



annual report 2007



Landsvirkjun

Recipient of the Icelandic Quality Award 2007

Green energy

Landsvirkjun's electricity production is certified as green energy from the German certifier TÜV SÜD. On the basis of this, Landsvirkjun sells green certificates to electricity retailers in EU member states.

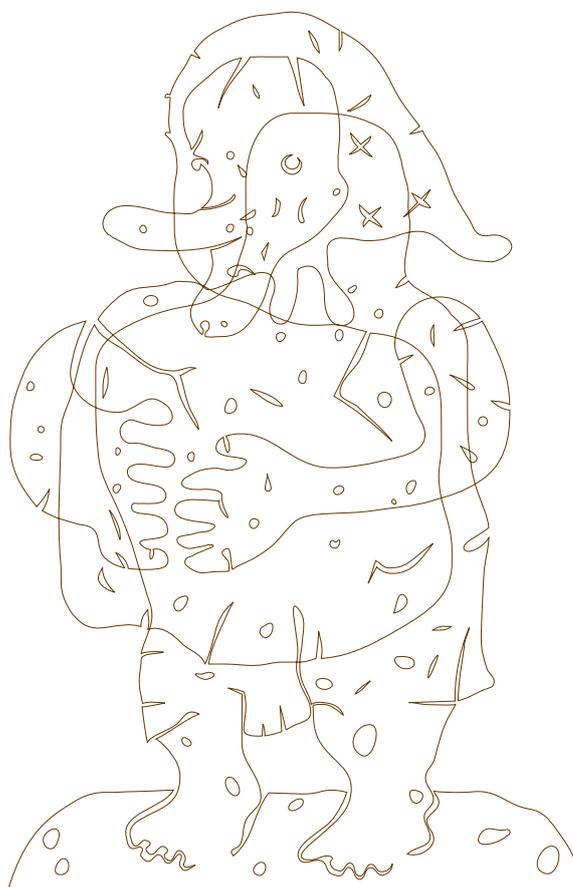


The golden plover has arrived!

Landsvirkjun sponsored artist Steingrímur Eyfjörð, as the representative of Iceland at the Venice Biennale in 2007. Steingrímur's exhibition, entitled "The golden plover has arrived", will be open to the public free of charge in Landsvirkjun's gallery at the Ljósifoss power station, south Iceland, in the summer of 2008.

Pictures of Steingrímur's work at the Venice exhibition give particular elegance to this year's Annual Report.

Steingrímur Eyfjörð was born in Reykjavík in 1954. Having graduated from the Icelandic College of Art and Craft in 1978 he studied at the Ateneum in Finland and the Jan van Eyck Academie in the Netherlands. The artist has held various exhibitions in Iceland and abroad in recent years. Steingrímur lives in Reykjavík



Overview	2
Board of Directors	3
From the Chairman of the Board and Managing Director	4
Social responsibility	6
Environmental issues	7
Power production, purchases and sales	9
Marketing	11
Research and development	12
Kárahnjúkar Hydropower Project	13
Finance	15
Risk management	17
Financial statements 2007	19



Highlights of the annual accounts (ISK)

	2007	2006
Net profit	28,474 million	11,009 million
Cash gen. by operating activities	8,588 million	9,100 million
Liabilities	219.6 billion	194.4 billion
Owners' equity	99 billion	7.8 billion
Equity ratio	31.1 %	26.7 %

Electricity production, purchases and sales

	2007	2006
Total production	8,481 GWh	7,428 GWh
With hydropower	7,963 GWh	6,918 GWh
With geothermal power	518 GWh	510 GWh
Electricity purchases	422 GWh	463 GWh
Sales to general market	2,645 GWh	2,498 GWh
Sales to power-intensive industries	6,258 GWh	5,393 GWh
Sales increase	12.8 %	3.2 %

Overview

At the beginning of the year, Landsvirkjun concluded a sponsorship agreement with the artist Steingrímur Eyfjörð, who represented Iceland at the Venice Biennale in 2007.

Steingrímur's piece, entitled "The golden plover has arrived", will be on display in Landsvirkjun's gallery at the Ljósifoss power station in the summer of 2008. Pictures of His work from the Venice exhibition give particular elegance to this year's Annual Report.

In February, Landsvirkjun accepted an invitation to participate in the Global Roundtable on Climate Change (GROCC). GROCC's objective is to encourage international solidarity in responding to global warming. A Landsvirkjun working group took part in writing the joint GROCC statement.

Landsvirkjun's Energy Division was awarded the environmental management certificate ISO 14001 in February. The Energy Division is the eighth Icelandic enterprise to be certified according to the ISO 14001 standard.

In mid-summer, Landsvirkjun began using the first hydrogen-powered passenger car in Iceland. Transport is an important factor in being a role-model in environmental issues. Using a fleet of more environmentally friendly vehicles that can use domestic, renewable energy sources is a step in the right direction. Landsvirkjun acquired two additional hydrogen-powered vehicles in the autumn.

In mid-August, Landsvirkjun and the company Becromal signed an energy supply contract for a planned plant that will be constructed in Akureyri next year. The plant will manufacture aluminium foil for capacitors which is a specialised high-technology process that requires considerable amounts of power – approximately 640 GW per annum – and does not release greenhouse gases. The aluminium foil production plant will create 90 new jobs.

In September, it was announced that the first borehole in the Iceland deep drilling project, IDDP, would be drilled at the Krafla site in 2008.

At the beginning of November, the Board of Directors decided to enter into negotiations concerning energy sales with companies that intend to build and operate data centres. Landsvirkjun's emphasis on data centres and purified silicon production is based on the view that higher prices can be expected in such power contracts than in contracts with other power-intensive customers. Moreover, the move enhances customer diversification. The Board of Directors announced that Landsvirkjun would not, for the time being, enter into negotiations with companies that intend to build new aluminium smelters in southern and western areas of the country.

The Landsvirkjun Board of Directors decided to adopt US dollar as its functional currency from 2008. The decision to adopt US dollar as the functional currency is based on requirements made by International Financial Reporting Standards (IFRS) that have been enacted into Icelandic legislation. The company's business with its customers in domestic wholesale markets will continue in krona as before.

Landsvirkjun was awarded the Icelandic Quality Award for 2007. This was a great achievement for our staff, as this is one of the most sought-after awards available to Icelandic companies and institutions. The award is presented in recognition of tangible management results, and is an encouragement to companies to set clear objectives and regularly monitor progress.

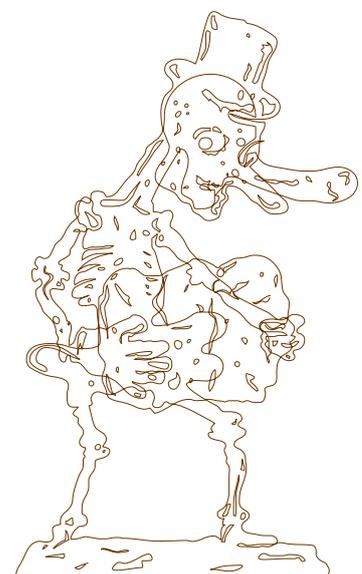
The Kárahnjúkar hydropower station was formally put on stream on 30 November by Árni M. Mathiesen, Minister of Finance, and Össur Skarphéðinsson, Minister of Industry. Five of the six turbines in Fljótsdalur Powerhouse, the Kárahnjúkar project's power station, were on stream by the end of the year.

In 2007, Landsvirkjun established a new subsidiary, Landsvirkjun Power which formally began operating at the beginning of 2008. The Landsvirkjun Engineering and Construction Division was thereby discontinued and the division's employees transferred to Landsvirkjun Power. The new company will be responsible for managing Landsvirkjun construction work as well as international projects.

Full-time positions in 2007

In 2007, Landsvirkjun's permanent staff worked for a total of 212 man-years. Temporary staff worked for approximately 36 man-years.

Landsvirkjun hired a total of 192 young people in 2007, of whom 151 performed conventional summer tasks, while 41 were university students in various other types of work.



Svartur

Board of Directors

A new Board of Directors, appointed by the Minister of Finance, took office at the 2007 Annual General Meeting.

Mr Páll Magnússon, *Chairman*
Mr Valur Valsson, *Vice-Chairman*
Ms Jóna Jónsdóttir
Mr Valdimar Hafsteinsson
Mr Ágúst Einarsson

Alternates:

Ms Ágústa Björnsdóttir
Ms Guðný Ester Adalsteinsdóttir
Mr Sveinn Agnarsson
Ms Vigdís M. Sveinbjörnsdóttir
Mr Thórdur Sverrisson

Executive Committee

Managing Director > Mr Fridrik Sophusson
Office Manager and Deputy Managing Director > Mr Örn Marinósson

Heads of Division:

Finance > Mr Stefán Pétursson
Energy > Mr Bjarni Bjarnason
Human Resources > Ms Sigthrudur Gudmundsdóttir
Information Technology > Mr Bergur Jónsson
Engineering and Construction > Mr Agnar Olsen

Corporate Communication > Mr Thorsteinn Hilmarsson

From 2008 the following changes were made to the Executive Committee:

- > Agnar Olsen took over as Deputy Managing Director when Örn Marinósson retired.
- > Kristján Gunnarsson became Head of Finance as Stefán Pétursson moved to HydroKraft Invest.
- > Einar Mathiesen became Head of Energy as Bjarni Bjarnason moved to Landsvirkjun Power.
- > The operations of Engineering and Construction were moved to Landsvirkjun Power.

From the Chairman of the Board and the Managing Director

Landsvirkjun received the 2007 Icelandic Quality Award, an annual award presented by the Icelandic Quality Management Association, the Office of the Prime Minister, the University of Iceland and the Reykjavík Commercial Workers Union, for excellence in systematic work practices based on quality management. Landsvirkjun is certified according to the ISO 9001 quality standard, and in February, the company received certification according to the ISO 14001 environmental management standard for the company's electricity production, covering all operations of the Energy Division. Work is underway to obtain certification for all Landsvirkjun activities in accordance with this standard. Furthermore, action is being taken to attain certification according to the ISO 27001 standard on information security. In recent years, internal work at Landsvirkjun has been carried out with regard to targeted policy formulation, recorded work procedures and good work practices. Working towards these goals makes Landsvirkjun more flexible and better prepared to address the company's future challenges and growth targets.

The Awards Committee for the Quality Award describes Landsvirkjun as an energetic and objective knowledge-based company that compares favourably with overseas companies of same size and type. Information systems are used in an efficient and practical manner, which lends effective support to objectives and work procedures, and is a good example of information utilisation for other companies. The company's executives and directors have a clear vision, which is moulded in a highly systematic and efficient manner, with the active participation of personnel. Company strategy is presented and implemented in every department, and the needs of clients and community are paramount. The company is actively involved in social projects in a positive and constructive manner.

Looking to the future

As previously mentioned, some points of emphasis are expected to change in the future. Landsvirkjun is currently looking at harnessing hydropower in the lower stretch of the River Thjórsá and geothermal energy in North Iceland. These projects could lead to regional economic development and boost hi-tech in-

dustries. It is not realistic to assume that future power projects in Iceland will be on as large a scale as recently. It is therefore essential for Landsvirkjun to broaden its horizons and look to other countries where the company's expertise can best be applied in order to create opportunities and added value. The company's capabilities in the power sector could be employed internationally to gain significant results. This is a key feature in obtaining optimal return on the company's inherent assets.

During 2007, the company made policy decisions that will have great impact on its future plans for achieving results abroad. In order to exploit opportunities on an international scale in the best manner possible, and to increase the company's flexibility to participate in projects abroad, Landsvirkjun has established the subsidiary Landsvirkjun Power Ltd. The subsidiary commenced activities at the beginning of 2008. Landsvirkjun Power is fully owned by Landsvirkjun, and the company's goal is to build on the know-how and strength of the parent company in international projects in the field of renewable energy. Employees who previously worked for Landsvirkjun's Engineering and Construction Division transferred to Landsvirkjun Power. The new company will also be responsible for the supervision of Landsvirkjun power projects in Iceland; among them the Kárahnjúkar Hydropower Project, preparations for the construction of hydropower plants in South Iceland and geothermal power stations in North Iceland.

It is essential to reiterate that power projects in Iceland will in the future, as in the past, be the responsibility of Landsvirkjun, and Landsvirkjun Power will act as an advisor on the said projects. The subsidiary was established as a limited liability company to limit the risk exposure of investments abroad.

In early 2007, Landsvirkjun established the limited liability company HydroKraft Invest, which it owns in partnership with Landsbanki Íslands. HydroKraft is an investment company that aims to lead projects based on the renewal, restructuring and construction of power plants in the field of hydropower and other renewable energy sources abroad. Landsvirkjun's share in HydroKraft Invest is held by Landsvirkjun Power.

Sales to power-intensive industries

As stated in last year's report, Landsvirkjun and Alcan concluded an agreement for the expansion of the Alcan aluminium smelter at the end of 2006. The agreement was not signed as the parties were waiting for the outcome of a local referendum in the community of Hafnarfjörður voicing the residents' position regarding the expansion of the Straumsvík smelter. Hafnarfjörður residents rejected these plans. Landsvirkjun's Board of Directors resolved that the company would begin exploratory negotiations with a number of interested buyers of electricity in South and West Iceland. By November, the outcome of these exploratory talks showed that the most favourable course for the company would be to enter into formal negotiations with a number of parties planning to build and operate data centres, manufacture purified silicon and operate other high-tech businesses. Landsvirkjun's Board hopes that this will lead to higher income from electricity sales, greater diversity in the energy-intensive industries sector and a significant increase in environmentally friendly businesses needing a large supply of electrical energy. Negotiations began with a company that plans to build a data centre in the Sudurnes area and a second undertaking that wants to build a plant for the production of purified silicon in Thorlákshöfn. Landsvirkjun does not intend to enter into negotiations, for the time being, with companies that plan to build new aluminium smelters in South and West Iceland.

It is Landsvirkjun's opinion that the best option regarding the use of the electricity from the power plants now under preparation on the River Thjórsá would be to sell the electricity to industries of the type described above, along with a possible increase in the sale of electricity to aluminium smelters already operating in Iceland. Preparations for power plants on the River Thjórsá continue, and construction work could begin in early 2009 if everything goes according to plan.

In fact, successful results were achieved in this respect earlier in the year when an agreement was reached on the sale of electricity to the Italian company Becromal for a plant in Akureyri for the production of aluminium foil for capacitors; the plant will begin operating in

late 2008. The magnitude of the Landsvirkjun energy sale to Becromal is equivalent to six times the current energy consumption of the Akureyri area.

Work continued in accordance with the MOU between Landsvirkjun and Alcoa concerning possible geothermal power plants in North Iceland that might produce electricity for an aluminium smelter at Bakki near Húsavík.

It is clear that the present plans regarding the development of energy-intensive high-tech businesses in Iceland and plans for an aluminium smelter in Húsavík mean that substantial demands will be placed on Landsvirkjun in developing the power system in coming years. It is important to increase the company's equity, or take measures that will ensure that Landsvirkjun will be able to meet the demands made of the company, both by the community at large and by the Government, Landsvirkjun's owner.

Kárahnjúkar Power Project

Construction work on the Kárahnjúkar Hydropower Project began in 2003 as a result of an energy supply contract with Fjarðaál, a subsidiary of Alcoa. The newly constructed 690 MW power station will be an addition to Landsvirkjun's current capacity of 1200 MW. The start-up of the Fljótisdalur Powerhouse took place in a formal ceremony on 30 November.

The Kárahnjúkar Hydropower Project is now expected to be more profitable than shown in the 2002 assessment that was used as a reference when the decision was made to sign an agreement with Alcoa and begin construction of the power plant. Landsvirkjun published a renewed economic assessment at the beginning of 2008 which was reviewed by independent consultants and found to be well-founded and thorough. The power plant's profitability turns out to be greater than originally estimated,

mainly because high aluminium prices generate more income than previously anticipated.

- Return on equity is now 13.4% as opposed to the previous figure of 11.9%.
- The net present value of the construction beyond the owners' profitability targets is ISK 15.5bn. This is an increase of ISK 8.9bn above the original estimate.
- Kárahnjúkar Hydropower Project annual profits before taxes are estimated to be on average ISK 4.2bn at 2008 price levels.

Construction costs for the Kárahnjúkar Project, excluding capital costs during construction, are now estimated at ISK 123.9bn, which is 7% higher than the original cost estimate based on price levels at the end of September 2007. Total costs, including capital during construction, are estimated to be ISK 133bn.

New accounting principles

Landsvirkjun's Annual Accounts were prepared for the first time in accordance with International Financial Reporting Standards (IFRS) as required by law. The total effect of the changed financial reporting on the group's equity was that shareholders' equity at the start of 2007 increased by ISK 8.1bn.

In 2007, net profits of the Landsvirkjun Group amounted to ISK 28.5bn. By year-end, the total assets of the company totalled ISK 318.8bn and equity amounted to ISK 99.2bn, which was an increase of ISK 28.4bn during the year. The equity ratio was 31.1% at the end of 2007.

Profits rose by ISK 17,465m from the previous year. The increase in operating income was mainly the result of energy sales to Fjarðaál that began during the year. Operating expenses before depreciation were similar to those of the previous year. Financial income in excess of financial expenses amounted to ISK 27,630m, which can mainly be attributed to foreign exchange gains from long-term liabilities, and

fair-value changes to embedded derivatives contracts. Exchange rate gains and fair value adjustments are, for the most part, unrealised, and it is important to keep this fact in mind when assessing the company's performance.

According to International Financial Reporting Standards, the company is required to determine its operating currency based on specific items. A decision has been taken to employ US dollar as the company's functional currency as of the beginning of 2008. This means that 2007 will be the last year in which the company's Annual Accounts will be based on the Icelandic krona.

The outlook for Landsvirkjun operations in 2008 is good. Income from electricity sales to power-intensive industry will enhance the company's total revenue. Exchange rate developments and adjustments to the fair-value price of embedded derivatives will largely determine performance this year.

Operating results

It is a principal feature of Landsvirkjun's vision that the company plans to be a responsible enterprise that operates in the spirit of sustainable development. Therefore, Landsvirkjun insists on operating results that deliver economic, environmental and social value based on long-term considerations.

The development of the company's production units and the underpinning of infrastructure that has taken place during recent years have laid the foundation for the company's solid economic growth as shown by these Annual Accounts. Landsvirkjun has developed a power system that uses only renewable, emission-free energy for its production, and offers it at a price that is among the most competitive in the Western world, benefiting society at large.





Social Responsibility

An important factor in Landsvirkjun's assessment of success is how well the company's activities harmonize with society and serve to create long-term bonds with the surroundings. Landsvirkjun takes note of the fact that among Iceland's largest companies, the company is unique in that its operations are centered in rural areas. The growth and prosperity of the neighboring society is the best guarantee of Landsvirkjun's future. It is important to initiate partnerships where all parties contribute to further their joint interests.

Co-operation with tourism

Landsvirkjun emphasizes the development of tourism in the vicinity of power stations. This also entails cooperation in cultural activities by staging exhibitions and events in our power stations, thereby supplying venues for local artistic talents.

Several of the company's power stations around the country are open to the public over the summer months. Thousands of visitors come every year to acquaint themselves with energy issues and enjoy a diverse range of cultural and informative presentations. These undertakings have offered substantial support towards building up the tourist industry in the communities closest to the stations.

Furthermore, such undertakings have broadened the assortment of attractions offered to tourists in power plant areas, while collaboration with local residents on maintaining and improving access to places of interest in the environs has led to an increasing volume of tourists in areas surrounding the power plants. Promotion of Icelandic electricity production also fits well into Iceland's image as clean and environmentally sound, which is the essence of the tourist industry's message to foreign tourists.

Landsvirkjun's research fund

Landsvirkjun founded a research fund in 2007 which supports research in the area of energy and the environment. The board of the fund is headed by Dr. Sveinbjörn Björnsson, former Dean of the University of Iceland. Other universities in Iceland also have representatives on the board. The aim of the fund is to interest scientists and Academia in doing research on environmental issues and energy and to encourage students to pursue careers in the energy sector.

Many hands make light work

Landsvirkjun has for many years employed a large number of youths in work over the summer months. They take on important maintenance and environmental projects in

places where Landsvirkjun operates, all over the country.

Under the caption of "Many hands make light work", Landsvirkjun has in past years advertised collaboration in which Landsvirkjun offers its summer work groups for assisting with development in the fields of tourism and the environment.

As part of this program, Landsvirkjun cooperated with 12 afforestation and land reclamation societies, municipalities and other organizations on revegetation and afforestation projects in all parts of the country in 2007. Landsvirkjun also worked with 17 partners on improving access for tourists by making paths and other facilities in many of the country's prime tourist locations. In 2007, Landsvirkjun's work groups also assisted numerous sports clubs in maintenance and improvement on their facilities. Furthermore the youngsters Landsvirkjun employs assisted at a summer camp for handicapped children and on an archaeological dig.

Environmental issues

The year was Landsvirkjun's second operating year in energy production according to the certified environmental management system, ISO 14001.

Five principal goals in environmental issues have been identified based on Landsvirkjun's environmental policies. Their implementation has revealed the following results:

Work in harmony with the natural ecosystem

No serious incident occurred during the year with respect to interaction with the natural ecosystem.

Better use of resources

In order to achieve this goal, the utilisation of geothermal reserves and water reserves in reservoirs and river flows is monitored and managed. Work on increasing fluid injection back into the geothermal reservoir in Krafla is in progress. It increased by 15.8% from the previous year.

Operations without environmental accidents

One incident classified as an environmental accident occurred during the year. During the incident, 1.5 kg of SF₆ gas leaked into the atmosphere due to equipment malfunction in the River Thjórsá area.

Reduction in emissions of greenhouse gases

Emissions of greenhouse gases from geothermal power stations were reduced by 23% in 2007 despite an increase of 1.4% in energy production. Emissions are calculated based on measurements of the total volume of water and steam that is processed in the Krafla area.

Less waste

The total volume of waste from Landsvirkjun operations was approximately 5.4% less in 2007 than in 2006. Approximately 80% of the waste generated by the company is sorted and sent for recycling, energy production or appropriate disposal.

Greenhouse effects of reservoirs

Assessments of the emission of greenhouse gasses from reservoirs in Iceland is based on the use of emission factors issued by the Intergovernmental Panel on Climate Change

Flow factors for CO₂ and CH₄ emissions from Gilsá reservoir together with IPCC emission factors.

Gas	Time of year	Emission process	Emission from Gilsá Reservoir	IPCC
CO ₂ [kg ha-1 d-1]	Ice-free period	flow	9.8	11.8
		degassing	3.1	
	Reservoir covered in ice	flow	0	0
		degassing	0	
CH ₄ [kg ha-1 d-1]	Ice-free period	flow	0.024	0.086
		air bubbles	0.48	0.29
		degassing	0.02	
	Reservoir covered in ice	flow	0	0
		air bubbles	0.012	0
		degassing	0	

(IPCC). It is recommended that countries use more precise indicators than the IPCC emission factors.

As the emission of greenhouse gases from reservoirs has not been specifically assessed in Iceland, Landsvirkjun initiated comprehensive research into emissions from Gilsá Reservoir, the intake reservoir for the Blanda power station. Gilsá Reservoir was chosen because the reservoir site was completely covered in vegetation before construction began. As a result, there is a considerable amount of organic carbon under water and it is therefore likely that there is some emission of greenhouse gases from the reservoir.

The results of the research are shown in the table above. Results are calculated as emission per hectare of reservoir per day in accordance with IPCC reports.

The research project also investigated whether it would be possible to estimate the emission of methane and nitrous oxide from reservoirs based on the volume of submerged organic material, and thus calculate the emission of greenhouse gases. The results indicate that there is a good relationship between the emission of methane and the volume of organic carbon.

A model showing this relationship proved to be so accurate that it can be used to predict emissions from reservoirs other than Gilsá Reservoir. See table below.

Estimated emission of carbon dioxide and methane from Landsvirkjun's reservoirs in the River Thjórsá area and Blanda Reservoir, based on the volume of organic carbon at the reservoir site. Measured emissions from Gilsá Reservoir and IPCC factors in 2006 are shown for comparison.

Reservoir	kg C m-2 reservoir site	kg per ha per day	
		CO ₂	CH ₄
Krókur Reservoir	1.92	0.230	0.0092
Hrauneyjar Reservoir	0.88	0.106	0.0042
Bjarna Reservoir	0.63	0.076	0.0030
Sultartangi Reservoir	0.68	0.082	0.0033
Vatnsfell Reservoir	0.0	0.0	0.0
Blanda Reservoir	38.9	4.67	0.187
Gilsá Reservoir	108.7	12.90	0.524
IPCC 2006 ice-free period		11.80	0.086



Landsvirkjun's carbon fixation

Ever since 1968, Landsvirkjun has been involved in extensive revegetation and afforestation in areas near the company's power projects, in co-operation with a large number of parties, including the Soil Conservation Service of Iceland, afforestation associations and local residents. Landsvirkjun has revegetated an area of approximately 116 km² that was for the most part barren.

It is possible to roughly estimate the carbon fixation of the revegetation and afforestation areas in which Landsvirkjun has been involved. An estimate of Landsvirkjun's annual CO₂ fixation returns a figure of approximately 18,600 tonnes. In comparison, it may be noted that the total emission of all Landsvirkjun activities amounted to just over 50,000 tonnes of CO₂ equivalents last year. Of this amount, the emission of all activities other than geothermal processing amounted to approximately 500 tonnes.



Landsvirkjun's power stations

Hydropower stations	1,797 MW
Fljótsdalur	690 MW
Búrfell	270 MW
Hrauneyjafoss	210 MW
Blanda	150 MW
Sigalda	150 MW
Sultartangi	120 MW
Vatnsfell	90 MW
Írafoss	48 MW
Laxá	28 MW
Steingrímstöð	26 MW
Ljósfoss	15 MW
Geothermal stations	63 MW
Krafla	60 MW
Bjarnarflag	3 MW
Fossil fuel stations	42 MW
Straumsvík	35 MW
Akureyri	7 MW
Total installed capacity	1,902 MW

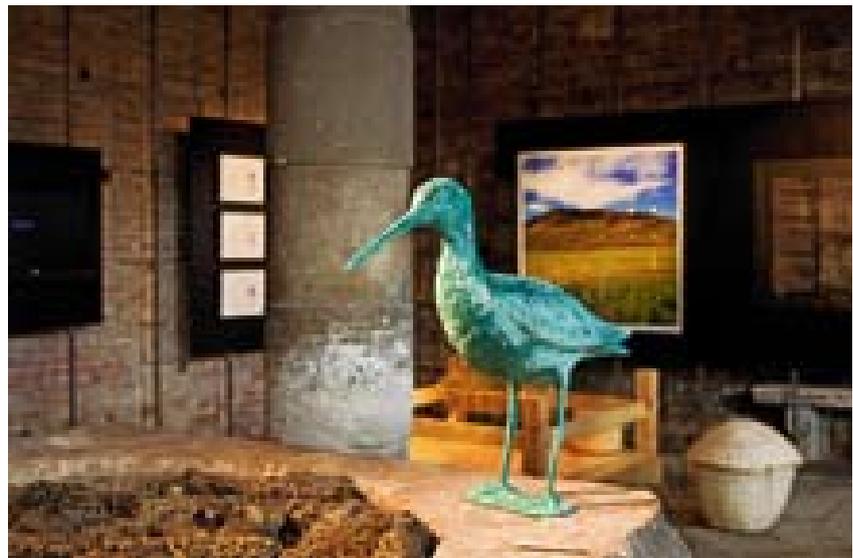
Power Production, purchases and sales

Landsvirkjun currently operates eleven hydropower plants, two geothermal plants and two fossil fuel plants for back-up.

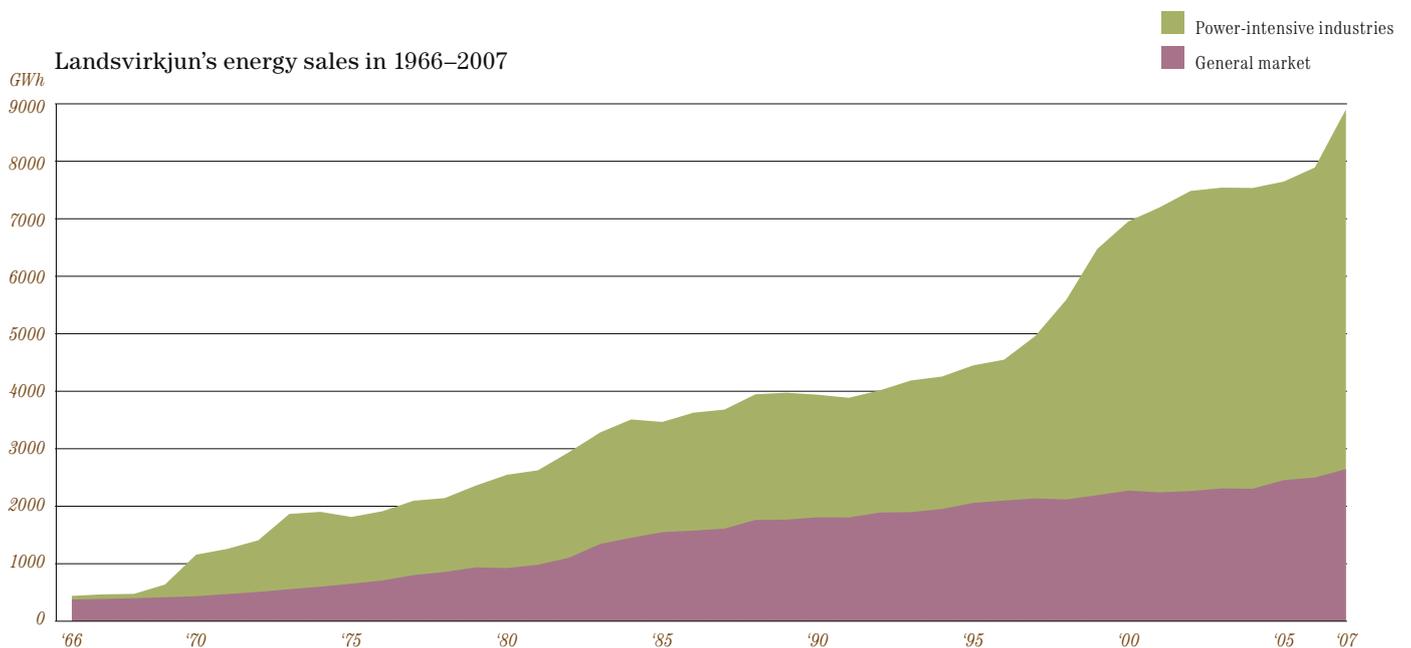
Landsvirkjun's electricity production in 2007 amounted to 8,482 GWh. This is an increase of 14% from 2006. Over 93.9% of electricity produced by Landsvirkjun comes from hydropower, while geothermal power contributes some 6.1%, which is a proportion similar to previous years.

Landsvirkjun's electricity sales in 2007 amounted to 8,903 GWh. Sales of primary electricity to public utilities increased by approximately 5.4% and to power-intensive industries by approximately 16%. Delivery of electricity to Alcoa Fjarðaál began during the year, which accounts for most of the increase. Furthermore, Landsvirkjun sold short-term electricity to Nordurál in order for the company to begin operation of its plant expansion ahead of schedule.

Iceland's total electricity production amounted to 11,976 GWh, of which Landsvirkjun's share is approximately 72%, a decrease of 4 percentage points from the previous year. Landsvirkjun's share of hydropower electricity production was 96% along with 15% of all geothermal electricity production. In Iceland, 68% of electricity is produced using hydropower and just under 32% using geothermal power.

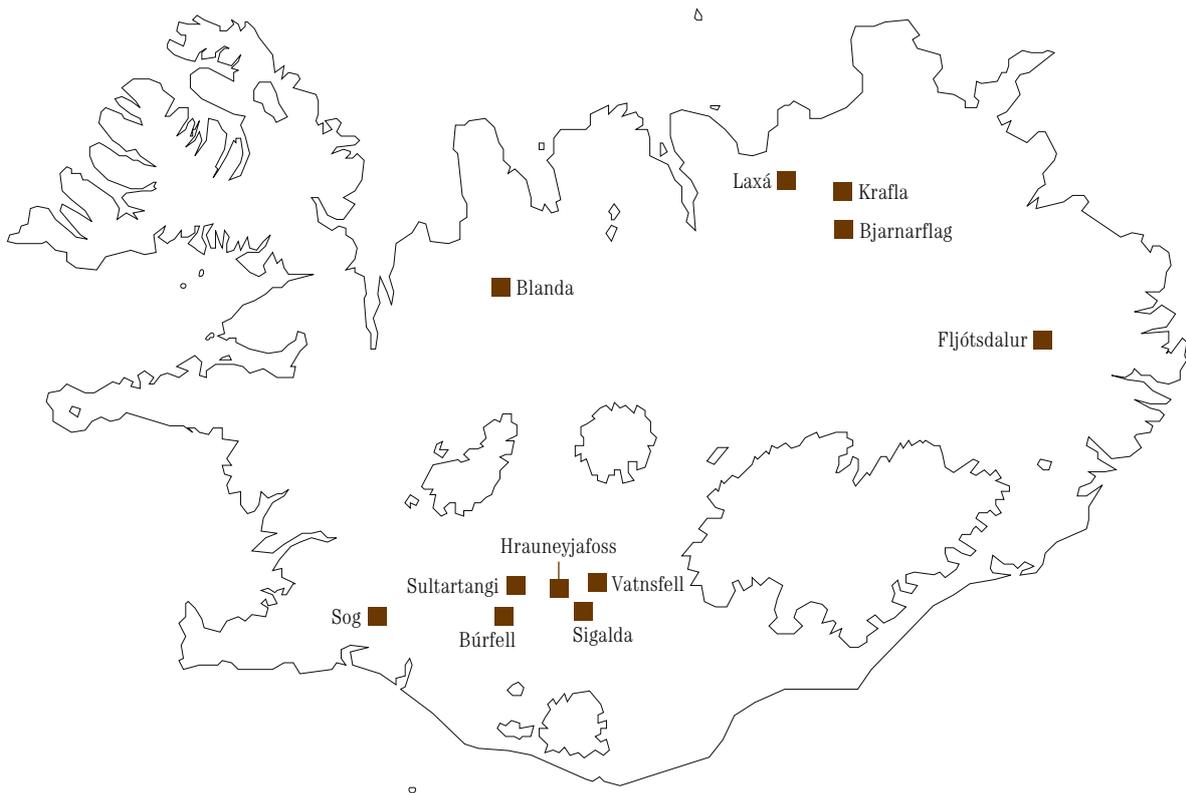


Steingrímur Eyfjörð: The Curlew 2007 – Photo: Spessi





Landsvirkjun's power stations





Marketing

The results of the local referendum in Hafnarfjörður concerning site issues at Alcan's aluminium smelter in Straumsvík meant that Alcan had to cancel plans to expand the plant. Previously, Landsvirkjun and Alcan had completed negotiations on the sale of electricity to the enlarged aluminium plant. This transaction was not realised due to the results of the referendum.

In the autumn, Landsvirkjun embarked on exploratory talks with a number of companies that were interested in developing operations in South and West Iceland, and which were interested in purchasing electricity from the power plants planned on the lower sections of the River Thjórsá and from Búdarháls on the River Tungnaá. It is clear that demand for electricity far exceeds supply. The electricity buyers involved in the talks operate a range of industries, including aluminium production, silicon production, silicon refining for solar panels and the operation of data centres.

It is important for Landsvirkjun that the company receives as high a price as possible for its electricity, that risk is diversified and that the company has a diverse customer base. As a result, Landsvirkjun decided to initiate power negotiations with Verne Holding, a

company planning to develop a data centre in the Sudurnes area, and with Becromal regarding electricity supply for purified silicon production for solar panels. Landsvirkjun's emphasis on data centres and purified silicon is based on the fact that it expects higher prices for electricity in such transactions than with other power-intensive customers. As a result, Landsvirkjun will not, for the time being, enter into negotiations with companies that intend to build new aluminium smelters in South or West Iceland.

It is Landsvirkjun's opinion that the best option regarding the use of electricity from the power plants now in preparation on the River Thjórsá would be to sell the electricity to industries of the above type, alongside a possible increase in the sale of electricity to existing aluminium smelters in Iceland. Agreements regarding electricity sales to Verne Holding were reached in early 2008.

In 2007, a short-term agreement was signed with Nordurál for the sale of electricity in 2007 and 2008. Nordurál was thus able to complete the expansion of its plant at Grundartangi to a 260,000 tonne production capacity in mid-2007. Furthermore, Landsvirkjun entered into an agreement with Becromal for the sale of electricity to a plant

in Akureyri, manufacturing aluminium foil for capacitors. This plant will begin operating in 2008.

In February, Alcoa-Fjarðaál began receiving electricity to run tests on the aluminium plant's pot room in Reydarfjörður. Due to delays in the construction of the Kárahnjúkar Hydropower Project, a decision was made to deliver 100 MW to the plant from sources other than Kárahnjúkar. This delivery lasted from the spring until later in the year. Delivery of this electricity was a success despite the fact that there was a slight risk due to lengthy transmission distances. The start-up of the aluminium plant continued into the beginning of November when the Kárahnjúkar turbines came on-stream. By the end of the year, the aluminium smelter was operating at just over half capacity.

Work continued in accordance with the MOU between Alcoa and Landsvirkjun with respect to power plants in North Iceland to supply the planned aluminium smelter at Bakki near Húsavík.



Research and development

Deep-drilling project (IDDP)

As of 2000, Landsvirkjun, Reykjavík Energy and Hitaveita Sudurnesja have been engaged in research into whether it would be possible to find supercritical geothermal fluid in the companies' current production areas, as well as investigating the practicality of utilising such fluids. A watershed was reached in the project when the above companies decided to drill 4–5 km deep wells during the next few years, each in their own production area. Alcoa joined the project in 2007. In July, a new partnership agreement was signed for the project and its funding.

A 2006 decision put the site of the first deep-drilled well in the Krafla area. Since then there has been continuous preparatory work on the project, first on design and then on invitations to tender and contract negotiations. Agreements were reached during the year for all lining materials and well caps, which have a long delivery time. Negotiations regarding the drilling also took place.

In the autumn, work began on a review of all the available research material relating to the Krafla area to determine the precise location of the deep well. Plans currently indicate that drilling at this site will begin in early August 2008 and continue until the end of the year. The design of an experimental power plant could then follow, although this installation will have to be in operation for several years before the best method of utilising supercritical geothermal fluid for energy production can be determined.

Energy research and greenhouse effects

Over the past four years, Landsvirkjun has participated in the joint Nordic project "Climate and Energy" and a corresponding Icelandic project. The project involves research into possible climate changes in Iceland and the Nordic countries in coming decades and their impact on water systems and energy production. A follow-up project has been initiated for the next four years, 2007–2010, named "Climate and Energy

Systems", with the support of funds from the Nordic Energy Research Fund. According to current forecasts on rising temperatures, the run-off from glaciers will increase substantially in the future. Operating models of Landsvirkjun's energy systems currently use hydrological data from the past 20 years. This is done in light of the fact that there is little likelihood that the "iceberg years" will come again, and that it is generally agreed that the climate around Iceland is getting warmer. Older discharge data from 1950–2004, however, is still used for comparison and is, moreover, recalculated based on anticipated future temperatures and precipitation in order to evaluate the effects of climate change on energy production and energy capacity, and for preparing optimal designs for future power stations.



Kárahnjúkar Hydropower Project

The construction of the Kárahnjúkar Hydropower Project began in 2003 and work has been underway for the past five years. The project was divided into many contracts. As a result, a large number of consultants and contractors have been involved in the project, both Icelandic and foreign. At the end of the year, approximately 500 workers were employed on the project site, although that figure was over 1,500 for most of the year.

The power plant's first turbine was turned on at the beginning of April when delivery of electricity to the Fjarðaál aluminium smelter began in accordance with the initial schedule. At the time, the headrace tunnel was not ready for operation, and this first delivery of up to 100 MW of electricity was obtained from other Landsvirkjun power stations. Fljótsdalur Powerhouse was connected to the national grid, and the first turbine of six ran with the system in order to ensure reliable delivery.

In 2007, emphasis was placed on completing work on the 40 km long headrace tunnel from Hálslón Reservoir. The boring of the

tunnel was completed in 2006, somewhat behind schedule due to geological problems. The lowest third of the tunnel, between adits 1 and 2, was completed at the end of July. This section and the vertical pressure shafts were then filled with water to test the generating units. Thus, a significant amount of time could be saved when the generators were tested in the autumn. Finishing work was completed in October when the tunnel was filled with water and subjected to full pressure from Hálslón Reservoir. Production and electricity delivery from Fljótsdalur Power station began in the first week of November, and five of the six turbines were fully tested and on-line by the end of the year.

Hálslón Reservoir dams

Hálslón Reservoir began filling in September 2006. Casting of the concrete face on the upstream side of the dam was completed during the same year. In 2007, a 6-metre high concrete parapet wall was cast on top of the face and full-height filling of the dam crown was completed. The most intensive work on the Kárahnjúkar dam involved construction of the spillway at the western

end of the dam where water flows over a concrete wall into a deep trough then along a concrete channel leading down the hillside to the canyon edge. Hálslón Reservoir was full by October and excess water flowed over the spillway until late November.

Finishing work on the two saddle dams continued, and water reached them last summer as the level in Hálslón Reservoir rose. Seepage under the three Hálslón Reservoir dams has been closely monitored, as have crustal and seismic movements in the vicinity of the reservoir. It became apparent that the construction project has been a resounding success. Seepage from under the dams is less than a fifth of anticipated levels, and it will decrease relatively quickly due to the self-sealing qualities of glacial water, as experience has shown at other dams. Dam subsidence and movement in concrete joints are well within reference limits. Land movement near the reservoir has been negligible.

Headrace tunnels

During 2007, a great deal of work went into completing the 40 km long tunnels from Hálslón Reservoir to the intake above



Fljótsdalur Powerhouse. Rock support had to be completed where needed with rock bolting, shotcrete and concrete; rails needed to be removed as did various types of machinery, and the tunnel had to be cleaned. Complex concrete structures had to be built at access tunnels and tunnel junctions. All these operations were carried out in very wet conditions as water ingress into the tunnels was substantial, making all work difficult. Approximately 700 men worked on the tunnels, and transport over the long distances was for the most part by train. This complex work was finished by the end of October when water was released through the intake gates at Háslón Reservoir.

The Jökulsá and Hraunaveita diversions

One of the three large tunnel boring machines (TBMs) began boring the Jökulsá tunnel in a southerly direction from the River Axará at the beginning of April, preparing for the diversion of the River Jökulsá in Fljótsdalur to the power station. Boring was generally successful, and by the end of the year 6.5 km had been completed and 2 km remained. The Chinese crew on this TBM set a brilliant world record in this category of TBM tunnels when they completed over 115 metres during a single 24-hour period. In comparison, the average performance is typically 25 metres per 24-hour period, with delays due to rock reinforcement and maintenance.

Work on other parts of the Jökulsá and Hraunaveita diversions went well; the River Jökulsá in Fljótsdalur was diverted into the bottom outlet, bypassing the dam foundations at Ufsir at the beginning of August, and the construction of Ufsir dam was completed for the most part during the year. Work began on the Kelduá dam and the Hraunaveita tunnels on both sides of River Kelduá. The Jökulsárveita diversion will be taken into use in the summer of 2008, and all work on Hraunaveita will be completed in 2009.

Fljótsdalur Powerhouse

Finishing work was carried out on Fljótsdalur Powerhouse, from the intake above the installation to the opening of the tailrace canal at the River Jökulsá in Fljótsdalur. The installation and testing of all equipment was completed and the station was formally started up by the Minister of Finance and the Minister of Industry on 30 November. At the time, five turbine units were operational and work was underway to bring the sixth on-line.



Desjará river dam



Fljótsdalur Powerhouse

Finance

Landsvirkjun's Annual Accounts were prepared in accordance with International Financial Reporting Standards (IFRS). This is the first time that the company prepares its Annual Accounts in this manner. The total effect of the changed financial reporting on the Group's equity is that shareholders' equity at the beginning of 2007 increased by ISK 8.1bn, or from ISK 61.1bn to ISK 69.2bn. Comparative figures from the 2006 Annual Accounts were changed in accordance with IFRS. The changes are described in detail in the Notes to the Annual Accounts.

Profit in 2007 amounted to ISK 28.5bn as compared to ISK 11bn in the previous year. Operating performance was the best in the history of the company; the operation has shown a profit since 2002. There are two main reasons for the year's profit. Firstly, there were substantial foreign exchange gains on the company's debt portfolio as the rate of Icelandic krona strengthened by 7% during the year. Secondly, fair-value changes to embedded derivatives in electricity supply contracts were positive.

Foreign exchange gains amounted to ISK 13.9bn, and positive fair-value changes on derivatives contracts amounted to ISK 18.8bn. In 2006, the company's exchange rate losses amounted to ISK 17.8bn, and fair-value changes in derivatives contracts were positive by ISK 6.8bn. Return on equity was 40.2% in 2007 as compared to 18.3% in 2006. The exchange rate gains and the changes in fair-value are for the most part unrealised, a fact that must be kept in mind when assessing the company's performance.

According to IFRS, the company is under obligation to determine its functional currency. The decision has been made to adopt US dollar as the company's functional currency as of the beginning of 2008.

Profit and loss statement

The group's operating revenue in 2007 amounted to ISK 22.9bn, an increase of 7.4% from the previous year. The increase was mainly due to energy sales to Fjarðaál which began during the year.

The group's operating expenses totalled ISK 11.6bn, up from ISK 11.1bn in 2006. Depreciation of operating assets made up the largest part of operating expenses; being ISK 5.1bn, up from ISK 4.8bn in 2006. Depreciation rose by 6.5% from the year before. Operating expenses rose in other respects by just over 2.9% between 2006 and 2007.

According to this, the group's 2006 earnings before interest and taxes (EBIT) increased by ISK 1.1bn from the year before. Earnings before interest, tax, depreciation and amortisation (EBITDA) rose by ISK 1.4bn from the previous year to ISK 16.3bn in 2007. This amount is important by virtue of indicating the company's ability to meet interest payments and pay instalments on long-term liabilities. Below is a table showing EBITDA as a percentage of long-term loans, including next year's payments of long-term liabilities:

Year	(EBITDA)	Long-term Liabilities	Percentage
2007	16.3	191.2	8.5%
2006	14.9	171.4	8.7%
2005	9.6	113.4	8.5%
2004	9.0	96.9	9.3%
2003	8.4	88.1	9.5%

The percentage has not changed much, in spite of increases in long-term liabilities resulting from investments that have yet to return full revenues. A prime example is the Kárahnjúkar Hydropower Project.

Interest expenditures amounted to ISK 5.7bn, as compared to almost the same amount the year before. The average nominal interest on long-term loans was approximately 4.7%, as opposed to approximately 4.6% the previous year. Interest on funds that are invested in fixed assets is capitalised until the assets are put into operation. Capitalised interest expenses amounted to ISK 4.3bn in 2007, compared to ISK 2.9bn the year before. The reason for this was that investments in projects under construction had risen between years. Interest was capitalised until November 2007 when the Kárahnjúkar Hydropower Project was put into operation.

Interest revenue in excess of interest

expenses totalled ISK 27.6bn in 2007, while the same amounted to approximately ISK 16.3bn the year before. The difference between years, ISK 43.9bn, is for the most part due to exchange rate difference and fair-value changes embedded to derivatives. In 2007, exchange rate gains amounted to ISK 13.9bn while there were exchange rate losses amounting to ISK 17.8bn in 2006. Positive fair-value changes from derivatives contracts amounted to ISK 18.7bn compared to ISK 6.8bn in 2006.

Electricity companies had been exempt from income tax, but became taxable as of January 1st 2006, pursuant to Act No. 50/2005. There was a significant turnaround in income tax between 2007 and 2006. In 2007, charged income tax amounted to ISK 10.4bn, while in 2006 income tax amounted to ISK 17.2bn as income. Tax assets at year-end 2007 amounted to ISK 6.6bn.

Balance sheet

In the 2007 consolidated statement, the company's assets amounted to ISK 318.8bn, fixed assets amounted to ISK 294.9bn and current assets totalled ISK 23.9bn. In the previous year, assets amounted to a total of ISK 265.3bn. The increase is for the most part due to 2007 investments in the Kárahnjúkar Hydropower Project amounting to ISK 30.7bn. In addition, the company's embedded derivatives rose by ISK 24.4bn.

At the end of 2007, Landsvirkjun's equity amounted to approximately ISK 99.2bn. The company's equity ratio was 31.1% as compared to 26.7% at the end of 2006. Equity increased by ISK 28.3bn from the previous year.

The company's long-term liabilities, including next year's payments, totalled ISK 191.2bn by the end of 2007, as compared to ISK 171.4bn the previous year. The fair value of derivatives contracts amounted to ISK 10.3bn at year-end 2007, as compared to ISK 12.7 at year-end 2006.

Statement of cash flow

In 2007, operations generated ISK 8.6bn to meet 2007 investments and repayment of



liabilities. Revenues were ISK 21.6bn, as compared to ISK 19.8bn the year before. Paid operating expenses totalled ISK 5.6bn in 2007, down from ISK 5.8bn the year before. As a result, net cash from operating activities, excluding interest, increased by approximately ISK 2.1bn between years. In 2007, net cash outflow stood at ISK 7.5bn, but was ISK 4.8bn in 2006. However, that amount includes an outflow of around ISK 3.8bn for risk hedging, so that cash outflow due to net interest and foreign exchange differences in 2007 was ISK 3.7bn.

Paid investments in fixed assets in 2007 amounted to ISK 33bn, down from ISK 45.4bn in 2006. By far the largest portion of both years' investments was due to the Kárahnjúkar Hydropower Project. Investments in fixed assets were debt financed, with 2007 borrowings amounting to ISK 33.6bn, as opposed to ISK 57.7bn in 2006. Paid-out dividends to owners amounted to ISK 500m in 2007, up from ISK 427m the previous year.

Funding

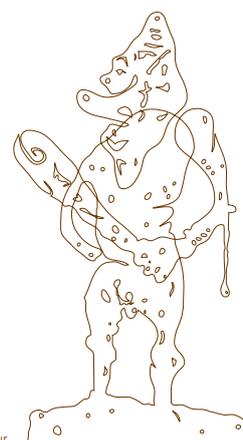
As previously stated, borrowings in 2007 amounted to a total of ISK 33.6bn, a substantial decrease from the previous

Landsvirkjun's credit rating		
	Moody's	Standard & Poor's
Short term	P-1	A-1
Long term	Aaa	A+/Negative

year. There were a total of four bond issues during the year, three in May and one in December. In May, the company issued bonds equivalent to EUR 160m for a term of 10 years and USD 75m for a term of 10 years. Landsvirkjun was well placed as regards financing when the liquidity crises began in the latter part of July. As a matter of fact, the company did not need further funding, although it issued bonds amounting to USD 75m for a term of 7 years in December. This borrowing improved the liquidity position of the company even further, something which is extremely important under current circumstances.

In spite of generally worsening market conditions, the terms of this loan were only marginally higher than the loans taken in May. All the bonds were issued under the Company's EMTN programme, and the terms in all circumstances were very advantageous, being less than 10 basis points above interbank rates.

Landsvirkjun also has access to a multi-currency revolving credit facility amounting to USD 400m. This facility is important, as it ensures that the company always has sufficient liquidity when circumstances in bond markets change temporarily. At the end of the year, the bank loan was undrawn by approximately USD 350m. Cash and cash equivalents at the end of 2007 amounted to ISK 11.1bn. The company had access to a total of ISK 32.9bn to meet its 2008 financial requirements which are expected to be ISK 32bn.



Risk management

Landsvirkjun attaches great importance to the constant monitoring and active control of financial risk. Risk management has been organised with this in mind. The Landsvirkjun Board of Directors sets the strategy for risk management where acceptable risk levels in each risk category are specified. They take into account defined goals for preferable hedging proportions which must generally be targeted. Decision making and monitoring of risk management performance is the responsibility of the Risk Management Committee, which is composed of the Managing Director, the Deputy Managing Director and the Head of Finance. The Managing Director is the chairman of the Risk Management Committee.

Day-to-day risk management is the responsibility of the Head of Risk Management. The principal role of Risk Management is to analyse, control and monitor Landsvirkjun's risk for the purpose of ensuring the company's operating performance by reducing fluctuations in the operation that result from changes in exchange rates, interest rates and the price of aluminium. Risk Management regularly issues reports to the Risk Management Committee and the Board, where the company's risk and the performance of Risk Management is assessed.

Landsvirkjun's financial risk

Using active controls, efforts are made to reduce volatility in the company's cash flow and financial position with respect to financial risk, and to ensure that operating results are in accordance with goals. Financial risks of particular note are changes in aluminium prices on global markets, interest rate risk, currency risk and liquidity risk. Counterparty risk is also regarded as a financial risk. Risk relating to counterparties in contracts have been limited through requirements made by the company as regards to their credit quality.

Aluminium price risk

The risks posed to the company because of possible changes to aluminium prices are considerable, as a large proportion of Landsvirkjun's income is dependent on aluminium prices in global markets. In

order to protect the Company's aluminium related income base, Risk Management is authorised to hedge up to 100% of next year's aluminium risk, and then a decreasing proportion year by year for up to seven years. These authorisations have partly been utilised through derivatives contracts intended to minimise the impact of downward trends in aluminium prices on operating revenues. In most cases, such contracts set a certain price range for aluminium, which obviously means the company may forego revenue on aluminium price increases. Conversely, in the event of falling aluminium prices these same derivatives will give the company higher revenues than prevailing market prices indicate. At the end of December, the fair value of the risk hedging agreements was negative by ISK 7.5bn. The contracts will remain in effect for the next seven years.

With the adoption of IFRS, the main change to Landsvirkjun's financial reporting is that the company now enters all derivatives contracts into its accounts and does not provide information only on their fair value in the notes to the accounts, as was previously the case. Moreover, the effects of embedded derivatives in power sales contracts must be shown, which is an innovation and was done for the first time in the 2007 6-month interim statement. Furthermore, the initial balance sheet at the close of 2006 has been altered to comply with the new standard. Landsvirkjun has defined the part of the power sales contracts that is linked to aluminium prices as embedded derivatives. For this reason, the fair value of embedded derivatives in power sales contracts alters concurrently with changes in aluminium prices. Changes to the fair value of the agreements over periods are entered into the company's profit and loss account, and have an effect on results and equity. At the end of December, the fair value of embedded derivatives in power sales contracts was positive by ISK 41.2bn. These contracts are effective for up to 40 years.

Uncertainties regarding forward aluminium prices relating to the long term of the contracts have been taken into account during calculation of the fair value of embedded

derivatives. Using this approach, and the above-mentioned derivatives contracts, Landsvirkjun aims to reduce fluctuations in its results due to changes in the forward price of aluminium. Nevertheless, it is clear that the adoption of new accounting procedures means that substantial changes to aluminium prices will have an effect on the company's results. Note No. 50 in the Annual Accounts contains a more detailed description of embedded derivatives and aluminium derivatives contracts.

Liquidity risk

The liquidity position of Landsvirkjun is monitored at all times. Revenue deposits and expenditure are analysed along with the due dates of accounts payable and accounts receivable to assess the company's financing requirements. Access to financing and the necessary flexibility are ensured through different types of loans and the company's EMTN (Euro Medium Term Note) Program. Furthermore, Guaranty of Collection from the Owners on Landsvirkjun's loans and a good credit rating have made debt financing easier for the company.

Landsvirkjun has set itself the goal of having access, with little notice, to liquid funds that are generally equivalent to requirements for a minimum of six months. At year-end 2007, Landsvirkjun's cash and cash equivalents amounted to approximately ISK 11bn. The company also had access to an undrawn bank loan amounting to USD 350m, or approximately ISK 22bn. In total, therefore, the company had secure liquid funds amounting to approximately ISK 30bn, equivalent to the liquid funds requirements for 12 months. Note No. 53 in the Annual Accounts contains a more detailed break-down of the company's liquidity position.

Interest rate risk

Landsvirkjun's interest rate risk exists due to interest carrying assets and liabilities with fixed or variable interest for varying lengths of time. Interest bearing liquid liabilities were considerably higher than interest bearing liquid assets, and it is in the company's advantage to minimise interest costs.



At the end of 2007, the proportion of loans with variable interest was 76%, as compared to 73% at the end of 2006. A 1% change in interest rates would involve a change in interest costs to the tune of approximately ISK 1.35bn in 2007 and approximately ISK 1.25bn in 2006.

The fair value of interest rate swaps is recorded in the profit and loss account as they are not specified as a risk hedge relationship. Landsvirkjun has made contracts for interest rate swaps that are intended to reduce the company's interest costs and reduce risk. At the close of December 2007, the fair value of interest rate swaps was negative by approximately ISK 1bn. An interest rate change of 1% would mean a change to the fair value of the swaps of ISK 630m.

Currency Risk

Landsvirkjun's cash flow, assets and liabilities are stated not only in Icelandic krona and, as a result, changes to exchange rates can have an effect on profits and the company's balance sheet. Landsvirkjun's foreign exchange risk exists due to differences in the inflow and outflow of funds according to currency and the composition of its debt portfolio. Cash flow risk is for the most part limited to revenues from electricity sales to power-intensive industries, instalments and interest payments on foreign currency loans together with overseas purchases.

Considerable fluctuations can occur to the company's loan portfolio with respect to the Icelandic krona between financial reporting periods, as over 80% of the loan portfolio is in foreign currencies. The risk of changes in the loan portfolio is hedged at all times based on the Board's risk criteria. For this purpose, the company uses currency swaps and options. Furthermore, the company ensures part of its cash flow with respect to the functional currency for up to three years in the future by means of forward contracts and options.

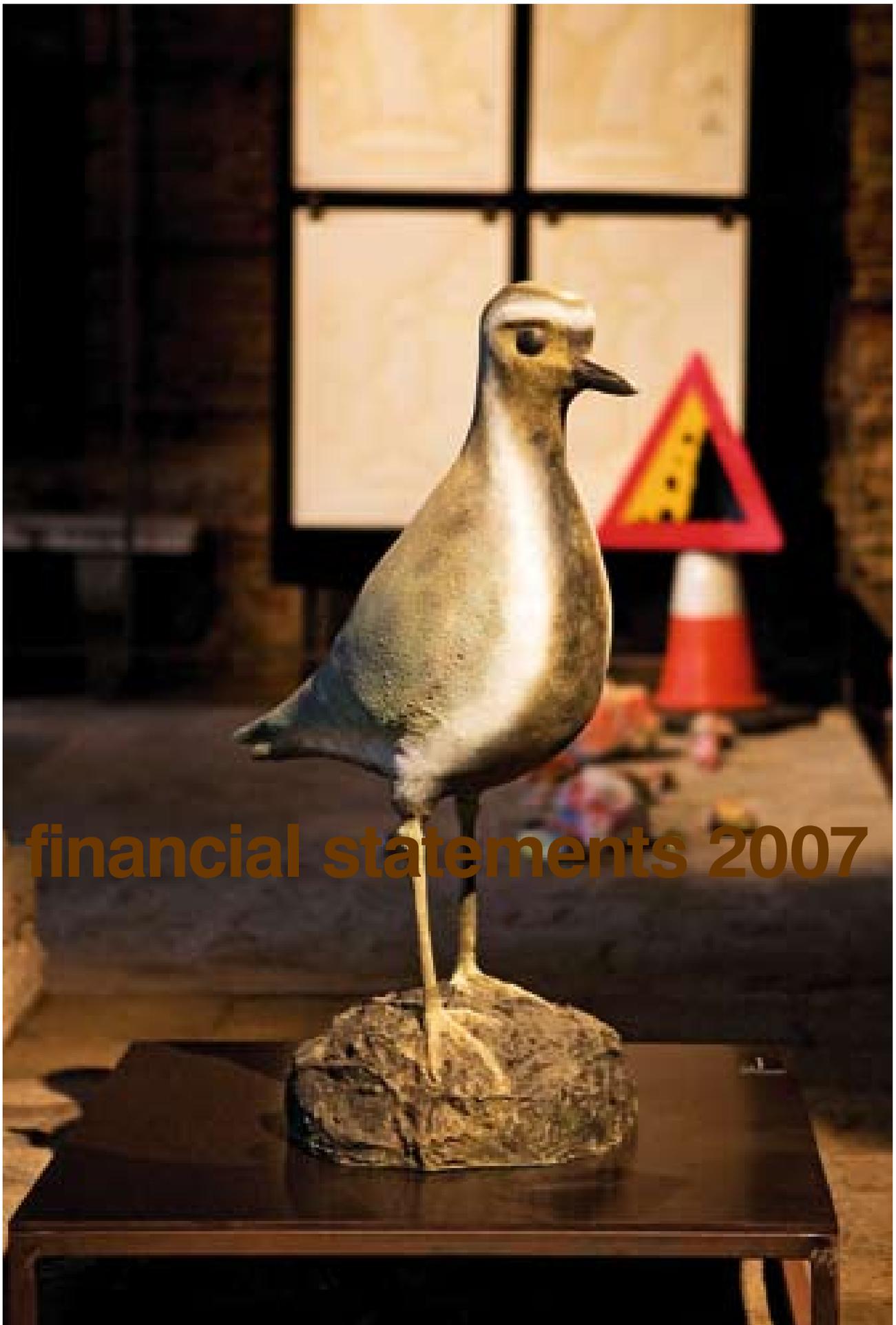
The company has not taken the route of increasing the weight of the krona in its loan portfolio as this would mean increased interest burden in the future. Greater emphasis has been placed on hedging cash flow, which is increasingly in US dollars. The composition of the loan portfolio has taken account of this, and the company has systematically increased the weight of the US dollar in the loan portfolio.

According to IFRS which is mandatory according to the Act on Financial Reporting as confirmed by the EU, the Board is under obligation to determine its functional currency. After detailed examination, the Board of Directors has decided to adopt the US dollar as the company's functional currency as it will be the dominant currency in the company's income generation as of 2008. The company's Annual Accounts will be based on

the Icelandic krona for the last time in 2007. Currency risk, therefore, will henceforth be based on exchange rate changes against the US dollar and risk management and risk criteria have, as a result, been adapted to these changes. Note No. 51 in the Annual Accounts contains further information on the company's currency risk.

Counterparty risk

Landsvirkjun's counterparty risk exists first and foremost due to power sales contracts with energy-intensive industries and the company's derivatives contracts, which are prepared for hedging purposes. Such contracts are only made with financial institutions. Although considerable amounts may be involved, the risk is limited by the company's quality requirements with respect to counterparties. Landsvirkjun has established criteria pertaining to derivatives transactions to the effect that no contracts will be made with financial undertakings that have a credit rating lower than AA- from Standard and Poor's, or a comparable credit rating from another accredited credit rating agency, unless separate Credit Support Agreements (CSA) are made between the parties limiting the risk posed to Landsvirkjun. Before entering into contracts for the sale of electricity, the financial position of the companies and their parent companies, if applicable, must be examined in detail. Note No. 54 in the Annual Accounts contains a more detailed itemisation of counterparty risks.



financial statements 2007

Endorsement by the Board of Directors and the Director

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, five subsidiaries, Fjarski ehf., Icelandic Power Insurance Ltd., Landsnet hf., Landsvirkjun Power ehf. and Íslenski jarðhitatækni ehf.

The financial statements of Landsvirkjun for the year 2007 are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU and these are the Company's first financial statements based on those standards. The Company's financial statements for the previous years have been prepared on the basis of Icelandic GAAP. The total effect of transition to IFRS on the Company's equity is that book value of Landsvirkjun's equity at the beginning of year 2007 increased by ISK 8.127 million or from ISK 61.107 million to ISK 69.234 million. Effect of changed standards on the profit for the year 2006, which amounted to ISK 3.503 million according to the Icelandic GAAP, is an increase in the profit by ISK 7.557 million. The effect of the introduction of the standards on the Company's financial statements is further explained in the notes to the financial statements. According to IFRS, the Company shall decide on functional currency and the result is that the USD will become the prevailing currency in the Company's operation as of year 2008. The year 2007 is therefore the last year for which the ISK is Landsvirkjun's functional currency.

The Group's operating income amounted to ISK 22.9 billion in the year 2007 compared to ISK 21.3 billion the previous year. Operating expenses amounted to ISK 11.6 billion in the year 2007 but amounted to ISK 11.1 billion in the year 2006. According to this, the Company's operating profit amounted to ISK 11.2 billion in the year 2007 compared to ISK 10.2 billion the previous year. The operating improvement is explained by increased operating income without a corresponding increase in operating expenses.

Financial income in excess of financial expenses amounted to ISK 27.6 billion in the year 2007 but in the year 2006, financial expenses in excess of financial income amounted to ISK 16.3 billion. The change between years amounts to a total of ISK 43.9 billion. The difference between years is

mainly explained by a change in net income on financial assets and liabilities that was positive by ISK 33 billion in 2007 but was negative by ISK 11 billion in 2006. A foreign exchange gain on long-term loans, which is mainly explained by changes in the exchange rate of the EUR and the USD against the ISK, is an unrealised profit as well as fair value changes in derivative agreements, which must be considered in the assessment of the Company's profit. According to the income statement, the profit for the year amounted to ISK 28.5 billion compared to ISK 11.0 billion the previous year.

Landsvirkjun has entered into derivative agreements in order to manage risk in the Company's operation. 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 in the world market aluminium prices as a part of the operating income is based thereon. The Company has also made agreements in order to benefit from short-term fluctuations in the currency market. Information on the balance of open agreements at year end was previously included in the notes, whether they were made for a hedging or trading purpose, but are now recognised in the Company's financial statements according to the IFRS. Negative fair value of hedge agreements in order to ensure the Company's sales income amounted to ISK 7.5 billion at year-end 2007. The fair value of other derivative agreements at year-end 2007 was positive by ISK 4.7 billion. Considerable work has been carried out in order to assess the fair value of embedded derivatives in energy sales agreements with aluminium plants and their positive fair value is in total estimated at ISK 41.2 billion at year end 2007.

Investments in operating assets amounted to a total of ISK 35 billion in the year 2007 and were mainly financed with borrowings amounting to ISK 33.6 billion. The parent company's investment in the Kárahnjúkar hydropower project amounted to ISK 32 billion in the year compared to ISK 33 billion the previous year. In November 2007, production of electricity began at the powerhouse at Fljótsdalur.

From the beginning of year 2007, the Company is a partnership owned by the State and Eignarhlutir ehf. Eignarhlutir ehf. is entirely owned by the State. The State owns a 99.9% share in the Company

and Eignarhlutir ehf. 0.1%. The Board of Directors of Landsvirkjun will put before the Company's Annual General Meeting a proposal of payment of dividends to the owners for the year 2007. If the intended proposal will be approved, ISK 600 million will be paid out in the year 2008. Reference is otherwise made to the notes to the financial statements on further allocation of profit and other changes in the Company's book value of equity.

The city of Reykjavik and the town of Akureyri provide, together with the state, a guarantee of collection for all obligations of Landsvirkjun, entered into before the end of year 2006. The Company's payments due to guarantees for long-term loans amounted to ISK 419 million in the year 2007. From the beginning of year 2007, the State and Eignarhlutir ehf provide a guarantee of collection for all of Landsvirkjun's obligations entered into after that date.

Statement of the Board of Directors and the Director

According to the best knowledge of the Board of Directors and the Managing Director, 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 Managing Director that the financial statements give a fair view of the Company's assets, liabilities and financial position as at December 31, 2007 and the Company's profit and changes in cash in the year 2007.

Furthermore, it is the opinion of the Board of Directors and the Managing Director that the financial statements and the Report by the Board of Directors for the year 2007 give a fair view of the Company's profit, financial position and development and describe the main risk factors faced by the Company.

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

Reykjavik, March 7, 2008.

The Board of Directors: Páll Magnússon, Ágúst Einarsson, Jóna Jónsdóttir, Valdimar Hafsteinnsson, Thórdur Sverrisson.

Managing Director: Fridrik Sophusson

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 December 31, 2007, and the income statement, 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; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with 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 December 31, 2007, 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.

Reykjavik, March 7, 2008.

KPMG hf.

Jón Eiríksson
Reynir Stefán Gylfason

Income Statement for 2007

	Notes	2007	2006
Operating revenues			
Power sales		18,503,612	17,243,387
Transmission		3,943,263	3,060,148
Other income	24	420,198	994,153
	5	<u>22,867,073</u>	<u>21,297,688</u>
Operating expenses			
Energy production costs		5,848,108	5,528,089
Transmission costs		2,590,057	2,406,836
Cost of general research		1,218,749	970,540
Other operating expenses	27	1,984,209	2,238,207
		<u>11,641,123</u>	<u>11,143,672</u>
<i>Operating profit</i>		<u>11,225,950</u>	<u>10,154,016</u>
Financial income and (financial expenses)			
Interest income	6	389,312	453,080
Interest expenses	6	(5,716,233)	(5,677,085)
Net income (expenses) on financial assets and liabilities	7	32,960,743	(11,052,543)
Associated companies	34	(4,255)	(56,324)
	28	<u>27,629,567</u>	<u>(16,332,872)</u>
<i>Profit (loss) before taxes</i>		<u>38,855,517</u>	<u>(6,178,856)</u>
Income tax	10.29	(10,381,511)	17,188,266
Net profit		<u>28,474,006</u>	<u>11,009,410</u>
Attributable to:			
Owners of the parent company		28,752,899	11,060,460
Subsidiaries minority interest		(278,893)	(51,050)
		<u>28,474,006</u>	<u>11,009,410</u>

Balance Sheet December 31, 2007

Assets	Notes	2007	2006
Non-current assets			
Property, plant and equipment	12.30	226,402,936	110,645,873
Projects under construction		14,548,290	97,935,884
Intangible assets	11.31	5,834,993	3,047,065
Associated companies	4.34	428,900	444,190
Shares in other companies	34	143,394	57,175
Derivative financial instruments	13.33	40,889,969	19,589,629
Long-term notes receivable		30,641	42,810
Deferred tax asset	10.35	6,621,407	16,987,368
Total fixed assets		<u>294,900,530</u>	<u>248,749,994</u>
Current assets			
Inventories	36	337,083	362,616
Accounts receivables and other receivables	37	4,546,923	6,802,669
Derivative financial instruments	13.33	7,904,455	4,784,214
Cash and cash equivalents	38	11,133,807	4,647,730
Total current assets		<u>23,922,268</u>	<u>16,597,229</u>
Total assets		<u><u>318,822,798</u></u>	<u><u>265,347,223</u></u>
Equity and liabilities			
Equity			
Owners' contributions	39	36,363,718	36,363,718
Other equity		61,080,793	32,870,485
		97,444,511	69,234,203
Minority interest		1,764,473	1,648,652
Total equity		<u>99,208,984</u>	<u>70,882,855</u>
Long-term liabilities			
Long-term debt	40	169,616,713	167,102,895
Accrued pension liabilities	42	2,365,481	2,180,439
Obligation due to demolition	12.43	447,154	420,441
Derivative financial instruments	13.33	6,521,861	7,279,943
		<u>178,951,209</u>	<u>176,983,718</u>
Current liabilities			
Accounts payable and other short-term liabilities	44	15,331,143	7,730,078
Current maturities of long-term debt	41	21,534,428	4,330,070
Derivative financial instruments	13.33	3,797,034	5,420,502
		<u>40,662,605</u>	<u>17,480,650</u>
Total liabilities		<u>219,613,814</u>	<u>194,464,368</u>
Total equity and liabilities		<u><u>318,822,798</u></u>	<u><u>265,347,223</u></u>

Amounts in ISK thousands.

Statement of Equity from January 1, 2006 to December 12, 2007

	Notes	Owners' contribution	Other equity	Total	Minority interest	Total equity
Changes in equity year 2006						
Equity at December 31, 2005		32,750,143	25,252,419	58,002,562	1,720,117	59,722,679
Change due to introd. of IFRS	56	0	570,536	570,536	(20,415)	550,121
Equity at January 1, 2006, IFRS		32,750,143	25,822,955	58,573,098	1,699,702	60,272,800
For. exch. diff. due to subsidiary			27,484	27,484		27,484
Profit for the year 2006			11,060,460	11,060,460	(51,050)	11,009,410
Total profit for the year 2006			11,087,944	11,087,944	(51,050)	11,036,894
Restatement of owners' contrib.		4,040,414	(4,040,414)			
Dividends paid		(426,839)		(426,839)		(426,839)
Equity at December 31, 2006, IFRS		36,363,718	32,870,485	69,234,203	1,648,652	70,882,855
Changes in equity year 2007						
Equity at January 1, 2007, IFRS		36,363,718	32,870,485	69,234,203	1,648,652	70,882,855
For. exch. diff. due to subsidiary			(42,591)	(42,591)		(42,591)
Profit for the year 2007			28,752,899	28,752,899	(278,893)	28,474,006
Total profit for the year 2007			28,710,308	28,710,308	(278,893)	28,431,415
Subsidiaries share capital increase					394,714	394,714
Dividends paid			(500,000)	(500,000)		(500,000)
Equity at 31 December 2007, IFRS		36,363,718	61,080,793	97,444,511	1,764,473	99,208,984

Statement of Cash Flows for 2007

	2007	2006
Operating activities		
Cash received from customers	21,595,798	19,778,751
Cash expenses	(5,555,222)	(5,829,008)
From operation excluding interest	16,040,576	13,949,743
Interest income received	366,144	461,346
Interest expenses and foreign exchange difference paid	(4,051,099)	(2,337,601)
Hedging	(3,767,252)	(2,972,581)
Cash flow from operating activities	<u>8,588,369</u>	<u>9,100,907</u>
Investment activities		
Kárahnjúkar project - hydropower station	(31,913,340)	(33,438,405)
Transmission	(5,025,739)	(6,909,159)
Development costs	(1,515,728)	(954,103)
Purchased shares	(776,733)	0
Other capital expenditure	(1,397,682)	(1,450,729)
Assets sold	513,860	1,287,012
Increase (decrease) in paid investments	<u>5,035,039</u>	<u>(526,718)</u>
Other receivables, change	(35,080,323)	(41,992,102)
Investment activities	<u>2,063,731</u>	<u>(3,389,828)</u>
	<u>(33,016,592)</u>	<u>(45,381,930)</u>
Financing activities		
New loans	33,632,331	57,683,462
Amortization of long-term debt	(1,702,249)	(19,960,895)
Cash dividends	(500,000)	(426,839)
Financing activities	<u>31,430,082</u>	<u>37,295,728</u>
Increase in cash	7,001,859	1,014,705
Effect of exch. diff. on cash and cash equivalents	(515,782)	569,447
Cash and cash equivalents at the beginning of the year	<u>4,647,730</u>	<u>3,063,578</u>
Cash and cash equivalents at end of year	<u>11,133,807</u>	<u>4,647,730</u>

Amounts in ISK thousands.

Notes to the Financial Statements

1. Reporting entity	27	29. Income tax	38
2. Basis of preparation	27	30. Property, plant and equipment	38
3. Basis of consolidation	28	31. Intangible assets	39
4. Associated companies	28	32. Depreciation	39
5. Operating revenues	28	33. Derivative financial instruments	40
6. Interest income and expenses	28	34. Shares	40
7. Net income on fin. assets/liabilities	28	35. Deferred tax asset	41
8. Foreign currency transactions	29	36. Inventories	41
9. Impairment	29	37. Accounts receivable and other receivables	41
10. Income tax	29	38. Cash and cash equivalents	41
11. Intangible assets	30	39. Equity	42
12. Fixed assets	30	40. Long-term liabilities	42
13. Financial instruments	31	41. Current maturities of long-term debt	42
14. Fair value measurement	32	42. Accrued pension liabilities	42
15. Inventories	32	43. Obligation due to demolition	43
16. Cash and cash equivalents	33	44. Accounts payable and other payables	43
17. Equity	33	45. Related parties	43
18. Employees' benefits	33	46. Other notes	44
19. Obligations	33	47. Other notes	44
20. Segment reporting	33	48. Subsequent events	44
21. Reporting standards	33	49. Risk management	44
22. Management evaluation	35	50. Aluminium price risk	45
23. Statement of segments	35	51. Foreign exchange risk	46
24. Other income	36	52. Interest rate risk	47
25. Total number of employees	36	53. Liquidity risk	47
26. Total salaries	36	54. Counterparty risk	49
27. Other operating expenses	37	55. Fair value and book value of fin. assets/liab.	49
28. Financial income and (expenses)	37	56. Changes in accounting methods - IFRS	50

Notes

Reporting entity

1. Landsvirkjun

Landsvirkjun is a partnership having its place of business in Iceland and its headquarters at Háaleitisbraut 68, Reykjavík. Landsvirkjun operates on the basis of the Act on Landsvirkjun no. 42/1983. The financial statements include the Company's consolidated financial statements and its subsidiaries. The Company's main objective is to engage in activities in the energy sector.

2. Basis of preparation

Significant accounting policies used in the preparation of these financial statements are identified below.

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 presentation of the Financial Statements on March 7, 2008.

These are the first financial statements of Landsvirkjun which have been prepared on the basis of International Financial Reporting Standards. Introduction of International Reporting Standards (IFRS 1) has been applied during their preparation.

The preparation of the Company's financial statements according to the IFRS leads to changes in the accounting methods used in the preparation of the previous financial statements of the Group which were prepared according to the Icelandic GAAP. The accounting methods described below have been applied consistently to all periods presented in these financial statements. Furthermore, they have been applied in the preparation of the opening balance sheet according to the IFRS on January 1, 2006 in relation to the introduction of IFRS, according to IFRS I. Information on the effects of changes due to the introduction of the IFRS on the financial standing of Landsvirkjun and its return are presented in note 56. The note includes reconciliations of equity and the Group's profit for comparative periods, on the one hand, according to the Icelandic GAAP and on the other, according to IFRS.

b. *Basis of measurement*

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

c. *Presentation and functional currency*

The financial statements are presented in Icelandic krona, which is the functional currency of Landsvirkjun and its subsidiaries for the year 2007. All financial information presented in Icelandic krona 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 even in subsequent period if the change also affects those periods.

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

- note 42 accrued pension liabilities
- note 33 derivative financial instruments
- note 31 intangible assets

Significant accounting methods

Accounting policies set out below have been consistently applied to all periods presented in these financial statements, and also in the preparation of the opening balance sheet at January 1, 2006 due to the introduction of the IFRS.

3. Basis of consolidation

a) *Subsidiaries*

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that currently are exercisable are taken into account. The consolidated 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.

b) *Transactions eliminated on consolidation*

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

c) *Foreign subsidiaries*

Assets and liabilities of a foreign operation are translated to Icelandic krona at the exchange rate ruling at the accounting date. Income and expenses of the foreign operation are translated to Icelandic krona at the average exchange rate of the period. The exchange rate difference arising from the translation is entered as a specific item under equity.

4. Associated companies

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

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 previous share in losses has been balanced.

5. Revenue recognition

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

6. Interest income and expenses

Interest income and expenses are recognised in the income statement as they accrue using the effective interest method. Interest income and expenses include bank rates, premium and other difference arising on initial book value of financial instruments and amounts on the date of maturity using the effective interest method.

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

7. Net income (expenses) on financial assets and liabilities

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

8. Foreign currency transactions

Transactions in foreign currencies are recognised at the exchange rate ruling at the 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 Icelandic krona 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 Icelandic krona at the exchange rate ruling at the date of determination of fair value.

9. Impairment

i) 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 directly in equity.

ii) Non-financial assets

The carrying amounts of the Company's non-financial assets, other than inventories and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. Impairment tests are carried out at least once a year on intangible assets with undetermined useful life.

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

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

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

10. Income tax

Income tax on the profit 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 or substantively enacted 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.

A deferred tax asset is recognised in the financial statements. Its calculation is based on the difference in balance sheet items, according to the tax return, on the one hand, and the consolidated financial statements on the other. The difference thus arising is due to the fact that the tax assessment is based on other premises than the Group's financial statements and is in main respect a temporary difference as expenses are in general entered in the financial statement in an earlier period than in the tax return.

11. Intangible assets

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

Expenditure for general research cost is expensed in the period it is incurred. Development cost for future power projects is capitalised among fixed assets. The development cost is only capitalised if there is probability of future economic benefit and the Company intends and is able to conclude, use and 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 depreciation 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. Estimated useful life is specified as follows:

Software assets	25%	4 years
---------------------------	-----	---------

12. Fixed assets

Property, plant and equipment

Fixed assets are measured at cost value less depreciation and impairment loss. The cost value of fixed assets was determined on January 1, 2006, the implementation date of IFRS, and deemed to be equal to the book value on the same date.

Initial value of fixed asset includes the estimated cost of demolition following their use. Estimated demolition cost of high tension lines has been measured at discounted value based on the useful life and an obligation in relation thereto has been recognised among long-term liabilities. An increase in the obligation due to the discounted value is expensed 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 cost the Company incurs in making the asset operative.

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

Profit or loss on the sale of an operating asset is the difference between the sales value and the book value of the asset and is recognised in the income statement among other income.

Renewal cost of parts of fixed assets is capitalised if it is considered likely that the cost involves future economic benefit for the Company and furthermore, if the cost is measureable. Operating cost of fixed assets is recognised in the income statement.

Interest expenses on loans used to finance the cost value of projects is capitalised at the time of construction. Interest is not calculated on development cost. After the assets have been taken into operation, interest expense is recognised in the income statement.

Depreciation

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

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

Depreciation ratios are specified as follows:

Power stations:		<i>Useful life</i>
Powerhouses 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
Substaions	2.5%-5%	20-40 years
Power lines	2.00%	50 years
Office buildings	2.00%	50 years
Equipment	10-25%	4-10 years
Vehicles	10-20%	5-10 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

13. Financial instruments

i) *Non-derivative financial instruments*

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

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

Financial instruments are entered in the consolidated financial statements when the Company becomes a part of contractual provisions of the relevant financial instrument. Financial assets are eliminated if the Company's contractual right to cash flow due to the asset expires or the Company transfers the assets to another party without holding back control or almost all the risk and gain involved in the ownership. Conventional purchase and sale of financial assets are recognised at the transaction date, i.e. the date the Company enters into obligation to purchase or sell the asset. Financial obligations are eliminated from the consolidated financial statements if the obligations of the Company defined in an agreement expire, disallowed or are invalidated.

Cash and cash equivalents consist of cash and demand deposits. Demand deposit in a bank, which is an unseparable part of the Company's financial management, falls under cash and cash equivalents in terms of statement of cash flows.

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

Financial assets and liabilities at fair value through income statement

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

Other financial instruments

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

Off-setting of financial assets and liabilities

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

ii) Derivative financial instruments

The Company enters into derivative financial instruments to hedge its foreign currency, interest rate and aluminum price risk exposures. Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related and another instruments with the same provisions as the embedded derivative would be defined as a derivative and the mixed contract is not stated at fair value in the income statement.

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

Economic hedges

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

Separable embedded derivatives

Fair value changes of embedded derivatives separable from the host agreement are recognised when the fair value change takes place, see note 49 - 55 on risk management.

14. Fair value measurement

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

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

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

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

15. Inventories

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

16. Cash and cash equivalents

Cash consists of cash and demand deposits.

17. Equity

The Group equity is divided into owners' contribution, other equity and minority interest. The parent company's initial capital amounts to ISK 36,364 million and was revaluated to year-end 2006.

18. Employees' benefits

i) *Defined contribution plan*

Cost due to contribution to defined benefit plans is expensed in the income statement when incurred.

ii) *Defined benefit plan*

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

19. Obligations

Obligation is recognised when the Company is legally required to, or due to past events, it is likely that they will be settled and they can be reliably measured. The obligation is assessed on the basis of estimated cash flow, discounted on the basis of interests reflecting market interests and the risk inherent with the obligation.

20. Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing related products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and returns that are different from those of other segments. The Group's main segment is based on operating segments.

Inter-segment pricing is determined on an arm's length basis.

21. Reporting standards

The following new standards, amendments to standards and interpretations are not yet effective and do thus not affect the preparation of these financial statements.

New standards and interpretations thereon that have been implemented in the year 2007:

IFRS 7 Financial instruments: Disclosures and changes in IAS 1 Presentation of Financial Statements: financial information apply to the Company's financial statements for the year 2007. The adoption has the effect on the nature and volume of notes to the financial statements, but not on the return and financial standing of the Group.

IFRIC 7 - 10 came into effect in the year 2007 but did not have any effect on the Company's financial statements.

New standards and interpretations thereon that have not been implemented by the Group before their introduction.

The following new standards, amendments to standards and interpretations are not yet effective and do thus not affect the preparation of these financial statements:

IFRS 8 Operating Segments introduces the "management approach" to segment reporting, goods and services sold by the Company, geographical areas in which it operates and its main customers. IFRS 8 applies to periods starting after January 1, 2009 or later and will not affect the consolidated financial statements.

IAS 1 Presentation of Financial Statements (revised in 2007) replaces IAS 1 Presentation of Financial statements (revised in 2003) as amended in 2005. IAS 1 (Revised 2007) sets the overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content. The main change in revised IAS 1 is a requirement to present all non-owner changes in equity (changes in equity not resulting from transactions with owners in their capacity as owners) in one or two statements: either a single statement of comprehensive income, or in an income statement plus in a statement of comprehensive income. Unlike under current IAS 1, it is not permitted to present components of comprehensive income in the statement of changes in equity. IAS 1 (revised in 2007), which becomes mandatory for the Company's 2009 financial statements if endorsed by the EU, is expected to impact the presentation of the Company's income statement and the statement of changes in equity.

Revised IAS 23 Borrowing Costs removes the option to expense borrowing costs and requires that an entity capitalise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. If revised IAS 23 will be confirmed by the EU it will become mandatory for the Company's 2009 financial statements but will not lead to changes in its accounting methods.

The amendments to IFRS 2 Share Based Payment – Vesting Conditions and Cancellations (January 2008) clarify the definition of vesting conditions and the accounting treatment of cancellations. If endorsed by the EU, the amendments become mandatory for the Company's 2009 financial statements, with retrospective application required. The amendments are not expected to have any effect on the Company's financial statements.

IFRS 3 Business Combinations (revised in 2008) and amended IAS 27 Consolidated and Separate Financial Statements introduce changes to accounting for business combinations and for non-controlling (minority) interest. The most significant changes from IFRS 3 (2004) and IAS 27 (2003) are the following:

- IFRS 3 (2008) applies also to business combinations involving only mutual entities and to business combinations achieved by contract alone;
- The definition of a business combination has been revised to focus on control;
- The definition of a business has been amended;
- Transaction costs incurred by the acquirer in connection with the business combination do not form a part of the business combination transaction;
- Acquisitions of additional non-controlling equity interests after the business combination are accounted for as equity transactions;
- Disposals of equity interests while retaining control are accounted for as equity transactions;
- New disclosures are required.

IFRS 3 (revised in 2008) and amended IAS 27 will become mandatory for the Company's 2010 Financial Statements, if endorsed by the EU. The carrying amounts of any assets and liabilities that arose under business combinations prior to the application of IFRS 3 (revised in 2008) are not adjusted while most of the amendments to IAS 27 must be applied retrospectively. The Company has not yet determined the potential effect of the interpretation on the financial statements.

IFRIC 11 IFRS 2 – Group and Treasury Share Transactions requires a share-based payment arrangement in which an entity receives goods or services as consideration for its own equity instruments to be accounted for as an equity-settled share-based payment transaction, regardless of how the equity instruments are obtained. IFRIC 11 will become mandatory for the Company's 2008 financial statements, with retrospective application required. IFRIC 11 is not expected to have any impact on the financial statements.

IFRIC 12 Service Concession Arrangements provides guidance on certain recognition and measurement issues that arise in accounting for public-to-private service concession arrangements. IFRIC 12, which becomes mandatory for the Group's 2008 financial statements, is not expected to have any effect on the consolidated financial statements.

IFRIC 13 Customer Loyalty Programmes addresses the accounting by entities that operate, or otherwise participate in, customer loyalty programmes for their customers. It relates to customer loyalty programmes under which the customer can redeem credits for awards such as free or discounted goods or services. IFRIC 13 becomes mandatory for the Company's financial statements if endorsed by the EU. IFRIC 13 is not expected to have any impact on the financial statements.

IFRIC 14 IAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction clarifies when refunds or reductions in future contributions in relation to defined benefit assets should be regarded as available and provides guidance on the impact of minimum funding requirements (MFR) on such assets. It also addresses when a MFR might give rise to a liability. IFRIC 14 will become mandatory for the Company's 2008 financial statements if endorsed by the EU, with retrospective application required. The Company has not yet determined the potential effect of the interpretation on the financial statements.

22. Management's evaluation and assumption in relation to the application of accounting methods

The Group's management makes judgements, estimates and assumptions that may affect items in the Group's balance sheet for the next period. The management reviews on an ongoing basis its judgements and estimates based on previous experience and other relevant factors, such as estimated future events when decisions on judgements and estimates are made.

Fair value of derivative agreements

The fair value of derivative agreements not listed in effective markets is determined by using evaluation methods, which are reviewed on an ongoing basis by qualified independent employees. All evaluation models used must be approved and tested in order to ensure that the results reflect the documents used.

Segment reporting

23. Statement of segments

Segment information is presented by sectors. The main segment statement is presented according to the nature of the operation and is based on the Group's organisation and internal disclosure.

Inter-segment pricing is determined on an arm's length basis.

Segment operating income includes the segments pertaining directly to specific segments and the items that can be logically divided between the segments. Assets and liabilities of the Group are in the same manner divided between segments based on the beforementioned premises.

Operating segments

<i>Year 2007</i>	<i>Electricity production</i>	<i>Electricity transmission</i>	<i>Adjustments</i>	<i>Total</i>
Income from third party	18,886	3,981		22,867
Income within the Group	<u>1,825</u>	<u>2,983</u>	(4,808)	<u>0</u>
Segment income	20,711	6,964	(4,808)	22,867
Segment operating expenses	(7,887)	(3,480)	4,808	(6,559)
EBITDA	12,824	3,484		16,308
Depreciation	(3,884)	(1,207)	8	(5,082)
Segment earnings, EBIT	<u>8,940</u>	<u>2,277</u>	<u>8</u>	<u>11,226</u>
Segment assets	314,441	49,260	(45,307)	318,394
Shares in associated companies	<u>388</u>	<u>41</u>		<u>429</u>
Total assets	<u>314,829</u>	<u>49,301</u>	<u>(45,307)</u>	<u>318,823</u>
Segment liabilities	<u>212,998</u>	<u>44,314</u>	(37,698)	219,614
Total liabilities	<u>212,998</u>	<u>44,314</u>	(37,698)	219,614
Investments	26,836	6,691	(510)	33,017
Depreciation of operating assets	(3,161)	(1,188)	8	(4,340)
Depreciation of intangible assets	(27)	(18)		(45)
Impairment loss on intangible assets	(696)	(1)		(697)

<i>Year 2006</i>	<i>Electricity production</i>	<i>Electricity transmission</i>	<i>Adjustments</i>	<i>Total</i>
Income from third party	17,439	3,859		21,298
Income within the Group	<u>1,394</u>	<u>2,554</u>	(3,948)	<u>0</u>
Segment income	18,833	6,413	(3,948)	21,298
Segment operating expenses	(7,403)	(2,919)	<u>3,948</u>	<u>(6,374)</u>
EBITDA	11,430	3,494		14,924
Depreciation	(3,607)	(1,166)	<u>3</u>	<u>(4,770)</u>
Segment earnings, EBIT	<u>7,823</u>	<u>2,328</u>	<u>3</u>	<u>10,154</u>
Segment assets	263,284	41,807	(40,188)	264,903
Shares in associated companies	<u>412</u>	<u>32</u>	<u>0</u>	<u>444</u>
Total assets	<u>263,696</u>	<u>41,839</u>	<u>(40,188)</u>	<u>265,347</u>
Segment liabilities	<u>193,168</u>	<u>36,454</u>	<u>(35,158)</u>	<u>194,464</u>
Total liabilities	<u>193,168</u>	<u>36,454</u>	<u>(35,158)</u>	<u>194,464</u>
Investments	43,133	6,881	(4,632)	45,382
Depreciation of operating assets	(2,957)	(1,160)	3	(4,114)
Depreciation of intangible assets	(12)	(6)		(18)
Impairment loss on intangible assets	(638)	0		(638)

Other income

	2007	2006
24. Other income is specified as follows:		
Service sale, rent and other income	418	310
Sales profit on operating assets	<u>2</u>	<u>684</u>
Total other income	<u>420</u>	<u>994</u>

Salaries and salary related expenses

25. Total number of employees is specified as follows:

Average number of employees during the year calculated to full-time equivalents	347	338
Full-time equivalent units at year-end	301	287

26. Total salaries of employees are specified as follows:

Salaries	2,515	2,253
Pension premium payments	291	232
Defined pension benefit payments	98	99
Increase in pension obligation	185	230
Other salary related expenses	<u>236</u>	<u>242</u>
	<u>3,325</u>	<u>3,056</u>

Salary of the Board of Directors, Director, Deputy and Managing Directors are specified as follows:

Salaries of the Board of Directors of the parent company	9	10
Salaries of Boards of Directors of two subsidiaries	6	5
Salaries and benefits of the Director of the parent company	20	18
Salaries of the Deputy and five Managing Directors of the parent company	85	76
Salaries and benefits of the Director and three Managing Directors of subsidiaries	55	49

	2007	2006
<i>Salaries are divided as follows in the income statement:</i>		
Energy production costs	1,081	928
Transmission costs	910	755
Cost of general research	95	98
Other operating expenses	<u>1,239</u>	<u>1,275</u>
	<u>3,325</u>	<u>3,056</u>

Other operating expenses

27. Other operating expenses are specified as follows:

Corporate office	285	237
Finance	242	245
Human resources	84	82
Information technology	193	127
Engineering and construction	135	282
Pension	288	328
Other shared cost	<u>56</u>	<u>112</u>
	1,283	1,413
Other cost - relating to subsidiaries	518	681
Depreciation	<u>183</u>	<u>144</u>
	<u>1,984</u>	<u>2,238</u>
<i>Auditors' fees are specified as follows:</i>		
Auditing of financial statements	15	12
Reviewing of consolidated financial statements	5	0
Other services	<u>7</u>	<u>15</u>
	<u>27</u>	<u>27</u>

Financial income and (expenses)

28. Financial income and (expenses) are specified as follows:

Interest income	<u>389</u>	<u>453</u>
Interest expenses	(9,602)	(8,252)
Guarantee fee paid to owners	(419)	(366)
Capitalized interest costs	<u>4,305</u>	<u>2,941</u>
Total interest expenses	<u>(5,716)</u>	<u>(5,677)</u>
Exchange rate difference	13,892	(17,817)
Fair value changes of derivatives	18,769	6,791
Fair value changes of shares	(57)	(27)
Sales profit on shares in an associated company	<u>357</u>	<u>0</u>
Net income (expenses) on financial assets and liabilities	<u>32,961</u>	<u>(11,053)</u>
Effects through associated companies	<u>(4)</u>	<u>(56)</u>
Financial income and (expenses)	<u>27,630</u>	<u>(16,333)</u>

The borrowing costs on new long-term debt used for financing construction expenditure was 4.55%. The interest cost capitalized, including the guarantee fee, was 4.80% on funds invested in assets under construction.

Income Tax

	2007	2006
29. Income tax recognised in the income statement is specified as follows:		
Current tax	(15)	(1)
Decrease (increase) of deferred tax asset	(10,367)	17,189
(Expensed)/recognised as income in the income statement	(10,382)	17,188

	2007	2006
Effective tax ratio:		
Profit for the year	28,474	11,009
Tax asset at the Company's initial tax liability		(15,812)
Income tax for the year	10,382	(1,376)
Profit (loss) before income tax	38,856	(6,179)
Income tax acc. to the parent company's curr. tax rate	26.0%	26.0%
Non-deductible cost	-0.2%	-0.2%
Effect of different tax ratios within the Group	-0.1%	0.5%
Other items	1.0%	-4.0%
Effective income tax	26.7%	22.3%

Non-current assets

30. Property, plant and equipment, their initial value and depreciation is specified as follows:

	Power stations	Transmission	Communicat. equipment	Other assets	Total
<i>Cost value</i>					
Total value at 1.1.2006	167,872	23,504	692	4,553	196,621
Effect of introduction of IFRS	(881)	397	0	(127)	(611)
Total value at 1.1.2006	166,991	23,901	692	4,426	196,010
Additions during the year	271	9	42	888	1,210
Transferred from assets in construction	0	5,548	0	(5)	5,543
Sold and disposed of	0	(52)	0	(903)	(955)
Total value at 31.12.2006	167,262	29,406	734	4,406	201,808
Additions during the year	466	3,054	55	497	4,072
Transferred from assets in construction	105,930	10,117	0	(9)	116,038
Sold and disposed of	0	0	0	(94)	(94)
Total value at 31.12.2007	273,658	42,577	789	4,800	321,824
<i>Depreciation and impairment loss</i>					
Total value at 1.1.2006	85,748	1	240	1,398	87,387
Effect of introduction of IFRS	0	0	0	(85)	(85)
Total value at 1.1.2006	85,748	1	240	1,313	87,302
Depreciation of the year	2,813	1,070	53	178	4,114
Sold and disposed of	0	0	0	(253)	(253)
Total value at 31.12.2006	88,561	1,071	293	1,238	91,163
Depreciation of the year	3,018	1,067	52	202	4,339
Sold and disposed of	0	0	0	(81)	(81)
Total value at 31.12.2007	91,579	2,138	345	1,359	95,421
<i>Non-current assets are specified as follows:</i>					
<i>Book value</i>					
1.1.2006	81,243	23,900	452	3,113	108,708
31.12.2006 and 1.1.2007	78,701	28,335	441	3,168	110,646
31.12.2007	182,079	40,439	444	3,441	226,403

Official assessment of fixed assets and insurance value

The official assessment of those assets amounted to ISK 26.4 billion at year-end 2007. The insurance value of the Company's assets amounted to approximately ISK 324 billion including a Contractors' All Risk insurance due to the Kárahnjúkar project at year-end 2007.

31. Intangible assets are specified as follows:

	Capitalised development cost	Water and geothermal rights	Software	Total
<i>Cost value</i>				
Total value at 1.1.2006	3,178	881	0	4,059
Effect of introduction of IFRS	(82)		126	44
Total value at 1.1.2006	3,096	881	126	4,103
Additions during the year	957	0	93	1,050
Total value at 31.12.2006	4,053	881	219	5,153
Additions during the year	1,773	1,634	134	3,541
Transferred to projects under construction during the year	(12)	0	0	(12)
Total value at 31.12.2007	5,814	2,515	353	8,682
<i>Depreciation and impairment loss</i>				
Total value at 1.1.2006	1,363	0	0	1,363
Effect of introduction of IFRS	0	0	86	86
Total value at 1.1.2006	1,363	0	86	1,449
Depreciation and impairment loss during the year	638	0	18	656
Total value at 31.12.2006	2,001	0	104	2,105
Depreciation and impairment loss during the year	697	0	45	742
Total value at 31.12.2007	2,698	0	149	2,847
<i>Book value</i>				
1.1.2006	1,733	881	40	2,654
31.12.2006 and 1.1.2007	2,052	881	115	3,047
31.12.2007	3,116	2,515	204	5,835

32. The Group's depreciation is divided as follows:

	2007	2006
Power stations	3,018	2,813
Transmission	1,067	1,070
Telecommunication equipment	52	53
Other assets	202	178
Depreciation of assets in operation	4,340	4,114
Impairment loss on development cost	697	638
Depreciation of software	45	18
	5,082	4,770
<i>The Group's depreciation is divided as follows by sector:</i>		
Energy production costs	3,063	2,860
Transmission costs	1,140	1,128
Cost of general research	696	638
Other operating expenses	183	144
	5,082	4,770

33. Derivative financial instruments in the balance sheet are specified as follows:	2007	2006
<i>Assets</i>		
Embedded derivatives in electricity sales agreements	42,504	21,899
Currency swaps	5,820	2,345
Interest rate swaps	301	130
Other derivatives	169	0
	<u>48,794</u>	<u>24,374</u>
Derivative financial instruments are divided as follows:		
Long-term component of derivative agreements	40,890	19,590
Short-term component of derivative agreements	7,904	4,784
	<u>48,794</u>	<u>24,374</u>
<i>Liabilities</i>		
Embedded derivatives in electricity sales agreements	1,264	923
Aluminium hedges	7,530	10,690
Currency swaps	32	1,088
Interest rate swaps	1,324	0
Other derivatives	169	0
	<u>10,319</u>	<u>12,701</u>
<i>Derivative financial instruments are divided as follows:</i>		
Long-term component of derivatives	6,522	7,280
Short-term component of derivatives	3,797	5,421
	<u>10,319</u>	<u>12,701</u>

Shares

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

	2007		2006	
	Share	Book value	Share	Book value
Þeistareykir ehf.	32.0%	289	32.0%	259
Netorka hf.	40.8%	45	40.0%	36
HydroKraft Invest hf.	50.0%	95		-
Enex hf.		-	24.3%	149
		<u>429</u>		<u>444</u>

Net results of associated companies has immaterial effect, but a share in their loss amounted to a total of ISK 4 million in the year 2007 and 56 million in the year 2006. During the year, a share in Enex hf. was sold and the sales profit amounted to ISK 357 million.

<i>Shares in other companies are specified as follows:</i>	2007		2006	
	Share	Book value	Share	Book value
Farice hf.	9.4%	124	1.3%	1
Neyðarlínan hf.	7.9%	50	7.9%	50
Orkuvörður ehf.	9.0%	20		-
DMM Lausnir ehf.	17.8%	36	6.7%	12
Vistorka hf.	14.8%	35	13.6%	31
Other companies (5/6)		30		39
Total shares in other companies		<u>295</u>		<u>133</u>
Impairment loss on shares		(152)		(76)
		<u>143</u>		<u>57</u>

Shareholding has been decreased by the impairment loss, or by ISK 152 million due to an uncertainty on the future standing of individual companies, but some of the companies are established around high-risk start-up projects.

Landsvirkjun's subsidiaries are specified as follows:

	Share	Book value
Fjarski ehf.	100.0%	233
Icelandic Power Insurance Ltd.	100.0%	338
Íslensk jarðhitatækni ehf.	74.0%	16
Landsnet hf.	64.7%	3,228
Landsvirkjun Power ehf.	100.0%	2,001
		<u>5,816</u>

Tax asset

	2007	2006
35. Changes in the tax asset during the year is specified as follows:		
Calculated tax asset at the beginning of the year	16,987	(3)
Deferred tax asset due to introduction of IFRS	0	(199)
Calculated income tax	(10,382)	17,188
Current income tax	15	1
Deferred tax asset at year-end	<u>6,621</u>	<u>16,987</u>

The Company's deferred tax asset is specified as follows:

Carry forward taxable loss	2,108	3,782
Non-current assets and intangible assets	12,511	15,363
Derivative financial instruments	(8,694)	(2,801)
Other items	696	643
Deferred tax asset at year-end	<u>6,621</u>	<u>16,987</u>

Current assets

36. Inventories

Inventories are specified as follows:

Oil	35	35
Spareparts and consumables	328	328
Precautionary write-down	(26)	0
	<u>337</u>	<u>363</u>

37. Accounts receivable and other short term receivables

Accounts receivable and other short term receivables are specified as follows:

Nominal value of accounts receivable	3,747	3,392
Other short-term receivables	800	3,411
	<u>4,547</u>	<u>6,803</u>

At year-end 2007, 95% of accounts receivable were under 30 days old and almost no receivable was older than 60 days.

38. Cash and cash equivalents

Cash and cash equivalents are specified as follows:

Bank deposits	5,668	3,128
Market securities	5,466	1,520
	<u>11,134</u>	<u>4,648</u>

Equity

39. The parent company

The parent company is a partnership owned by the Icelandic State and Eignarhlutir ehf. The State owns a 99.9% share in the Company and Eignarhlutir ehf. holds 0.1%. The Company is an independent taxable entity.

40. Long-term debt are specified as follows by currencies:

		2007		2006	
	<i>Maturity date</i>	<i>Average interests</i>	<i>Remaining balance</i>	<i>Average interests</i>	<i>Remaining balance</i>
Liabilities in ISK, indexed	2009-2020	3.8%	34,940	4.5%	32,940
Liabilities in ISK, unindexed	2008-2009	13.3%	472	6.8%	472
Liabilities in CHF	2011-2022	2.5%	5,484	2.5%	2,405
Liabilities in EUR	2008-2026	4.2%	97,756	3.7%	86,297
Liabilities in GBP	2011-2016	11.4%	1,177	11.4%	1,310
Liabilities in JPY	2010-2011	1.6%	2,720	1.6%	2,945
Liabilities in USD	2008-2026	4.8%	48,602	5.7%	45,064
			<u>191,151</u>		<u>171,433</u>
Current maturities of long-term debt			(21,534)		(4,330)
Total long-term debt			<u>169,617</u>		<u>167,103</u>

Interest terms on the parent company's loans range from 1.0-14.5%. On average, nominal interest rates for the period were approximately 4.69% but they were approximately 4.63% the previous year

The city of Reykjavik and the town of Akureyri provide, together with the State, a Guarantee of Collection for all obligations of Landsvirkjun, entered into before the end of year 2006. From the beginning of year 2007 the State and Eignarhlutir ehf. provide such a guarantee for all of Landsvirkjun's obligations entered into after that date.

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

	2007	2006
2007	-	4,330
2008	21,534	18,919
2009	1,647	1,732
2010	10,622	11,158
2011	14,151	15,468
2012	11,767	-
Later	<u>131,430</u>	<u>119,826</u>
	<u>191,151</u>	<u>171,433</u>

As in past years, it is assumed that the parent company's long-term loans will be partially refinanced and maturities extended. Therefore, it can be assumed that the amortization schedule will be different from the above.

42. Pension fund obligation

The Company's obligation to refund the indexation charges on retirement payments to current and former employees, which hold pension rights with state and communal pension funds amounted to ISK 2,365 million at year end 2007 according to an actuary's evaluation, which is based on estimated future changes in salaries and prices. Interest in excess of price increase are assessed at 3.5% and salary increase in excess of price increase is assessed at 1.5% per year in average. Premises on life expectancy and mortality rate are in accordance with 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. The obligation at the beginning of the year amounted to ISK 2,180 million and has increased during the year by ISK 185 million but in addition, ISK 98 million have been paid and therefore, a total of ISK 283 million are expensed in the year 2007.

<i>Pension fund obligation, 5 year statement</i>	<i>2007</i>	<i>2006</i>	<i>2005</i>	<i>2004</i>	<i>2003</i>
Present value of the obligation	<u>2,365</u>	<u>2,180</u>	<u>1,951</u>	<u>1,779</u>	<u>1,691</u>

43. Obligation due to demolition

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

	2007	2006
Balance at 1.1.	420	397
Expensed during the period	<u>27</u>	<u>23</u>
Balance at 31.12.	<u>447</u>	<u>420</u>

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

44. Accounts payable and other short-term payables

Accounts payable and other short-term payables are specified as follows:

Accounts payable	7,984	4,633
Bill of exchange	3,466	0
Accrued interest	2,765	2,358
Other short-term liabilities	<u>1,116</u>	<u>739</u>
	<u>15,331</u>	<u>7,730</u>

45. Related parties

Definition of related parties

Associated companies and key management are among the Company's related parties.

Transactions with key management

Payments to key management

In addition to salaries, Directors and Managing Directors enjoy company car benefits.

<i>Other transactions with related parties</i>	2007	2006
<i>Sale of goods and services</i>		
Associated companies	61	21
<i>Cost</i>		
Associated companies	3	3
<i>Accounts receivable</i>		
Associated companies	21	8
<i>Accounts payable</i>		
Associated companies	0	4

Other notes

46. On August 22, 2007, a special evaluation committee issued a ruling on a settlement amount for water rights due to the Kárahnjúkar Hydropower Project and the division thereof between owners. The total settlement amounted to in approx. ISK 1.6 billion. Most owners of water rights in Jökuldalur valley and three in Fljótisdalur valley announced that they would not accept the ruling of the committee and filed a case in court on February 22, 2008. Forty cases were confirmed in the District Court of East Iceland on January 15, 2008. The parties involved are owners of one third of the water rights.

Settlement payments for land rights due to Háslón in the land of Brú in Jökuldalur valley has been put on hold subsequent to the ruling of the Committee for the Interior, which deemed the land as public land.

47. The construction of Kárahnjúkar started in 2003 after power sales contracts were entered into with Fjarðaál, a subsidiary of Alcoa Inc. The power station's capacity is 690 MW and transmission lines have been erected to Reydarfjörður. Five out of six units of the power station were operational in the fourth quarter of 2007. The last unit was put on stream in February 2008. Further information on the project can be found at the project's website: www.karahnjukar.is.

Capitalised construction cost of the part of the power project of Kárahnjúkar taken into operation in November 2007 amounted to ISK 106 billion at that time. At the end of year 2007 construction cost due to the part of the plant not already in operation amounted to over ISK 13 billion. Construction cost due to transmission projects in construction amounted to ISK 1.5 billion.

48. Subsequent events

Nothing has come forth after the balance sheet date which would require adjustments or changes to the financial statement for the year 2007.

49. Risk management

Landsvirkjun is exposed to various risks in its operation. The most important factors in effective risk management is the analysis of risk factors, risk measurement, response in order to limit the risk and monitoring. 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
- That generally accepted methods are used in assessing the risk
- That effective management is applied in accordance with authorisations
- That 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

Landsvirkjun's risk management strategy defines a benchmark in each risk category with respect to hedging limits. The Company's Board of Directors receives on an ongoing basis an overview of the Company's risks and performance of risk management.

Decisions and the supervision of how hedging is implemented is entrusted to a risk management committee. The risk management committee consists of the Managing Director, his deputy and the Financial Director. The Managing Director is the chairman of the risk management committee. Daily risk management is the responsibility of the Head of Risk Management.

The objectives of risk management are to analyse, manage and monitor Landsvirkjun's risks in order to stabilize operating income by reducing volatility due to exchange rate, interest and aluminium price changes.

Financial risk is divided into market risk, liquidity risk and counterparty risk.

The Company's market risk consists mainly in three risk categories:

- Risk due to fluctuations in world market price of aluminium
- Interest rate risk due to the Company's liabilities
- Exchange rate risk due to liabilities and income in foreign currencies

Liquidity risk and counterparty risk also fall under financial risk but these risk factors do not significantly affect the Company's operation.

50. Aluminium price risk

A considerable part of Landsvirkjun's risk has to do with volatility in the world market price of aluminium, a factor that increases with the Kárahnjúkar project coming on stream. Risk management monitors the status and development in aluminium markets. Furthermore, assistance from foreign specialists is sought regarding analysis and long-term forecasts on aluminium price.

Landsvirkjun's risk is based on a potential decrease in future aluminium price. The Company has in that respect entered into derivative agreements in order to ensure its income base and reduce fluctuations. In most cases such agreements consist in fixing aluminium price within a certain price range. At the end of December, fair value of such hedge agreements was negative by ISK 7.5 billion and the agreements are effective over the next six years. Risk management's authority to make forward hedging on aluminium price gradually decreases. Risk management may hedge up to 100% of next year's aluminium price risk exposure but only 10% of the corresponding risk in six years. Around half of the authorisation had been used at year end 2007.

The implementation of the IFRS leads to the change to Landsvirkjun's financial statements that all derivative agreement are recorded in the Company's books instead of only providing information on their fair value in the notes to the financial statement prior to 2007. Furthermore, effects of embedded derivatives in energy contracts made by the Company must be accounted for. According to the IFRS, embedded derivatives are considered as derivative agreements that are a part of other agreements, but are handled as separate derivative agreements when economic characteristics and risk are not closely related to the original agreement.

Landsvirkjun has defined the part of electricity sales agreements which are linked to aluminium price level as embedded derivatives. Therefore, the fair value of embedded derivatives in the Company's electricity sales agreements changes parallel to changes in aluminium prices. Fair value changes of the agreements are recognised in the income statement. Fair value changes of embedded derivatives have limited effect on the Company's cash flow as the agreements tenor are up to 40 years.

In evaluating embedded derivatives, generally accepted evaluation methods are used. The fair value of the agreements is calculated on the basis of the forwards price of aluminium, present valued with US zero-coupon curve, taking volatility effects into account. An effective aluminium forward market is approximately 7 years and therefore the aluminium price must be estimated from that time until the end of the term of the underlying energy agreement. This has been done by extending the forwards aluminium prices with unchanged prices from the last effective price in the forward curve. In calculating the fair value of embedded derivatives, account has been taken for uncertainty of forward aluminium prices in relation to long agreement terms.

Landsvirkjun has entered into agreements on the purchase of energy for resale to power intensive industries. Those agreements are linked to the price of aluminium and do thus have embedded derivatives. The fair value of the agreements is calculated in the same way and on the basis of the same conditions as the Company's energy agreements.

	2007	2006
<i>The fair value of embedded derivatives is specified as follows:</i>		
Fair value of embedded derivatives at the beginning of the year	20,976	6,179
Fair value changes during the year	20,264	14,797
Fair value of embedded derivatives at year end	41,240	20,976

Division of embedded derivatives is specified as follows:

Long term components of embedded derivatives	36,399	16,494
Short term component of embedded derivatives	4,841	4,482
Total embedded derivatives	41,240	20,976

Fair value of embedded derivatives, taking into account derivative agreements entered into in order to hedge, amounted to ISK 33.7 billion at the end of December (2006: 10.3 billion). The accompanying table shows fair value changes of agreements related to aluminium price and interest changes, but effects due to volatility are insubstantial.

Amounts in the table are before taxes.

		Aluminium price		
		-10%	0%	10%
Interests	+bp100	-17,598	-7,896	1,407
	0	-10,603	0	10,051
	-bp100	-2,299	9,195	20,122

51. Foreign exchange risk

Foreign exchange risk consists in the risk of losses due to change in the value of foreign currencies. The risk arises due to a difference in the in- and outflow of cash by currency and composition of loan portfolios. Foreign exchange risk in cash flow is mainly related to income from sales of energy to power intensive industries, amortizations and interest payments on foreign loans and foreign supplies.

There can be considerable fluctuations in the Company's loan portfolio against the Icelandic krona over the accounting period, as about 80% of the loan portfolio consists of foreign currencies. The risk from changes in the loan portfolio is limited compared to risk benchmarks determined by the Board at each time. For that purpose, the Company uses foreign exchange swaps and options. The Company also ensures the fixed rate of cash flow against the functional currency for up to three years with forward agreements and options.

Landsvirkjun is conscious about the effects of exchange rate changes of the Icelandic krona on the Company's operating profit. The foreign part of the loan portfolio is managed in terms of composition of the exchange rate index of the Icelandic krona and the composition of the Company's revenues is also taken into consideration. The Company has decided not to increase the weight of the Icelandic krona in the loan portfolio as it would lead to increased interest burden in the long term. More emphasis has been placed on hedging cash flow increasingly related to the USD. The loan portfolio composition is based on this policy and the Company has systematically increased weight of the USD in the loan portfolio.

The Group's currency risk is specified as follows in nominal value (ISK million):

	USD	EUR	CHF	Other currencies
2007				
Accounts receivable and short-term receivables	1,598	18	0	161
Derivatives	43,919	64,139	0	554
Bonds	(45,467)	(97,747)	(5,455)	(3,809)
Bank loans	(3,136)	(8)	(29)	(88)
Accounts payable	(651)	(3,305)	(29)	(54)
Risk in balance sheet	(3,737)	(36,903)	(5,513)	(3,236)
2006				
Accounts receivable and short term receivables	3,652	0	0	175
Derivatives	(17,623)	44,970	(10,470)	(4,336)
Bonds	(41,427)	(86,231)	(2,368)	(4,210)
Bank loans	(3,637)	(66)	(37)	(45)
Accounts payable	(1,309)	(1,419)	(21)	(23)
Risk in balance sheet	(60,343)	(42,746)	(12,896)	(8,439)

Exchange rate of the main currencies for the years 2007 and 2006 are specified as follows:

	Average rate		Rate at year end	
	2007	2006	2007	2006
USD	64.17	69.94	62.15	72.00
EUR	87.84	87.96	91.45	94.87
GBP	128.38	129.00	124.59	141.32
CHF	53.49	55.91	55.26	59.03
JPY	0.5456	0.6021	0.5548	0.6061
NOK	10.97	10.94	11.48	11.49
GVT (Icelandic krona index)	118.3	121.3	120.0	129.2

The rates are based on the ask-rate of the Central Bank of Iceland.

Sensitivity analysis

An increase in the Icelandic krona by 10% against the following currencies at December 31, would have increased the Group's profit by the following amounts after taxes. The analysis is based on that all variables, especially interest rate, remain unchanged. The analysis was made in the same way for the year 2006.

	<i>Profit</i>	
	2007	2006
USD	11,245	8,298
EUR	4,184	3,042
CHF	164	950

A decrease of the Icelandic krona by 10% against the beforementioned currencies would have the same effect in the opposite direction, provided that all variables would remain unchanged.

The proportion of Landsvirkjun's income in USD has increased in the past years with new electricity sales agreements with power intensive industries. The proportion remained nearly unchanged between the years 2006 and 2007 or at about 50%, but the estimate for the year 2008 allows for a USD share of 70%. The estimate is based on the assumption that prices of aluminium remain unchanged.

This is the first time that the financial statements of Landsvirkjun are prepared on the basis of IFRS, as adopted by the EU. According to those standards, the Company's Board of Directors shall decide on the Company's functional currency. After a detailed review, the Company's Board of Directors has decided that the Company's functional currency will be the USD as it is among other things the prevailing currency in the Company's revenues for the year 2008. The year 2007 will be the last year that the ISK is the functional currency of Landsvirkjun. Foreign currency risk will thus be based on foreign exchange differences against the USD and risk management and limits have been adjusted to those changes.

The fair value of currency swaps was positive by ISK 4.5 billion at the end of December 2007. The underlying principal amount is ISK 49 billion. The fair value of forward currency agreements was positive by ISK 797 million while the underlying principal amount is ISK 58.4 billion. The fair value of currency option agreements was positive by ISK 465 million and the underlying principal amount was approx. ISK 33.3 billion.

52. Interest rate risk

Landsvirkjun faces interest rate risk as the Company has interest bearing assets and liabilities. Interest bearing financial liabilities are much higher than interest bearing financial assets. In the case of fixed interest rate of financial liabilities the market risk consists of that fixed interest rate can decrease in the future and the Company would therefore carry a higher financing cost than prevailing in the market. In the case of financial instruments with floating interest rates the risk consists in interest increase.

At year-end 2007, the proportion of loans with floating interest rates was 76% compared to 73% at year-end 2006. A change in interest rate by 1% would have led to a change in interest expenses by ISK 1,350 million in the year 2007 and by ISK 1,250 million in the year 2006. The Company's financial instruments with fixed interest rate are not sensitive to interest rate changes. At year-end 2007, the estimated market value of the Company's long-term liabilities was approximately ISK 2.6 billion less than book value.

The fair value of interest rate swaps, not defined as hedging, is recognised in the income statement. Landsvirkjun has entered into agreements on interest rate swaps, which aim at reducing the Company's interest expenses and risk exposure. At the end of December 2007, the fair value of interest rate swaps was negative by ISK 1.0 billion. The underlying amount is ISK 27.2 billion. A change in interest rate by 1% would have led to fair value changes in the agreements by ISK 630 million.

53. Liquidity risk

Liquidity risk consists of the risk of losses should the Company not be able to keep its obligations at maturity date. In order to minimize such risk, the Company's liquidity balance is monitored by analysing the flow of revenues and expenses and the maturity dates of financial assets and liabilities. Effective control on liquidity ensures sufficient access to cash at each time. In order to ensure clear access to cash and maintain flexible financing possibilities Landsvirkjun has used different loan types. In the past years, financing has mostly taken place through a framework agreement with EMTN (Euro Medium Term Note). With this agreement the Company's visibility on foreign bond market is ensured. The availability of financial resources usually has been in excess of demand. The total amount that the Company can borrow through the EMTN agreement is USD 2 billion.

Guarantee of Collection from the State for Landsvirkjun's loans and a good credit rating has facilitated the Company's access to loan financing. Landsvirkjun pays an annual guarantee fee of 0.25% on capital of loans at each time. The Company's refinancing risk is limited with an even distribution of amortizations and interest and with a long contractual term of outstanding loans.

Landsvirkjun aims at having unreserved access to liquid assets corresponding to the average of the Company's net liquidity need for six months. Falling under liquid assets are cash, short-term securities and open loan access with financial companies. At year-end 2007, this amount was ISK 11 billion, but Landsvirkjun also has access to a Revolving Credit Facility of USD 400 million of which USD 350 million, or approximately ISK 22 billion are undrawn. The Company had in total ensured liquid assets to the amount of approximately ISK 30 billion, which corresponds to a 12 months funding need.

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

2007	<i>Book value</i>	<i>Contractual cash flow</i>	<i>Within one year</i>	<i>1 - 2 years</i>	<i>2 - 5 years</i>	<i>More than 5 years</i>
Non-derivative financial instruments						
Long-term loans	(191,151)	(272,218)	(27,952)	(9,502)	(58,452)	(176,312)
Accounts receivable	3,747	3,747	3,747			
Accounts payable	(14,215)	(14,215)	(14,215)			
	<u>(201,619)</u>	<u>(282,686)</u>	<u>(38,420)</u>	<u>(9,502)</u>	<u>(58,452)</u>	<u>(176,312)</u>
Derivative financial instruments						
Currency swaps	4,992	6,077	1,498	154	646	3,779
Interest rate swaps	(1,023)	(1,372)	(51)	(81)	(296)	(944)
Forward agreements	797	800	800			
Aluminium derivatives	(7,530)	(8,728)	(4,000)	(2,653)	(2,038)	(37)
Embedded derivatives in electricity sales agreements.	<u>41,240</u>	<u>58,088</u>	<u>5,419</u>	<u>5,947</u>	<u>19,599</u>	<u>27,123</u>
	<u>38,476</u>	<u>54,865</u>	<u>3,665</u>	<u>3,367</u>	<u>17,912</u>	<u>29,921</u>
2006						
Non-derivative financial instruments						
Long-term loans	(171,433)	(252,217)	(10,907)	(26,933)	(46,334)	(167,691)
Accounts receivable	5,451	5,451	5,451			
Accounts payable	(6,991)	(6,991)	(6,991)			
	<u>(172,973)</u>	<u>(253,757)</u>	<u>(12,447)</u>	<u>(26,933)</u>	<u>(46,334)</u>	<u>(167,691)</u>
Derivative financial instruments						
Currency swaps	918	1,763	107	1,190	(81)	547
Interest rate swaps	130	437	47	47	112	231
Forward agreements	338	340	340			
Aluminium derivatives	(10,689)	(11,178)	(4,500)	(4,145)	(2,499)	(35)
Embedded derivatives in electricity sales agreements.	<u>20,976</u>	<u>23,583</u>	<u>4,617</u>	<u>5,880</u>	<u>10,364</u>	<u>2,722</u>
	<u>11,673</u>	<u>14,944</u>	<u>611</u>	<u>2,972</u>	<u>7,896</u>	<u>3,465</u>

54. 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 agreements and derivatives entered into for hedging purposes, but such agreements are only entered into with financial companies. 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 AA- from Standard and Poor's or a comparable rating from other recognised credit rating agencies. If credit rating is not available a special Credit Support Agreement (CSA) is made between parties limiting Landsvirkjun's risk. Before energy agreements are made the financial standing of the relevant companies and their parent companies are thoroughly reviewed.

	2007	2006
The Company's counterparty risk is specified as follows at year end:		
Cash and cash equivalents	11,134	4,648
Derivative financial instruments	48,794	24,374
Bonds	31	43
Accounts receivable	3,747	5,451
	<u>63,706</u>	<u>34,516</u>

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

	2007		2006	
	<i>Book value</i>	<i>Fair value</i>	<i>Book value</i>	<i>Fair value</i>
Shares in other companies	143	143	57	57
Derivative agreements	38,476	38,476	11,673	11,673
Accounts receivable	3,747	3,747	5,451	5,451
Cash and cash equivalents	11,134	11,134	4,648	4,648
Interest bearing long-term liabilities	(191,151)	(188,512)	(171,433)	(171,303)
Accounts payable	(14,215)	(14,215)	(6,991)	(6,991)

Changes in accounting methods to the International Financial Reporting Standards (IFRS)

56. As stated in note 2 on accounting methods, this is the first time Landsvirkjun presents the Group's financial statements according to IFRS.

The Group's financial statements for the year 2007 are prepared in accordance with the accounting methods discussed in the notes on accounting methods. This also applies to comparative figures from the year 2006 and the opening balance sheet as at 1 January 2006.

Amounts in the opening balance sheet as at 1 January 2006 have been changed in accordance with IFRS, but were previously presented on the basis of the Icelandic GAAP. Accompanying tables and notes show the effect of the transition from the Icelandic GAAP to the IFRS.

During the preparation of the financial statements for the year 2007, it was discovered that correction had to be made to previous calculations due to embedded derivatives in energy sales agreements, which lead to a change in the amounts in the final IFRS opening balance sheet at the beginning of year 2007 compared to what was previously stated in the Company's interim financial statements 30 June 2007. The correction lead to a decrease in equity at the beginning of year 2007 by ISK 11.8 billion but had insubstantial effect on the operating return for the period from January to June 2007.

Changes in equity from previous GAAP to IFRS:

	Equity
Equity according to Icelandic GAAP 31 December 2006	61,106,667
Equity according to IFRS 1 January 2007	<u>69,234,203</u>
<i>Changes from previous GAAP to IFRS</i>	<u>8,127,536</u>

Changes at the beginning of year 2006:

Derivatives	IAS 39	823,324
Associated companies	IAS 28	7,663
Subsidiaries		(46,387)
Tax effect	IAS 12	<u>(214,064)</u>
<i>Total changes due to IFRS 1 January 2006</i>		<u>570,536</u>

Changes in the year 2006:

Derivatives	IAS 39	9,950,519
Depreciation of fixed assets	IAS 16	335,703
Share in the return of associated companies	IAS 28	(56,324)
Other changes		1,520
Tax effect	IAS 12	<u>(2,674,418)</u>
Effects due to the introduction of IFRS on profit in year 2006		7,557,000
<i>Total changes from previous GAAP to IFRS</i>		<u>8,127,536</u>

Changes in the profit for the year 2006:

Profit according to previous GAAP	3,503,460
Effects of the introduction of IFRS on profit of the year	<u>7,557,000</u>
Profit according to IFRS	<u>11,060,460</u>

Effects on equity due to the transition to IFRS is an increase by ISK 8,128 million. Following the effects of those new accounting standards on the income statement and the balance sheet are further discussed.

Derivatives

In accordance with IAS 39, Landsvirkjun has recognised derivatives and embedded derivatives at fair value and this lead to an increase in equity by ISK 10,774 million.

Associated companies

Shares in associated companies are recognised in the consolidated financial statements on the basis of the equity method. This change decreases book value of equity by ISK 49 million compared to the previous GAAP.

Operating assets

Upon the implementation of the IFRS, the Group's depreciation methods were changed in accordance with IAS 16. This change has the effect that expensed depreciation in the year 2006 is ISK 335 million lower than according to the previous GAAP.

Subsidiaries

The effect of the implementation of the IFRS on subsidiaries is that equity decreases by ISK 44 million.

Income tax

The total effect of the implementation of the IFRS on income tax is that equity decreases by ISK 2,888 million.

From previous GAAP to IFRS

The accompanying table shows a statement of the effect of the transition to IFRS defined by changes in assessment and presentation.

Income statement 2006, change from previous GAAP to IFRS

Previous GAAP		Assessment change	Change in presentation		IFRS
Power sales	17,243,387			17,243,387	Power sales
Transmission	3,060,148			3,060,148	Transmission
Other income	994,153			994,153	Other income
Energy production costs	(2,629,981)		(2,898,108)	(5,528,089)	Energy production costs
Transmission costs	(1,255,839)	2,670	(1,153,667)	(2,406,836)	Transmission costs
Cost of general research	(333,026)		(637,514)	(970,540)	Cost of general research
Other operating expenses	(2,158,359)		(79,848)	(2,238,207)	Other operating expenses
Depreciation	(5,131,378)	335,703	4,795,675	0	
Interest income	453,080		453,080		Interest income
Interest expenses	(3,584,963)		(2,092,122)	(5,677,085)	Interest expenses
For. exch.diff and indexation	(23,068,646)	9,950,519	2,065,584	(11,052,543)	Net exp.on fin.assets and liabilities
		(56,324)		(56,324)	Share in the profit of associated companies
Income tax	19,863,164	(2,674,898)		17,188,266	Income tax
	3,451,740	7,557,670		11,009,410	Profit of the year
Minorities' int. share in loss	51,720	(670)		51,050	Minorities' interest share in loss
Profit according to previous GAAP	3,503,460	7,557,000	0	11,060,460	Profit of the year pertaining to the owners of Landsvirkjun

Balance sheet, change from previous GAAP to IFRS

<i>Previous GAAP</i> <i>December 31, 2006</i>		<i>Assessment</i> <i>changes</i>	<i>Changes in</i> <i>presentation</i>		<i>IFRS</i> <i>January 1, 2007"</i>
Fixed assets					
Operating assets	110,924,047	718,080	(996,254)	110,645,873	Property, plant and equipment
Projects under construction . . .	97,935,884			97,935,884	Projects under construction
Development costs	2,091,545		(2,091,545)	0	
		(40,734)	3,087,799	3,047,065	Intangible assets
		(48,661)	492,851	444,190	Associated companies
Shares in other companies . . .	550,026		(492,851)	57,175	Shares in other companies
		19,589,629		19,589,629	Derivative financial instruments
Long-term notes receivable . . .	42,810			42,810	Long-term notes receivable
Deferred tax asset	19,861,666	(2,874,298)		16,987,368	Deferred tax asset
Total fixed assets	231,405,978	17,344,016	0	248,749,994	
Current assets					
Inventories	362,616			362,616	Inventories
Accounts receivable-trade . . .	3,392,085		3,410,584	6,802,669	Accounts receivable and other receivables
Other short-term receivable . . .	3,410,584		(3,410,584)	0	
		4,784,214		4,784,214	Derivative financial instruments
Cash and bank deposits	4,647,730			4,647,730	Cash and cash equivalents
Total current assets	11,813,015	4,784,214	0	16,597,229	
Total assets	243,218,993	22,128,230	0	265,347,223	Total assets
Long-term liabilities					
Long-term debt	163,740,062	899,555	2,463,278	167,102,895	Long-term debt
Accrued pension liabilities . . .	2,180,439			2,180,439	Accrued pension liabilities
		420,441		420,441	Obligation due to demolition
		7,279,943		7,279,943	Derivative financial instruments
Total long-term liabilities	165,920,501	8,599,939	2,463,278	176,983,718	
Short-term liabilities					
Accounts payable	5,371,984		2,358,094	7,730,078	Acc. payable and other short term liabilities
Accrued interest payable	2,358,094		(2,358,094)	0	
Curr. mat. of long-term debt . .	6,793,348		(2,463,278)	4,330,070	Current maturities of long-term debt
		5,420,502		,420,502	Derivative financial instruments
Total short term liabilities	14,523,426	5,420,502	(2,463,278)	17,480,650	
Total owners' equity	61,106,667	8,127,536		69,234,203	Total owners' equity
Minority interest	1,668,399	(19,747)		1,648,652	Minority interest
Total equity	62,775,066	8,107,789		70,882,855	Total equity
Total equity and liabilities	243,218,993	22,128,230	0	265,347,223	Total equity and liabilities



Design: Pipar

Printing: Svansprent

Supervision: Thorsteinn Hilmarsson

Kristjana Thórey Guðmundsdóttir



**Landsvirkjun is the recipient of
the Icelandic Quality Award 2007**

The Award is presented by the office of the Prime Minister of Iceland, the University of Iceland, the Icelandic Quality Management Society and VR trade union.

The Icelandic Quality Award is presented in recognition of tangible management results, and is an encouragement to companies to set clear objectives and regularly assess progress.

