Financial Statements 2008

Landsnet hf
Gylfaflöt 9
112 Reykjavík

Reg no. 580804-2410

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Endorsement by the Board of Directors and the President and CEO

General

Landsnet hf was established in August 2004 on the basis of the Electricity Act passed by the Icelandic parliament, Althingi, in the spring of 2003. The role of Landsnet is to administer the transmission of electricity and system management in accordance with the provisions of Chapter III of the Electricity Act No. 65/2003.

Results of the year 2008

According to the income statement, loss for the year amounted to ISK 12.8 billion. According to the balance sheet, equity at year-end amounted to ISK 7.3 billion, including share capital in the amount of ISK 5.9 billion. Regarding other changes in equity, reference is made to the statement of changes in equity.

Share capital and articles of association

The Company's Board of Directors decided to exercise a provision in the International Accounting Standard IAS 16 to revaluate property, plant and equipment based on its revaluation model. The revaluation is based on estimated future cash flows in addition to the estimated reconstruction value, taking into account the useful lives of the assets. The result of the revaluation is an increase in the book value of the Company's transmission system to the amount of ISK 17.7 billion. The effect of the revaluation on equity is an increase of ISK 15.1 billion after income tax effects. Regarding other changes in equity, reference is made to the statement of changes in equity.

Share capital at year-end is owned by the following four shareholders:

	Share
Landsvirkjun	64.73%
Rafmagnsveitur rikisins ohf	22.51%
Orkuveita Reykjavikur	6.78%
Orkubu Vestfjarða hf	5.98%

Statement of the Board of Directors and the President and CEO

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

To the best of our knowledge and belief, the financial statements give a true and fair view of the Company's financial performance during the year 2008, assets, debt and financial position as at 31 December 2008 as well as changes in cash during the year.

It is also our opinion that the financial statements and the report of the Board of Directors and the President and CEO provide a clear overview of the Company's development, performance and position and describe the primary risks and uncertainty that the Company faces.

The Board of Directors and the President and CEO of Landsnet hf hereby confirm the financial statements for the year 2008 with their signatures.

Reykjavík, 3 March 2009.

Board of Directors:

President and CEO:

Independent Auditor's Report

To the Board of Directors and shareholders of Landsnet hf.

We have audited the accompanying financial statements of Landsnet hf, which comprise the balance sheet as at 31 December 2008 and the income statement, statement of changes in equity and cash flow statement for the year then ended, together with 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 controls relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error, as well as 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 as to 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 assessing the risks of material misstatement in the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. 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 Landsnet hf as at 31 December 2008 and of its financial performance as well as cash flows for the year then ended in accordance with the International Financial Reporting Standards as adopted by the EU.

Reykjavík, 3 March 2009.

KPMG hf

Income Statement
for the year ended 31 December 2008

	Note	2008	2007
Operating revenue:			
Transmission	6	10,743,814	6,880,030
Other income	7	108,897	83,179
		10,852,711	6,963,209
Operating expenses:			
Energy production costs		1,550,607	1,313,717
Transmission costs		2,831,349	2,150,113
System management		575,815	560,682
Other operating expenses		728,452	662,525
		5,686,223	4,687,037
Operating profit		5,166,488	2,276,172
Financial income		1,192,368	46,055
Financial expenses		(21,355,997)	(3,290,526)
Net financial expenses	10	(20,163,629)	(3,244,471)
Share in net earnings of associated company	13	7,237	(5,405)
Loss before income tax		(14,989,904)	(973,704)
Income tax	11	2,210,258	175,252
Loss for the year		(12,779,646)	(798,452)
Loss per share:			
Basic loss - diluted loss per share of ISK 1	19	(2.17)	(0.14)

Notes 1 to 30 are an integral part of these financial statements

Amounts in ISK thousand

Balance Sheet as at 31 December 2008

Assets

	Note	2008	2007
Assets			
Fixed assets in operation	12	61,405,502	44,236,105
Projects under construction	12	1,781,611	1,506,006
Intangible assets	12	1,716,814	551,603
Shares in other companies	13	48,832	41,595
Deferred tax assets	14	0	229,363
Fixed assets		64,952,759	46,564,672
Inventories	15	480,439	302,331
Derivatives		0	369,732
Receivables from related companies		396,605	354,589
Accounts receivable and other receivables	16	853,021	725,283
Cash and bank deposits	17	2,700,681	984,259
Current assets		4,430,746	2,736,194
Total assets		69,383,505	49,300,866
Equity			
Share capital		5,902,733	5,902,733
Revaluation account		14,743,274	0
Retained earnings		(13,371,242)	(916,179)
Equity	18	7,274,765	4,986,554
Liabilities			
Long-term loans from related companies	20	34,808,942	29,915,095
Loans and borrowings	20	6,676,851	3,238,789
Derivatives	22	2,954,197	215,108
Deferred income tax liability	14	219,412	0
Other obligations	21	475,723	447,154
Long-term liabilities and obligations		45,135,125	33,816,146
Loans from related companies		15,813,603	6,034,415
Derivatives		37,428	150,539
Accounts payable and other payables	23	1,122,584	4,313,212
Short-term liabilities		16,973,615	10,498,166
Total liabilities		62,108,740	44,314,312
Total equity and liabilities		69,383,505	49,300,866

Notes 1 to 30 are an integral part of these financial statements

Amounts in ISK thousand

Statement of Changes in Equity
for the year ended 31 December 2008

	Share Capital	Revaluation account	Accumulated deficit	Total
Changes in equity 1 January - 31 December 2007:				
Equity 1 January 2007	5,902,733	0	(117,727)	5,785,006
Loss for the year			(798,452)	(798,452)
Equity 31 December 2007	5,902,733	0	(916,179)	4,986,554
Changes in Equity 1 January - 31 December 2008:				
Equity 1 January 2008	5,902,733	0	(916,179)	4,986,554
Revaluation of transmission system		17,726,890		17,726,890
Income tax effect of total revaluation		(2,659,033)		(2,659,033)
Loss for the year			(12,779,646)	(12,779,646)
Depreciation on revaluation recognised under accumulated loss		(324,583)	324,583	
Total earnings for the year		14,743,274	(12,455,063)	2,288,211
Equity 31 December 2008	5,902,733	14,743,274	(13,371,242)	7,274,765

Notes 1 to 30 are an integral part of these financial statements

Amounts in ISK thousand

Statement of Cash Flows
for the year ended 31 December 2008

	Note	2008	2007
Cash flow from operating activities:			
Cash received from customers		10,683,265	6,502,694
Cash expenses		(3,839,947)	(3,369,208)
From operations excluding interest		6,843,318	3,133,486
Interest income received		118,478	32,280
Interest expenses paid		(1,201,543)	(1,078,966)
Net cash from operating activities		5,760,253	2,086,800
Cash flow from investing activities:			
Investments in substations	12	(1,304,077)	(5,996,104)
Fixed assets sold	12	700	4,345
Investment in substations under construction	12	(275,605)	(385,379)
Investment in intangible assets		(1,204,552)	(355,638)
Investments in equity securities		0	(15,000)
Change in unpaid construction costs		130,757	57,175
Net cash (to) from investment activities		(2,652,777)	(6,690,601)
Cash flows from financing activities:			
Change in loans from related companies		3,019,900	(1,068,290)
Proceeds from long-term loans		0	3,033,654
Proceeds from short-term loans due to construction		(4,891,728)	3,320,614
Net cash (to) from financing activities		(1,871,828)	5,285,978
Net increase in cash		1,235,648	682,177
Effect of exchange rate changes on cash		480,774	(5,731)
Cash at 1 January		984,259	307,813
Cash at 31 December		2,700,681	984,259

Investing and financing activities not affecting cash:

		2008	2007
Investment in substations		0	(400,000)
Paid in share capital		0	400,000

Notes 1 to 30 are an integral part of these financial statements

Amounts in ISK thousand

Notes to the financial statements

Notes to the Financial Statements

1. Reporting entity

Landsnet hf has its headquarters in Iceland and is domiciled at Gylfaflöt 9 in Reykjavik, Iceland. The Company is a subsidiary of Landsvirkjun, which holds a 64.73% share. Landsnet was established in 2004 on the basis of the Electricity Act passed by the Icelandic parliament, Althingi, in the spring of 2003. The role of Landsnet is to administer the transmission of electricity and system management in accordance with the provisions of Chapter III of the Electricity Act No. 65/2003, which stipulates that the Company must not engage in any activities other than necessary to perform its duties under the Act.

2. Basis of preparation

a. ***Statement of compliance***

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

The financial statements were approved by the Board of Directors on 3 March 2009.

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

b. ***Basis of measurement***

The financial statements have been prepared on the historical cost basis, except that derivative financial instruments are regognised at fair value and the Company's transmission system is recognised at a revalued amount. The methods to measure fair value are discussed further in Note 4.

c. ***Functional and presentational currency***

These financial statements are presented in ISK, which is the Company's functional currency. All financial information presented in ISK has been rounded to the nearest thousand.

d. ***Use of estimates and judgements***

The preparation of the financial statements in conformity with IFRS standards 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 in the period in which the estimates are revised and in any future periods affected.

Information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements is included in the following notes:

- Note 3c - Property, plant and equipment
- Note 3d - Intangible assets
- Note 3m (i) - Estimation of provision due to site restoration
- Note 14 - Income tax

3. Significant accounting policies

The following accounting methods have been consistently applied to all disclosed periods in the financial statements, except that the Company has as of 1 January 2008 recognised its transmission network according to the revaluation method in accordance with IAS 16. Thus, the Company's power lines and substations are recognised at a revalued price in the balance sheet, which is their fair value at the revaluation date less revalued depreciation value from the date that the assets were acquired. Note 3c includes more details on the accounting policies applied in relation to the revaluation.

a. ***Foreign currency***

Transactions in foreign currencies are translated to the functional currency of the Company at the exchange rates on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies on the reporting date are retranslated to the functional currency at the exchange rate on that date. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate on the date that the fair value was determined. Foreign currency differences arising on retranslation are recognised in profit or loss.

b. ***Financial Instruments***

(i) Non-derivative financial instruments

Non-derivative financial instruments consist of investments in equity and debt securities, trade and other receivables, cash and cash equivalents, loans, borrowings and trade and other payables.

Non-derivative financial instruments are recognised initially at fair value. For instruments not recognised at fair value through profit or loss, any directly attributable transaction costs are initially entered as an increase in their value. Subsequent to initial recognition, non-derivative financial instruments are measured as described below.

A financial asset and liability is recognised when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognised if the Company's contractual rights to the cash flows from the financial assets expire or if the Company transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset. Regular-way purchases and sales of financial assets are accounted for on the trade date, i.e. the date that the Company commits itself to purchase or sell the asset. Loans and receivables are recognised on the date that they are originated. Financial liabilities are derecognised if the Company's obligations specified in the contract expire or are discharged or cancelled.

Cash and cash equivalents comprise cash balances and call deposits.

Accounting for finance income and expense is discussed in note 3(o).

Financial assets at fair value through profit or loss

An instrument is classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial instruments are designated at fair value through profit or loss if the Company manages such investments and makes purchase and sale decisions based on their fair value. Upon initial recognition, attributable transaction costs are recognised in profit or loss when incurred. Financial instruments at fair value through profit or loss are measured at fair value, and changes therein are recognised in profit or loss.

Other financial instruments

Financial instruments other than derivative financial instruments are recognised at the amortised cost value based on effective interest rates, less depreciation if detected.

(ii) Derivative financial instruments

The Company holds derivative financial instruments to hedge its foreign currency and interest rate risk exposures.

3. Significant accounting policies, continued

(ii) Derivative financial instruments, continued

The Company holds foreign currency and interest rate swaps for the purpose of managing exchange rate and interest rate risks. Hedge accounting is not applied to derivative financial instruments that economically hedge monetary assets and liabilities denominated in foreign currencies. Changes in the fair value of such derivatives are recognised in profit or loss as part of foreign currency gains or losses.

(iii) Share capital

Share capital is classified as equity.

c. ***Property, plant and equipment***

(i) Fixed assets in operation

Items of property, plant and equipment other than transmission lines and substations are measured at cost less accumulated depreciation and impairment losses.
The cost includes expenditures directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to a working condition for its intended use and the costs of dismantling and removing the items as well as restoring the site on which they are located.

When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

In accordance with the provisions of the International Accounting Standard IAS 16, the Company's power lines and substations are recognised on the basis of the revaluation method. The Company's power lines and substations are thus stated at a revalued cost in the balance sheet, which is their fair value on the revaluation date less revalued depreciation from the assets' acquisition date. The revaluation of those assets will be performed on a regular basis and when the management believes that their fair value has changed significantly, among other things due to external factors. All value increases due to the revaluation are entered in a revaluation account among equity after income tax. Depreciation of the revalued price is recognised in the income statement. Upon sale or disposal of an asset, the part of the revaluation account pertaining to that asset is recognised in retained earnings.

(ii) Transmission structures under construction

Projects under construction are capitalised on the basis of the cost of purchased services, materials, direct wages and other costs directly attributable to the property. Assets that have not been put to use are not depreciated. Cost of capital for financing the cost of projects under construction is capitalised in the period that the asset is being constructed and is considered a part of the cost of the asset. Capitalised cost of capital is the Company's weighted average cost of capital.

(iii) Leased assets

The leases the Company holds are operating leases. Leased assets are not recognised in the Company's balance sheet.

(iv) Subsequent costs

The cost of replacing a part of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the futurue economic benefits embodied within the part will flow to the Company and its cost can be measured reliably. The costs of day-to-day servicing of property, plant and equipment are recognised in profit or loss when incurred.

(v) Depreciation

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant or equipment until the salvage value is reached. The estimated useful lives for the current and comparative periods are as follows:

3. Significant accounting policies, continued

(v) Depreciation, continued

Substations	20 - 40 years
Power lines	50 years
Buildings	50 years
Other assets	4-10 years

Depreciation methods, useful lives and residual values are reviewed at each reporting date.

d. ***Intangible assets***

(i) Developement cost

Expenditure on research activities is recognised in profit or loss when incurred. Developement cost is capitalised within fixed assets. This cost consist largely of expenses relating to exploration of power line sites, preparation for power line masts and environmental impact assessments of proposed projects. The Company has concluded agreements whereby the prospective buyers of electricity shall bear all expenses of the project if it is cancelled. Cost of capital attributable to developement costs is not capitalised. Developement cost is not depreciated at this stage, but possible impairment losses have been considered, as discussed in Note (i).

When the decision to construct a transmission structure has been made and all neccessary approvals have been acquired, the development cost of the transmission structure is capitalised in fixed assets as a project under construction.

(ii) Software and other intangible assets

Software and other intangible assets are measured at cost less accumulated amortisation and accumulated impairment losses.

(iii) Amortisation

Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful lives of intangible assets from the date that they are available for use. The estimated useful lives for the current and comparative periods are as follows:

Software	4 years

e. ***Subsidiaries***

The Company has one subsidiary, Landsnet ehf. The financial statements of the two companies are not consolidated and the share is measured at cost. The subsidiary has not had any activity since its establishment.

f. ***Investment in associates***

Associates are those entities in which the company has significant influence, but not control, over financial and operating policies. Significant influence is presumed to exist when the company holds between 20 and 50 percent of the voting power of another entity. Associates are accounted for using the equity method and are initially recognised at cost. The financial statements include the Company's share of the total recognised gains and losses of equity movements of associates on an equity-accounted basis from the date that significant influence commences until the date that the significant influence ceases. When the Company's share of losses exceeds its interest in an associate, the Company's carrying amount, including any long-term investments, is reduced to nil and recognition of further losses is discontinued except to the extent that the Company has undertaken an obligation for or made payments on behalf of the investee.

3. Significant accounting policies, continued

g. ***Inventories***

Inventories are measured at the lower of cost and net realisable value. Net realisable value is the expected sales price in normal operation net of any cost of selling the product. The cost of inventories is based on the first-in-first-out (FIFO) principle of inventory valuation and includes cost incurred in acquiring the inventories and bringing them to their existing location and condition.

h. ***Accounts receivable and other receivables***

Accounts receivable and other receivables are measured at cost net of any impairment losses.

i. ***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.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognised in profit or loss.

(ii) Other assets

The carrying amount of the Company's other assets, except for inventories and deferred tax assets, is reviewed at each reporting date to determine whether there is any indication of an impairment loss. If any such indication exists, the assets's recoverable amount is estimated.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows of other assets or groups of assets (the "cash-generating unit"). Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis. An impairment loss of revalued assets is recognised in revaluation account amongst retained earnings.

j. ***Employee benefits***

(i) Defined contribution plans

The Company pays a contribution for its employees to defined contribution pension funds. The company has no responsibility regarding the obligations of the pension funds. The contributions are recognised as an expense under salary and salary related expenses as incurred.

3. Significant accounting policies, continued

(ii) Defined benefit plans

Under an agreement between the Company and the Pension Fund for State Employees (LSR), the Company's obligations regarding employees who are members of LSR shall be settled yearly. LSR estimates specifically at year-end the present value of the pension obligation accrued during the year and deducts from that amount the contributions paid by employees and the Company to LSR due to pension rights accrued during the year. The difference is recognised in profit or loss and settled on a yearly basis. The actuarial estimation shall assume that the obligation accrued for the year is calculated to the present value at year-end using the interest rate normally used to estimate the obligations of pension funds, which is now 3.5% per annum.

k. *Share capital*

When share capital recognised as equity is repurchased, the amount of the consideration paid, including directly attributable costs, is recognised as a deduction from equity. Repurchased shares are classified as treasury shares and presented as a deduction from total equity.

l. ***Provisions***

A provision is recognised if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are estimated by discounting the expected future cash flows at a pre-tax rate that reflects the current market assessment of the time value of money and the risks specific to the liability.

(i) Site restoration

The Company has estimated the cost of demolition of current line lots. The estimation is based on expert assessment. The demolition cost has been discounted based on the estimated useful life of the Company's power transmission lines and. The discounted value is entered, on the one hand, as an increase for the relevant asset and, on the other hand, as an obligation in the balance sheet. Estimated demolition cost is discounted by the nominal yield of state-guaranteed securities, which is now around 9%.

m. ***Revenue***

Income from the transmission of electricity is stated in the income statement on the basis of measured delivery during the period. Other revenue is recognised as earned or delivered.

The Company's tariff is subject to the National Energy Authority's opinion. On the basis of Article 12 of the Electricity Act No. 65/2003, the National Energy Authority sets an annual limit on the Company's revenue from transmission of electricity to distribution system operators on the one hand and industrial users on the other hand. Under the Act, the Company's authorised return on transmission to distributors is based on 50% of the five-year nominal yield on government bonds for the year 2005 but will increase progressively until full return is reached five years after the establishment of Landsnet. The Act permits full return on transmission to industrial users from the date of the Company's establishment.

The Company's tariff is denominated partly in the Icelandic króna (ISK) and partly in the US dollar (USD).

n. ***Lease payments***

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease.

An asset lease is expensed in the financial statements, the amount of which corresponds to financing cost and depreciation during the year, in relation to the use of electricity companies' transmission structures. The lease charge is determined by the National Energy Authority.

3. Significant accounting policies, continued

o. ***Finance income and expenses, continued***

Finance income comprises interest income on funds invested, changes in the fair value of financial assets at fair value through profit or loss and foreign exchange rate differences recognised in profit or loss. Interest income is recognised as it accrues in profit or loss, using the effective interest method.

Finance expenses comprise interest expense on borrowings, reversal of discounting of obligations, foreign exchange losses, changes in the fair value of financial assets at fair value through profit or loss and impairment losses recognised on financial assets.

p. ***Income tax***

Income tax on the profit for the year is deferred income tax. Income tax is recognised in profit or loss except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

q. ***Earnings per share***

The Company presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is the same as basic EPS, as the Company has not issued any call options or convertible bonds.

r. ***Segment reporting***

Under the Electricity Act, the Company may only administer the transmission of electricity and system management in Iceland and operate an electricity market. The Company has not begun operating an electricity market and considers its present operation as one single segment, for which reason it does not provide segment reporting.

s. ***New standards and interpretations***

(i) New standards and interpretations

The following new standards, amendments to standards and interpretations of them had not taken effect at year-end 2008, and have not been applied in preparing these financial statements:

- *IFRS 8 Operating Segments* introduces the “management approach” in relation to segment reporting, goods and services sold, geographical areas of operation and main customers. IFRS 8 becomes applicable for periods beginning on 1 January 2009 or later and will not have a significant effect on the Company's financial statements.

- *IAS 1 Presentation of Financial Statements (revised in 2007)* presents the concept of total return, which consists of changes in equity other than in relation to transactions with owners in their capacity as owners Total return may be presented in one or two statements: either a single statement of comprehensive income or an income statement plus a statement of comprehensive income. The revised IAS 1 will become mandatory for the Company's 2009 financial statements.

- The 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. Revised IAS 23 will become mandatory for the Company's 2009 financial statements and will consitute a change in accounting policy for the Company. The changes are not expected to affect the Company's financial standing.

3. Significant accounting policies, continued

New standards and interpretations, continued

- The revised *IFRS 3 Business Combinations* (2008) incorporates the following changes that are likely to be relevant to the Company's operations:

  – The definition of a business has been broadened, which is likely to result in more acquisitions being treated as business combinations.
  – Contingent consideration will be measured at fair value, with subsequent changes therein recognised in profit or loss.
  – Transaction costs, other than share and debt issue costs, will be expensed as incurred.
  – Any pre-existing interest in the acquiree will be measured at fair value with the gain or loss recognised in profit or loss.
  – Any non-controlling (minority) interest will be measured at either fair value, or at its proportionate interest in the identifiable assets and liabilities of the acquiree, on a transaction-by-transaction basis.

  The revised IFRS 3 will be applied in the preparation of the Company's 2010 financial statements if approved by the EU.

- The revised *IAS 27 Consolidated and Separate Financial Statements (2008)* requires accounting for changes in ownership interests by the Company in a subsidiary, while maintaining control, to be recognised as an equity transaction. When the Company loses control of a subsidiary, any interest retained in the former subsidiary will be measured at fair value with the gain or loss recognised in profit or loss. The amendments to IAS 27, which will be applied in the preparation of the Company's 2010 financial statements if approved by the EU, are not expected to have a significant impact on the financial statements.

- The revised *IFRS 2 Share Based Payment – Vesting Conditions and Cancellations* (2008) clarifies 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.
- The revised *IAS 32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation* requires puttable instruments, and instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation, to be classified as equity if certain conditions are met. The amendments, which become mandatory for the Conmpany's 2009 consolidated financial statements, with retrospective application required, are not expected to have any impact on the Company's financial statements.

- The revised *IAS 39 Financial Instruments: Recognition and Measurement – Eligible Hedged Items* clarifies the application of existing principles that determine whether specific risks or portions of cash flows are eligible for designation in a hedging relationship. The amendments will become mandatory for the Company's 2010 consolidated financial statements if endorsed by the EU, with retrospective application required. The amendments are not expected to have any impact 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 2009 financial statements if endorsed by the EU. IFRIC 13 is not expected to have any impact on the financial statements.

3. **Significant accounting policies, continued**

New standards and interpretations, continued

- *IFRIC 15 Agreements for the Construction of Real Estate* applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors. IFRIC 15, which becomes mandatory for the Company’s 2009 consolidated financial statements if endorsed by the EU, is not expected to have any impact on the financial statements.

- IFRIC 17 *Distributions of Non-cash Assets to Owners* provides guidance on when and how a liability for certain distributions of non-cash assets to owners acting in their capacity as owners is recognised and measured, and how to account for settlement of that liability. IFRIC 17, which becomes mandatory for the Company’s 2010 financial statements if endorsed by the EU, is not expected to have any impact on the financial statements.

One interpretation, *IFRIC 12 Service Concession Arrangements,* took effect for the year ended 31 December 2008 but has not been applied in preparing these financial statements as it has not yet been endorsed by the EU.

4. **Determination of fair values**

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

a. *Derivatives*

The fair value of derivative contracts is based on their listed market price, if available. If a listed market price is not available, then the fair value is estimated using accepted valuation techniques.

Valuation techniques include recent arm's lenght transactions between knowledgeable, willing parties, if available, reference to the current fair value of other instruments that are substantially the same, the discounted cash flow analysis and option pricing models. Valuation techniques incorporate all factors that market participants would consider in setting a price and are consistent with accepted methologies for pricing financial instruments. Periodically, the Company calibrates the valuation technique and tests for validity using prices for many observable current market transactions in the same instrument, without modification or repackaging, or based on any available observable market data.

The fair value of derivative agreements not listed in active markets is determined using valuation methods reviewed on a regular basis by qualified employees. All valuation models used must be approved and tested in order to ensure that the results reflect those documents that were used.

The most reliable verification of the fair value of derivative agreements at the beginning is the purchase value, unless the fair value of the instrument can by verified by comparison with other listed and recent market transactions of a comparable instrument or based on an evaluation method where variables are solely based on market documents. When such documents are available, the Company recognises profit or loss at the initial registration date of the instruments.

The fair value of interest rate swaps is based on broker quotes. Those quotes are tested for reasonableness by discounting estimated future cash flows based on the terms and maturity of each contract and using market interest rates for similar instruments at the measurement date.

b. *Non-derivative financial liabilities*

Fair value, which is determined for disclosure purposes, is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of intest at the reporting date.

5. Financial risk management

Overview

The Company has exposure to the following risks from its use of financial instruments.

- Credit risk
- Liquidity risk
- Market risk

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk and its management of capital. Further quantitative disclosures are included throughout these financial statements.

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board of Directors seeks consultation regarding financial risk both from its employees and external consultants and discusses it regularly at Board meetings.

The Company's objective is to discover and analyse the risks it faces, set a benchmark for risk exposure and control it. The Company's risk management policy is regularily reviewed to analyse market changes and changes within the Company.

Credit risk

Credit risk is the risk of financial loss of the Company owing to the failure of a customer or counterparty to a financial instrument to meet its contractual obligations. The Company's credit risk is mainly due to trade receivables.

Trade and other receivables

The Company's exposure to credit risk is influenced mainly by the individual characteristics of each customer. Approximately 87% of the Company's transmission income derives from the Company's shareholders.

In general, the Company's customers are financially strong energy companies, which have conducted business with the Company from its establishment. The Company's largest customers are also shareholders in the Company. As of its establishment, the Company has not incurred losses on accounts receivable and its representatives have assessed its credit risk as insubstantial based on current operations. The Company's collection issues are reviewed on a regular basis.

Liquidity risk

Liquidity risk is the risk that the company will not be able to meet its financial obligations as they will fall due. The Company endeavours to ensure, to the extent possible, that it always has sufficient liquidity to meet its liabilities when due, without incurring unacceptable losses or risking damage to the Company's reputation.

The Company has made an agreement on a line of credit with the parent company, Landsvirkjun in the amount of ISK 15 billion.

Market risk

Market risk is the risk that changes in the market prices of foreign exchange rates and interest rates will affect the Company's income or the value of its holding of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising return.

The Company enters into interest and currency swaps in order to manage its market risk and hedge the currency combination of its income.

5. Financial risk management, continued

Currency risk

The Company is exposed to currency risk on sales, purchases and borrowings that are denominated in a currency other than the Company's functional currency. The Company's functional currency is the Icelandic króna (ISK). However, the Company derives part of its income in US dollars (USD) and a portion of its purchases is made in USD and euros (EUR). The main currencies posing a foreign exchange risk are the USD, the Japanese Yens (JPY), Swiss Francs (CHF) and the Euros (EUR).

The Company does in general not hedge against foreign exchange risk but reviews on a regular basis the currency combination of its liabilities against the currency combination of its income.

The Company's borrowings in foreign currencies, mainly in USD, JPY and CHF, represent a foreign exchange risk, which is partly hedged. Interests on these loans are much lower than on the Company's ISK-denominated loans.

Interest rate risk

The Company's borrowings bear both variable and fixed interest. The majority of the Company's borrowings bear fixed interest, cf. Note 21.

Other market price risk

Other market price risk is limited because investment in bonds and shares is an insubstantial part of the Company's operations.

Capital management

It is the policy of the Company's Board of Directors to maintain a strong equity position in order to ensure stability in its operations' future development. The 2009 operating budget envisages that the Company's equity ratio will be 20% at year-end 2009.

The Company is not subject to external rules on minimum capital requirements.

6. Revenue

Transmission revenue consists of:	2008	2007
Energy transmission	8,990,365	4,720,143
Transmission losses and system services	1,680,689	1,332,931
Input fees	72,760	826,956
	10,743,814	6,880,030

7. Other income

Other income consists of:

Income from work sold and rent	108,897	83,179

Financial Statements of Landsnet hf. 2008 20 Amounts in ISK thousand

8. Personnel expenses

Salary and salary-related expenses are specified as follows	2008	2007
Salary	813,133	760,719
Defined contribution plan payments	93,857	88,282
Defined benefit plan payments	21,712	15,277
Other salary related expenses	64,365	58,401
	993,067	922,679

Salary and salary-related expenses consist of:

Transmission costs	442,226	427,624
System management	314,579	323,415
Other operating expenses	236,262	171,640
Average number of employees	96	94
Full-time equivalent units	90	84

Remuneration of the Board of Directors, CEO and two Executive Directors were as follows:

Reumuneration of the Board of Directors	6,240	3,640
Remuneration and benefits of the CEO	19,166	19,139
Remuneration of two Excecutive Directors	32,021	28,569

9. Depreciation and amortisation

Depreciation and amortisation are specified as follows:

Depreciation of fixed assets in operation, see Note 12	1,860,562	1,187,580
Amortisation and impairment losses, see Note 12	39,341	19,766
Depreciation and amortisation recognised in the income statement	1,899,903	1,207,346

Depreciation and amortisation are allocated as follows to operating items:

Transmission costs	1,751,480	1,088,654
System management	61,248	58,592
Other operating expenses	87,175	60,100
Depreciation and amortisation recognised in the income statement	1,899,903	1,207,346

10. Financial income and expenses

Financial income and expenses are specified as follows:

Interest income	118,477	46,055
Fair value changes of derivative financial instruments	1,073,891	0
Total finance income	1,192,368	46,055
Interest expenses	(2,095,549)	(2,090,692)
Indexation	(4,036,402)	(1,656,052)
Exchange rate difference	(15,408,950)	(387,854)
Changes in fair values of derivatives	0	(210,129)
Capitalised interest expense due to projects under construction	184,905	1,054,201
Total financial expenses	(21,355,996)	(3,290,526)
Net financial expenses	(20,163,628)	(3,244,471)

Amounts in ISK thousand

10. Financial income and expenses, continued

Financial income and expenses are specified as follows:

Net financial expenses due to the construction of a transmission infrastructure amounting to ISK 185 million is capitalised and has been reported as a reduction in financial expenses.

Capitalised financial expenses were 12.2% of capital tied in transmission structures under construction during the period (2007: 10.9%).

11. Income tax

In May 2008, the Icelandic parliament, Althingi, approved a decrease of the income tax rate from 18% to 15% as of 1 January 2008. The amended rate applies to 2009 tax assessment. Therefore, the Company's deferred tax assets have decreased by ISK 38 million from 31 December 2007. This effect is expensed in the income statement.

Income tax recognised in the income statement is specified as follows:	2008	2007
Increase in deferred tax asset	2,248,485	175,252
Effect of decrease of income tax rate from 18% to 15%	(38,227)	0
Income tax recognised in the income statement	2,210,258	175,252
Income tax recognised in equity:		
Income tax liability due to revaluation of fixed assets	2,659,033	0
Change in deferred tax assets is specified as follows:		
Change in temporary differences	(97,259)	(301,370)
Change in carry-forward losses	2,345,744	476,622
Decrease due to decrease of tax rate from 18% to 15%	(38,227)	0
Income tax liability due to revaluation of fixed assets	(2,659,033)	0
Change in deferred tax assets	(448,775)	175,252

Reconciliation of effective tax rate:

		2008		2007
Loss before income tax		(14,989,903)		(973,704)
Income tax according to the current tax rate	15.0%	2,248,485	18.0%	175,266
Non-deductible expenses and other items	0.0%		0.0%	(13)
Decrease due to change in tax rate	(0.3%)	(38,227)	0.0%	0
Effective tax rate	14.7%	2,210,258	18.0%	175,253

Amounts in ISK thousand

12. Property, plant and equipment

Property, plant and equipment are specified as follows:

Fixed assets in operation:

	Substations	Power lines	Other	Total
Cost				
Balance at 1 January 2007	11,506,249	18,036,270	1,940,096	31,482,615
Additions	1,344,198	1,709,486	385,379	3,439,063
Transferred from projects under construction	3,162,389	8,507,129	0	11,669,518
Sold and disposed of	0	0	(6,943)	(6,943)
Balance at 31 December 2007	16,012,836	28,252,885	2,318,532	46,584,253
Balance at 1 January 2008	16,012,836	28,252,885	2,318,532	46,584,253
Revaluation	3,311,377	16,027,312	0	19,338,689
Additions	664,892	258,444	380,741	1,304,077
Sold and disposed of	0	0	(1,479)	(1,479)
Balance at 31 December 2008	19,989,105	44,538,641	2,697,794	67,225,540

	Substations	Power lines	Other	Total
Depreciation and impairment losses				
Balance at 1 January 2007	430,230	643,080	89,904	1,163,214
Depreciation and impairment losses	461,124	615,347	111,112	1,187,583
Sold and disposed of	0	0	(2,649)	(2,649)
Balance at 31 December 2007	891,354	1,258,427	198,367	2,348,148
Balance at 1 January 2008	891,354	1,258,427	198,367	2,348,148
Revaluation	280,559	1,331,240	0	1,611,799
Depreciation and impairment losses	622,514	1,115,426	122,622	1,860,562
Sold and disposed of	0	0	(472)	(472)
Balance at 31 December 2008	1,794,427	3,705,093	320,517	5,820,037

Fixed assets in operation:

	Substations	Power lines	Other	Total
Net book value				
1.1.2007	11,076,019	17,393,190	1,850,192	30,319,401
31.12.2007 and 1.1.2008	15,121,482	26,994,458	2,120,165	44,236,105
31.12.2008	18,194,678	40,833,548	2,377,277	61,405,503

Financial Statements of Landsnet hf. 2008 23 Amounts in ISK thousand

12. Property, plant and equipment, continued

The book value of substations and power lines without the revaluation would have amounted to ISK 41,683 million at year-end 2008, compared with ISK 59,028 million after revaluation.

Basis of revaluation of fixed assets in operation

In accordance with the International Accounting Standard IAS 16, the Company's lines and substations are recognised according to the revaluation method. A revaluation was conducted both at the beginning and the end of the year. The reason for the second revaluation is that Company's income premises changed considerably during the year, for which reason its management found that a review of the resultant effects on the transmission network's revaluation price was needed. The revaluation was based on two methods. First, it was based on the estimated reconstruction cost of the transmission system, which was calculated by independent experts at the beginning of year and projected to year-end 2008. Second, the operating value was measured using a cash flow analysis. The valuation period was from 2009 to 2013, with the future operating value calculated thereafter. The year's revaluation was based on the operating value, the main premises of which were the Company's operating budgets for the years 2009-2013, a 30% equity ratio and that Landsnet's tariff for transmission to distributors would reflect price developments in Iceland while the tariff for industrial users would reflect price level changes in the United States. The estimation of weighted-average cost of capital (WACC) was based on comparable companies abroad.

Ratable value and insurance value

The rateable value of the Company's real property amounts to upwards of ISK 3.3 billion. Assessed value for the same property's fire insurance amounts to ISK 4.9 billion. The insurance value of the Company's assets amounts to ISK 28.8 billion, excluding power lines and cables, which are insured by an emergency insurance fund. The Company's emergency insurance amounts to ISK 75.3 billion.

Intangible assets and projects under construction:	Intangible assets	Projects under construction
Cost		
Balance at 1 January 2007	221,897	9,833,104
Additions	355,638	3,342,420
Transferred from projects under construction	0	(11,669,518)
Balance at 31 December 2007	577,535	1,506,006
Balance at 1 January 2008	577,535	1,506,006
Additions	1,204,552	275,605
Balance at 31 December 2008	1,782,087	1,781,611
Amortisation and impairment losses		
Balance at 1 January 2007	6,167	0
Write-downs in the year	18,499	0
Depreciation in the year	1,266	0
Sold and disposed of	0	0
Balance at 31 December 2007	25,932	0

Amounts in ISK thousand

12. Property, plant and equipment, continued

	Intangible assets	Projects under construction
Balance at 1 January 2008	25,932	0
Amortisation for the year	39,341	0
Balance at 31 December 2007	65,273	0
Net book value		
1.1.2007	215,730	9,833,104
31.12.2007 and 1.1.2008	551,603	1,506,006
31.12.2008	1,716,814	1,781,611

The book value of intangible assets at year-end 2008 is divided into software in the amount of ISK 235 million and capitalised development cost amounting to ISK 1,482 million.

13. Investment in other companies

The breakdown of investment in other companies is as follows:

	2008 Share	2008 Carrying amount	2007 Share	2007 Carrying amount
Landsnet ehf.	100.00%	500	100.00%	500
Netorka ehf.	37.18%	48,332	37.18%	41,095
Total value of investment in other companies		48,832		41,595

The Company's share in Landsnet ehf is stated at cost as the firm has not conducted any operations from its establishment. At the time of preparing Landsnet hf's financial statements, the financial statements of Netorka ehf were not available. However, the estimated share in Netorka's profit amounts to ISK 7 million for the year 2008 (2007: a loss of ISK 5 million).

14. Deferred tax assets

The breakdown of deferred tax assets is as follows:

	2008	2007
Deferred tax assets on 1 January	229,363	54,110
Calculated income tax for the year	2,210,258	175,253
Revaluation of transmission system	(2,659,033)	0
Deferred tax assets on 31 December	(219,412)	229,363

The breakdown of deferred tax assets was as follows at year-end:

	2008	2007
Property, plant and equipment	(2,606,646)	(487,367)
Intangible assets	(57,206)	(12,333)
Investments in other companies	(275)	973
Other obligations	(38,233)	80,488
Tax losses carried forward	2,482,948	647,602
Deferred tax assets on 31 December	(219,412)	229,363

Amounts in ISK thousand

14. Deferred tax assets, continued

The carry-forward taxable loss amounted to ISK 16.5 million. The loss is utilisable against taxable income over ten years from when the loss is incurred. The management believes that the Company's operation over the next ten years will generate taxable income and that the accumulated carry-forward taxable loss will be fully utilised. In 2008, an authorisation was obtained to decrease taxable depreciation of the transmission system with retrospective effect. The carry-forward losses for

Loss for the year 2006, applicable until year 2016	4,731	949,881
Loss for the year 2007, applicable until year 2017	909,954	2,647,908
Loss for the year 2008, applicable until year 2018	15,638,302	
Total unadjusted taxable loss	16,552,987	3,597,789

15. Inventories

Inventories are specified as follows:

	2008	2007
Spare parts and material inventories	480,439	302,331

16. Trade and other receivables

Trade and other receivables:

Nominal value of trade receivables	833,572	710,677
Other receivables	19,449	14,606
	853,021	725,283

17. Cash

Cash is specified as follows:

Bank balances	2,700,681	984,259

18. Equity

Share capital

The Company's total share capital according to its Articles of Association was ISK 5,903 million at year-end. The Company holds no treasury shares. Each share of ISK in the Company carries one vote. All share capital has been paid.

Revaluation account

The Company's revaluation account consists of revaluation increase of the Company's fixed assets after income tax effects. Depreciation of the revalued price is entered in the income statement and transferred from the revaluation account to unadjusted loss.

The Company's revaluation account must not be allocated in the form of dividends to the Company's shareholders.

Dividends

The Company did not pay dividends in 2008 for the financial year 2007.

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19. Loss per share

Basic loss and diluted loss per share:	2008	2007
Loss to shareholders	(12,779,646)	(798,452)
Weighted average number of ordinary shares:		
Shares at 1 January 2008	5,902,733	5,502,733
New shares	0	111,111
Weighted average number of ordinary shares as at 31 December 2008	5,902,733	5,613,844
Basic and diluted loss per share	(2.17)	(0.14)

20. Loans and borrowings

This Note provides information about the contractual terms of the Company's interest-bearing loans and borrowings, which are measured at amortised cost. For more information about the Company's exposure to interest rate, foreign currency and liquidity risk, see Note 24

	31.12.2008	31.12.2008
Long-term liabilities		
Indexed bond loan from parent company in ISK, interest rate 4.21%	34,808,942	29,915,095
Loan agreement in Swiss Francs (CHF), LIBOR + margin	6,676,851	3,238,789
	41,485,793	33,153,884

The bond is an inflation-indexed bullet bond maturing in 2020 with interest payable once per year. The loan agreement is denominated in Swiss Francs and each interest period is six months.

Short term liabilities		
Short-term loan from parent company	14,673,803	5,031,260
Debt note	0	3,466,002
Total interest-bearing liabilities	14,673,803	8,497,262
Total interest-bearing liabilities	56,159,596	41,651,146

Terms of interest-bearing loans and borrowings

Debts in foreign currencies:

			31.12.2008		31.12.2007	
	Nominal interest rate	Final maturity	Nominal value	Carrying amount	Nominal value	Carrying amount
Debt in CHF	3.10%	2022	6,676,851	6,676,851	3,238,789	3,238,789
Debt in CHF	4.50%	2008-2009	3,556,943	3,556,943	1,713,060	1,713,060
Debt in JPY	2.70%	2008-2009	2,018,412	2,018,412	832,200	832,200
Debt in USD	4,0 - 5,7%	2008-2009	9,098,448	9,098,448	5,952,002	5,952,002
			21,350,654	21,350,654	11,736,051	11,736,051
Loans in ISK:						
Indexed loans in ISK	4.2%	2020	34,808,942	34,808,942	29,915,095	29,915,095
Total interest-bearing loans and borrowings			56,159,596	56,159,596	41,651,146	41,651,146

Financial Statements of Landsnet hf. 2008 27 Amounts in ISK thousand

20. Loans and borrowings, continued

Maturities by year of interest-bearing loans and borrowings are as follows:	31.12.2008	31.12.2007
Year 2012	333,843	161,939
Year 2013	667,685	323,879
Later	40,484,265	32,668,066
	41,485,793	33,153,884

21. Provision due to site restoration

Change in the provision due to site restoration is specified as follows:	2008	2007
Balance at 1 January	447,154	420,441
Present value for the year	28,568	26,713
Balance at 31 December	475,722	447,154

Under IAS 16, the initial value of property, plant and equipment shall include their estimated cost of demolition after use. The estimated cost of demolition of lines has been assessed and then discounted based on assessed useful life. In return, an obligation has been written up under long term liabilities. An increase in the obligation due to the discounting in addition to depreciation of demolition cost is expensed in the income statement.

No new transmisssion systems were brought into use in 2008.

22. Derivative financial instruments

The Company has entered into a derivative agreement with Kaupthing Bank hf, which was taken over by the Icelandic government in October 2008. The agreement has a five-year term and provides for the exchange of inflation-indexed Icelandic krónas and US dollars at the end of term in addition to interest accrued during the contractual term. The agreement's term extends from the end of November 2007 to March 2013. Kaupthing Bank hf pays indexed krónas and Landsnet pays US dollars At-year end, considerable uncertainty prevails as to whether the bank will be able to meet its contractual obligations under the agreement, which would affect both its classification among liabilities and the debt amount. Therefore, the final settlement of the agreement is uncertain. The agreement is recognised at fair value at year-end 2008 in accordance with its terms, and the payment of principal and interest after 1 January 2010 is recognised in long-term liabilities, while the 2009 contractual payment is recognised under short-term liabilities. The total effect of the agreement on the income statement is a charge in the amount of ISK 2.8 billion under financial expenses, which is divided into fair value changes in derivative agreements, interest expenses and foreign exchange difference.

23. Pension fund obligation

The Pension Fund for State Employees calculates at the end of each year the benefit plan obligation accrued for the year. Actuary assessment is based on the accrued obligation for the year being discounted at year-end on the basis of the annual interest rate generally used to assess pension fund obligations. The present annual rate is 3.5%.

24. Trade and other payables

Trade and other payables are specified as follows:

	2008	2007
Trade payables	941,144	661,506
Notes payable	0	3,466,002
Other payables	181,441	185,704
Trade and other payables total	1,122,585	4,313,212

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25. Financial instruments

Credit risk

Highest possible loss due to credit risk

The Company's highest possible loss due to financial assets is their book value, which was as follows at year-end:

Receivables from related companies	396,605	354,589
Trade and other receivables	853,021	725,283
Cash	2,700,681	984,259
Derivatives	0	369,732
	3,950,307	2,433,863

The Company's most important customers are domestic energy companies. At year-end, receivebles from those companies amounted to ISK 1,398 million, including a receivable from Landsvirkjun, the parent company of Landsnet, in the amount of ISK 680 million.

Impairment losses

No impairment loss has been recognised in relation to accounts receivable at year-end; nor has loss on receivables been expensed during the year.

Liquidity risk

The following are the contractual maturities of financial liabilities including estimated interest payments:

31 December 2008

	Carrying amount	Contractual cash flow	Within 12 months	1-2 years	2-5 years	After 5 years
Non-derivative financial liabilities						
Payable to related companies	50,622,545	69,880,509	17,323,450	3,019,694	4,529,541	45,007,824
Long-term liabilities	6,676,851	9,503,651	155,119	94,052	1,028,167	8,226,312
Trade and other payables	1,122,585	1,122,585	1,122,585	0	0	0
	58,421,981	80,506,745	18,601,154	3,113,746	5,557,708	53,234,136
Derivative financial liabilities:						
Foreign currency and interest rate swaps:						
Outflow	(9,215,302)	(9,980,764)	(91,108)	(17,507)	(9,872,149)	0
Inflow	6,223,677	7,201,656	250,467	500,933	6,450,256	0
	(2,991,625)	(2,779,109)	159,359	483,426	(3,421,893)	0

31 December 2007

	Carrying amount	Contractual cash flow	Within 12 months	1-2 years	2-5 years	After 5 years
Non-derivative financial liabilities:						
Payable to related companies	35,949,511	52,322,042	7,293,841	1,259,426	3,778,275	39,990,500
Long-term liabilities	3,238,788	4,206,842	87,619	101,120	463,372	3,554,732
Trade and other payables	4,313,212	4,313,212	4,313,212	0	0	0
	43,501,511	60,842,096	11,694,672	1,360,546	4,241,647	43,545,232

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25. Financial instruments, continued

Derivative financial liabilities:

Foreign currency and interest rate swaps:						
Outflow	(4,767,674)	(5,838,809)	(215,954)	(134,124)	(371,755)	(5,111,932)
Inflow	4,402,027	6,162,166	65,962	212,020	636,060	5,248,125
	(365,647)	323,357	(149,992)	77,896	264,305	136,193

Currency risk

The Company's exposure to foreign currency risk, based on nominal amounts, was as follows:

31 December 2008	EUR	CHF	USD	NOK	SEK	JPY
Trade and other receivables			675,784			
Loans from related companies		(3,556,943)	(9,098,448)			(2,018,412)
Other long-term liab.		(6,676,851)				
Derivative agreements			(9,764,725)			
Accounts payable and other payables	(26,016)	(157,187)	(4,330)	(2,037)	(8,210)	
Net currency risk	(26,016)	(10,390,981)	(18,191,719)	(2,037)	(8,210)	(2,018,412)

In the year 2009, it is estimated that 70% of the Company's transmission income will be in USD while purchases will be mainly in ISK and EUR.

31 December 2007	EUR	CHF	USD	NOK	SEK	SEK
Trade and other receivables			77,786	431		
Loans from related companies		(1,722,063)	(2,070,918)			(834,141)
Other long-term liabilities		(3,238,789)				
Derivative agreements			(5,044,277)			
Trade and other payables	(4,354)	(19,259)	(6,266)	(3,612)		
Net currency risk	(4,354)	(4,980,111)	(7,043,675)	(3,181)	0	(834,141)

Currency risk

	Av. exch. rate for the year		Year-end exch. rate	
	2008	2007	2008	2007
EUR	127.46	87.60	169.97	91.45
CHF	80.69	53.34	113.92	55.26
JPY	0.87	0.54	1.34	0.55
USD	88.07	64.02	120.87	62.15

Sensitivity analysis

A 10% strengthening of the ISK against the following currencies at 31 December would have increased (decreased) after-tax profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant. The analysis is performed on the same basis for 2007.

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25. Financial instruments, continued

	2008	2007
EUR	2,211	357
CHF	883,233	408,369
JPY	171,565	68,400
USD	1,499,595	543,474

A 10% weakening of the ISK against the above currencies at 31 December would have had the equal but opposite effect on profit or loss after tax to the amounts shown above, given that all other variables remain constant.

Interest rate risk

The breakdown of the Company's interest-bearing financial instruments was as follows at year-end:

	Book value	
	2008	2007
Financial instruments with floating interest rate		
Financial liabilities	18,396,457	8,270,049
Derivative agreements	2,991,625	196,354
	21,388,082	8,466,403
Financial instruments with fixed interest rate		
Financial liabilities	34,808,942	29,915,095

Interest rate risk

Cash flow sensitivity analysis for fixed-interest-rate instruments

The Company's liabilities carrying fixed interest rates are an indexed bullet bond with a single repayment in 2020. Therefore, interest changes on the settlement date should not affect the Company's income statement.

Cash flow sensitivity analysis for floating interest rate instruments

An increase in interest rates of 100 basis points at the reporting date would have decreased equity and profit or loss after tax by amount stated below. If interest rates had decreased by 100 basis points, the effect would have had the equal but opposite effect on profit or loss after tax. This analysis assumes that all other variables, in particular the foreign exchange rate, remain constant. The analysis was performed in the same manner for the year 2007.

	Earnings		Equity	
	100 point increase	100 point decrease	100 point increase	100 point decrease
31 December 2008				
Financial instruments with floating interest rates	(110,815)	110,815	(110,815)	110,815
Cash flow sensitivy (net)	(110,815)	110,815	(110,815)	110,815
31 December 2007				
Financial instruments with floating interest rate	(23,270)	23,270	(23,270)	23,270
Cash flow sensitivy (net)	(23,270)	23,270	(23,270)	23,270

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25. Financial instruments, continued

Fair value

Fair value versus carrying amounts

The fair values and carrying amounts of financial assets and liabilities as reported in the balance sheet are broken down as follows:

	31 December 2008		31 December 2007	
	Carrying amount	Fair value	Carrying amount	Fair value
Loans and receivables	1,249,626	1,249,626	1,079,872	1,079,872
Cash	2,700,681	2,700,681	984,259	984,259
Loans from related companies, long-term	34,808,942	35,555,121	29,915,096	25,649,462
Derivative agreement, debt	2,991,625	2,991,625	365,647	365,647
Other long-term liabilities	6,676,851	6,676,851	3,238,789	3,238,789
Loans from related companies, short-term	15,813,603	15,813,603	6,034,415	6,034,415
Trade and other receivables	1,122,585	1,122,585	4,313,212	4,313,212
	65,363,913	66,110,092	45,931,290	41,665,656

26. Financial assets and liabilities

Classification and fair value of financial assets and liabilities

The following table shows the Company's classification of financial assets and liabilities and their fair value (before accrued interests).

31 December 2008	Financial assets and liabilities designated at fair value	Fin.assets for sale	Loans and payables	Investments to maturity	Book value
Investment in subsidiary		500			500
Receivables from related companies			396,605		396,605
Acc. receivable and other sh. t. rec.			853,021		853,021
Cash			2,700,681		2,700,681
	0	500	3,950,307	0	3,950,807
Payables to related companies			50,622,545		50,622,545
Derivative contracts	2,991,625				2,991,625
Acc. payable and other s.t. payables			1,122,584		1,122,584
	2,991,625	0	51,745,129	0	54,736,754
31 December 2007					
Investment in subsidiary		500			500
Derivative contracts	369,732				369,732
Receivables from related companies			354,589		354,589
Acc. receivable and other sh. t. rec..			725,283		725,283
Cash			984,259		984,259
	369,732	500	2,064,131	0	2,434,363
Payables to related companies			35,949,510		35,949,510
Derivative contracts			365,647		365,647
Acc. payable and other s.t. payables			4,313,212		4,313,212
	0	0	40,628,369	0	40,628,369

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27. Operating leases

The Company as lessee

The Company leases a part of the transmission structures it uses from domestic energy companies. The lease agreements have an indeterminate lease term and the lease price is determined by the National Energy Authority.

28. Other information

The Company is a party to two litigations brought before the District Court of East Iceland. The cases relate to the amount of an expropriation settlement relating to development of the Fljótsdalur lines 3 and 4, as the Company did not accept the conclusion of an evaluation committee on the expropriation settlement. The rulings in the cases were delivered at the end of December and were broadly in line with the committee's results. The parties to the cases have still not decided whether to negotiate payments or bring a case before courts of law in order to settle the disagreement. At year-end, the Company had paid to the relevant land owners a large part of the amount determined by the committee. The Company's management finds it likely that any additional payments will be insubstantial. The conclusion of these issues can affect the amount of settlement payments to other parties, which were not parties to the cases in question.

In accordance with the provisions of Article 12 of the Electricity Act No. 65/2003, the Company shall take into account if the connecting of new power stations or industries to the transmission system increases cost for other users of the system, and if the connection leads to more profitable construction or utilisation of the transmission system. At year-end, the Company brought into use the Fljótdalur lines 3 and 4 in addition to the associated substations. Settlement has not been made to the relevant industries but the Company will probably be required to pay the relevant party a system contribution where the transmission infrastructure in question will lead to the transmission system's more cost-effective development and utilisation. At year-end 2008, information on the exact amount was not available, but the estimated amount for 2008 has been entered in the financial statements.

29. Related parties

Identity of related parties

The Company has a related party relationship with its parent company, subsidiary, associates, directors, excecutive officers and companies in their possession.

Transactions with senior management

(i) *Payments to senior management*

In addition to receiving salaries, the Chief Executive Officer and Managing Directors (Vice Presidents) of the Company enjoy various benefits and a contribution to a defined benefit pension fund. Management's salaries are accounted for in Note 8.

Other transactions with related parties	Amounts during the year	
	2008	2007
Sale of goods and services:		
Landsnet's parent company and its subsidiaries	6,165,357	2,983,721
Cost:		
Landsnet's parent company and its subsidiaries	1,819,634	1,520,093
Landsnet's associate	977	866

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30. Financial ratios

The company's key financial ratios:

Financial performance:	2008	2007
EBITDA	7,066,391	3,483,518
Financial position:	31.12.2008	31.12.2007
Current ratio - current assets/current liabilities	0.26	0.26
Equity ratio - equity/total assets	10.5%	10.1%
Return on equity	(92.0%)	(14.5%)

Amounts in ISK thousand