interest rate risk, contd.:

Financial instruments with floating interest other than derivatives	**2013**	**2012**
Financial assets	287,987	188,884
Financial liabilities	(1,603,126)	(1,679,651)
	(1,315,139)	(1,490,767)
Derivative financial instruments		
Embedded derivatives	96,195	270,836
Other derivatives	(17,940)	(38,433)
	78,255	232,403

The fair value of interest rate swaps was negative by USD 38.1 million at year end 2013 and the underlying principal amounted to USD 185 million. The following tables show the effect of changes in interest rates on the fair value of the interest rate and currency swaps in USD thousand before tax.

2013

Interest Rates			
-0.2%	0.0%	1.0%	2.0%
(1,393)	-	6,453	12,050

2012

Interest Rates			
-0.2%	0.0%	1.0%	2.0%
(1,935)	-	8,896	16,509

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 30 includes sensitivity analysis on the fair value of embedded derivatives and shows the effect of change in interest rates and the price of aluminium.

33. Liquidity risk

Liquidity risk consists of risk of losses should the Company not be able to meet its obligations at maturity. The company limits liquidity risk with effective liquidity management ensuring that there is sufficient cash at each time in order to meet with the company's obligations. In order to limit such risk, the Company's liquidity balance is monitored and an 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 288 million at year end 2013 but when taking into account undrawn credit facilities (USD 200 million and ISK 10,500 million) and undrawn long-term loans in the amount of USD 10.7 million the company has access to a total of USD 590 million. Taking into consideration cash flow from operation the Company believes that access to liquid assets is ensured until year end 2015.

In order to ensure access to capital and maintain flexible funding possibilities, Landsvirkjun has used different types of funding. In past years, financing has mostly taken place through a state guarenteed Euro Medium Term Note Programme (EMTN). At year end, the balance of loans under the EMTN was USD 1.82 billion but the total amount that the Company can borrow under the programme is USD 2.5 billion.

In the year 2013, Landsvirkjun signed a new EMTN framework agreement on international bond issues, without a state guarantee. The total amount of the framework agreement is USD 1 billion. At year end, the balance of loans under the EMTN without a state guarantee was around USD 30 million.

The Company's risk related to refinancing is reduced with a well distributed maturity profile and long terms of outstanding loans. The weighted average life of the loan portfolio was 6.3 years and the proportion of loans with maturity within 12 months is 6.5%.

33. Liquidity risk, contd.:

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

2013	Book value	Contractual cash flow	Within one year	1 - 2 years	2 - 5 years	More than 5 years
Non-derivative financial instruments						
Long-term receivables ..	3,477	3,761	243	3,518	0	0
Cash and cash equiv.	287,987	287,987	287,987	0	0	0
Short term receiv.	67,630	67,630	67,630	0	0	0
Interest bearing liab.	(2,717,163)	(3,280,119)	(219,297)	(253,453)	(1,016,325)	(1,791,044)
Current liabilities	(75,701)	(75,701)	(75,701)	0	0	0
	(2,433,770)	(2,996,442)	60,862	(249,935)	(1,016,325)	(1,791,044)
Derivative financial instruments						
Currency swaps	10,137	11,759	7,486	(418)	4,691	0
Interest rate swaps	(38,124)	(38,776)	(4,496)	(29,214)	(5,066)	0
Aluminium deriv.	10,047	12,265	9,768	1,955	542	0
Embedded derivatives in electr. sales agr.	96,195	113,116	487	4,011	31,062	77,556
	78,255	98,364	13,245	(23,666)	31,229	77,556

2012

2012	Book value	Contractual cash flow	Within one year	1 - 2 years	2 - 5 years	More than 5 years
Non-derivative financial instruments						
Long-term receivables ..	3,107	3,577	217	217	3,143	0
Cash and cash equiv.	187,916	187,916	187,916	0	0	0
Restricted deposits	968	968	968	0	0	0
Short term receiv.	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 deriv.	9,997	12,032	8,726	3,306	0	0
Embedded derivatives in electr. 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

Consolidated Financial Statements of Landsvirkjun 2013 30 Amounts are in USD thousand

Notes, contd.:

34. Counterparty risk

Counterparty risk is the risk that a counterparty to an agreement does not comply with provisions of the agreement. Landsvirkjun's counterparty risk arises first and foremost due to the Company's energy contracts and derivatives entered into for hedging purposes. Though the amounts involved are considerably high, the risk is limited with the Company´s requirements for counterparty quality. Landsvirkjun has set a benchmark for derivatives which involves that no derivative agreements are made with financial companies that have a lower rating than A- from Standard and Poor's or a comparable rating from other recognised credit rating agencies. Before entering into power contracts the financial standing of the relevant companies and their parent companies is thoroughly reviewed, if applicable.

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

	2013	2012
Derivative financial instruments	138,189	311,667
Restricted deposits	0	968
Long-term receivables	3,477	3,107
Accounts receivables and other receivables	67,630	72,896
Cash and cash equivalents	287,987	187,916
	497,283	576,554

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

	2013		2012	
	Book value	Fair value	Book value	Fair value
Interest bearing long term liabilities	(2,717,163)	(2,904,201)	(2,624,455)	(2,831,376)

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

Inter bank rates and swap rates were used without premium for the relevant currencies as at the reporting date when discounting the estimated cash flow in calculating the fair value of interest bearing long-term liabilities. For interest bearing liabilities in ISK CPI, indexed rates were used for both years.

Interest rates are specified as follows:	2013	2012
Interest bearing liabilities in ISK	2.2-3.0%	1.9-2.5%
Interest bearing liabilities other than in ISK	0.0-4.0%	0.0-2.7%

36. Fair value classification

The table below shows the level categorisation for items in the financial statements recognised at fair value (see note 2).

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

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36. Fair value classification, contd.:

2012	Level 2	Level 3	Total
Embedded derivatives		270,836	270,836
Other derivatives	(38,433)		(38,433)
Shares in other companies		117	117
	(38,433)	270,953	232,520

Classification of financial assets between levels remains unchanged from the previous year. Fair value changes of financial assets at level 3 amounted to USD 174.6 million expensed in the year 2013 (USD 3.4 million in the year 2012) and is recognised among financial income and expenses.

37. Classification of financial instruments

According to the International Financial Reporting Standard *IAS 39 Financial instruments: recognition and measurement,* financial assets and liabilities are divided into defined groups. The classification affects how the evaluation of the relevant financial instrument is measured. Those groups to which the Company's financial assets and liabilities pertain and their basis for evaluation are specified as follows:

- 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.

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 value	Book value
2013					
Derivative financial instruments	138,189				138,189
Shares in other companies		133			133
Long-term receivables		3,477			3,477
Accounts receivables and other receivables			67,630		67,630
Cash and cash equivalents			287,987		287,987
Total assets	138,189	3,610	355,617	0	497,416
Interest bearing long term liabilities				2,717,163	2,717,163
Derivative financial instruments	59,935				59,935
Accounts payable and other payables				75,701	75,701
Total liabilities	59,935	0	0	2,792,864	2,852,799
2012					
Derivative financial instruments	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 and cash equivalents			187,916		187,916
Total assets	311,667	3,224	261,780	0	576,671
Interest bearing long term liabilities				2,624,455	2,624,455
Derivative financial instruments	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

Consolidated Financial Statements of Landsvirkjun 2013 32 Amounts are in USD thousand

38. Capital management

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

39. Subsequent events

Nothing has come forth after the balance sheet date, which would require adjustments or changes to the financial statement for the year 2013.

40. Significant accounting policies

The Group has adopted all International Financial Reporting Standards, amendments thereto and interpretations confirmed by the EU at year end 2013 and that apply to its operation. The Group has not adopted standards, amendments to standards or interpretations entering into effect after year end 2013, 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.

The Group has implemented the following accounting principles and changes in accounting standards as of 1 January 2013.

- IFRS 13, Fair value measurement
- IAS 19, Employee benefits

The effect of individual changes is explained as follows.

a) Fair value changes

IFRS 13 provides a single IFRS framework for measuring fair value and requires disclosures about fair value measurements according to IFRS. The Standard unifies the definition of fair value as the price that would be received in a transaction for an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The standard also applies to and expands the disclosure requirement on fair value measurement in other standards, including IFRS 7, *Financial Instruments: Disclosures.* The standard also expands the disclosure requirements about fair value measurements. As a result, the Group has included additional disclosures in this regard. The adoption of the standard has had no impact on the evaluation of assets and liabilities of the Group.

b) Defined benefit plan

The Group has changed its accounting policy for defined benefit plans parallel to the adoption of amendments to IAS 19.

The Group now recognises actuarial change in pension liabilities among other comprehensive income.

Comparative figures have been changed accordingly and the effect is specified as follows: Operating expenses decreased by USD 1.7 million and expensed income tax in the income statement increased by USD 0.6 million. Other comprehensive income decreased by USD 1.1 million.

Except for the aforementioned changes due to the implementation of new standards, the Group has consistently applied the following accounting policies to all periods presented in these consolidated financial statements.

41. Basis of consolidation

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.

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

Assets and liabilities of a subsidiary with an 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 year. The exchange rate difference arising from the translation to USD is entered as a specific item in the statement of comprehensive income and under equity. Amounts in the statement of cash flow are translated to USD at the average exchange rate of the year. The exchange rate difference arising from the translation to USD is entered as a specific item in the statement of cash flow.

42. Associated companies

Associated companies are those companies in which the 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.

43. 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.

44. Interest income and expenses

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

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

45. Other financial income and expenses

Other financial income (expenses) 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 differences. Dividend income is recognised in the income statement when distribution of dividends has been approved.

46. Foreign currency transactions

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

47. Impairment

a) Financial assets

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

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

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

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

b) Other assets

The carrying amounts of the Company's 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. Intangible assets with unspecified useful lives are tested annually for impairment.

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

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

For other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

48. Income tax

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

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

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

49. Property, plant and equipment

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 of the assets will revert to the Company and the cost can be measured reliably. All other cost is expensed in the income statement as it is incurred.

The Group's transmission and telecommunication systems are recognised at a revalued cost in the balance sheet, which is their fair value less depreciation from the date of revaluation in the year 2008. The revaluation of those assets will be carried out on a regular basis. All value increase due to the revaluation is recognised in the revaluation account among equity after income tax effect. Depreciation, of the revalued cost is recognised in the income statement. Upon the sale, depreciation or disposal of an asset, the part of the revaluation account pertaining to the asset is transferred to retained earnings.

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

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

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

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

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

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

49. Property, plant and equipment, contd.:

Depreciation

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

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

Depreciation ratios and useful life are specified as follows:

	Depreciation	Useful life
Power stations:		
Power houses and other structures	1.67%	60 years
Machinery	2.5-6.67%	15-40 years
Dams and waterways	1.67-3.33%	30-60 years
Thermal stations	1.67-6.67%	15-60 years
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

50. Intangible assets

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

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

Water and geothermal rights are capitalised in the balance sheet at cost value as intangible assets with unlimited useful life.

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

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

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

	Depreciation	Useful life
Software	25%	4 years

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Notes, contd.:

51. Financial instruments

a) Non-derivative financial assets

Non-derivative financial assets 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. The component of the transferred financial assets arising or retained by the Company is recognised as a specific asset or liability.

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

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

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

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

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

ii) Loans and receivables

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

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

ii) Assets available for sale

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

b) Non-derivative financial liabilities

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

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

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

51. Financial instruments, contd.,

c) Derivative financial instruments

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

i) Separable embedded derivatives

Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related 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.

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

52. Inventories

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

53. Cash and cash equivalents

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

54. Equity

The Group’s equity is divided into owners’ contribution, revaluation account, translation difference, other equity and minority interest. The parent company’s initial capital amounts to USD 587 million.

55. Employees’ benefits

a. Defined contribution plan

Cost due to a contribution to 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. Actuarial changes in the obligation are recognised among operating items under equity in the statement of comprehensive income. Other changes are recognised in the income statement.

56. Provisions

Obligations are recognised when the Company has a legal obligation or entered into obligations due to past events, it is likely that they will be settled and they 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.

57. 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 returns of the segments are 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.

Statement of Corporate Governance

Corporate Governance

Organisation

Landsvirkjun's operation is 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 the negative effect on the environment and community. The policy sets the basis for the Company to obtain its goal of becoming a leading energy company in the field of renewable energy and aims at Landsvirkjun taking note of the economy, environment, and community in its operation.

The Board of Directors

According to law, the Board of Directors of Landsvirkjun is appointed by the Minister of Finance for a one year term at a time and it is responsible for the financial matters and operation of the Company. The Board of Directors of Landsvirkjun consists of the following Directors: Bryndís Hlödversdóttir, Director of Human Resources at Landspitali, who is also the Chairman of the Board, Sigurbjörg Gísladóttir, chemist 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 and Stefán Svavarsson, auditor and chairman of the committee.

CEO, Deputy and Executive Directors

The Board of Directors of Landsvirkjun hires a CEO. The CEO of the Company is 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 basis for profitable operation and contribute to maximum results in all units of the Group.

Project planning division. The Head of the 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 Björgvin S. Sigurðsson. 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. Head of the energy division is Einar Mathiesen. The role of the division is to guarantee that energy production and distribution is in accordance with agreements with customers in a safe and 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.