

**BYGGÐASTOFNUN**

The Icelandic Regional Development Institute

**ANNUAL ACCOUNTS**

**2014**

# INDEPENDENT AUDITORS' REPORT

## To the board of directors and chief executive officer of the Icelandic Regional Development Institute

We have audited the following annual accounts of Byggðastofnun, the Icelandic Regional Development Institute, for the year 2014. The annual accounts comprise a report of the directors and chief executive officer, a profit and loss account, a balance sheet, a cash-flow statement, and details of important accounting procedures and other notes.

### Responsibility of directors and chief executive officer for the annual accounts

The directors and the chief executive officer are responsible for the preparation and presentation of the annual accounts in accordance with the Act on Annual Accounts, the Act on Financial Undertakings, and the Regulation on the Annual Accounts of Credit Institutions. The directors and chief executive officer are also responsible for such internal controls as are necessary in the preparation and presentation of the annual accounts so that they contain no material misstatements, whether through fraudulent activity or error.

### Auditors' responsibility

Our responsibility consists in the opinion we express on the annual accounts on the basis of the audit. The audit was carried out in accordance with international auditing standards. These standards require that we observe established ethical principles and organise and conduct the audit such that sufficient certainty may be obtained that the annual accounts contain no material misstatements.

An audit includes procedures designed to verify the figures and other information in the annual accounts. The choice of auditing procedures is based on the auditor's professional assessment of, among other things, the risk that the annual accounts may contain material misstatements, whether through fraudulent activity or error. In the assessment of this risk, regard is taken of the Institute's internal controls, their structure and effectiveness. The audit also takes in an assessment of the appropriateness of the accounting procedures and valuation methods used by the officers in the preparation of the annual accounts as well as an evaluation of their overall presentation.

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

### Opinion

It is our opinion that the annual accounts give a true and fair picture of the Institute's performance in the year 2014, its financial position as at 31 December 2014, and its cash flows in the year 2014, in accordance with the Act on Annual Accounts, the Act on Financial Undertakings, and the Regulation on the Annual Accounts of Credit Institutions.

Reykjavík, 16 March 2015

### Endurskoðendathjónustan ehf

[ 'Auditing services, private limited company',  
division of Íslenskir Endurskoðendur ehf  
'Icelandic Auditors, private limited company' ]

*Sævar Thór Sigurgeirsson*  
State Authorised Public Accountant

*Sveinbjörn Sveinbjörnsson*  
State Authorised Public Accountant

# REPORT OF THE DIRECTORS AND OFFICERS

## Functions

The Institute operates under the terms of the Icelandic Regional Development Institute Act, no. 106/1999, and Regulation no. 347/2000. The function of the Icelandic Regional Development Institute is to promote the economic development of the rural regions of Iceland and employment and industry in these areas. In accordance with this function the Institute contributes to the preparation, organisation and financing of projects and the provision of loans with the aim of ensuring continued regional settlement, promoting employment and supporting innovation in business and industry. The financing of projects shall, where appropriate, be in collaboration with others. The Institute monitors regional settlement trends in Iceland, through among other means research and the collection of data. The Institute organises and contributes to consultation services in co-operation with economic development agencies, regional associations of local authorities, local authorities and others. The Institute may draw up or have drawn up plans for the development of regional areas and business and industry with the aim of supporting settlement and employment in the county's non-metropolitan regions. The Institute may also contribute to local planning activities under the terms of the Planning Act.

## Operations in the year 2014

According to the profit and loss account, the Institute's operating profit for the year amounted to ISK 349 million. Capital reserves at the end of the year 2014 as per the balance sheet were ISK 2651.7 million. The capital adequacy ratio under the terms of the Act on Financial Undertakings was 20.20%. The provisions of the Act on Financial Undertakings stipulate that capital reserves shall not be less than 8% of the risk-weighted asset base and the Institute thus satisfied the provisions of the Act in this respect at the end of the year 2014.

A case was heard before the District Court for the North of Iceland (West) in 2013 regarding the legality of the restructuring of index-linked loans in Icelandic krónur into loans in foreign currencies through the issue of an addendum. Judgement in this case was delivered on 29 November 2013, by which the legality of the Institute's loans restructured in this way was upheld and this judgement was not appealed to the Supreme Court. Hótel Mývatn ehf has filed a claim against the Institute regarding the legality of the same loans as were treated in the aforementioned case. No special contingency provisions have been entered in the accounts as a result of these matters. For further details, see Note 19 to the annual accounts.

## Risk management

In 2015 a risk policy was established by the board of directors of the Icelandic Regional Development Institute. Risk management and effective internal controls are one of the central pillars for the responsible operation of the Institute. The Institute has identified and categorised the principal risk factors in its operations. These are credit risk, concentration risk, market risk, exchange rate risk, interest rate risk, prepayment risk, inflation risk, liquidity risk, outflow risk, marketability risk, operational risk, information technology risk, political and legal risk, reputational risk and employee risk. The Institute operates active internal controls and all processes have been recorded. These processes and risk factors are assessed regularly. Appraisals have shown that the designated monitoring methods are operating effectively.

## **Governance**

The present board of the Icelandic Regional Development Institute was appointed by the minister of industries and innovation at the Institute's annual general meeting on 28 April 2014. The board will serve up to the Institute's next annual general meeting, which will be held on 1 July 2015. The directors of the Institute seek to maintain good management practices and have established rules for the board's working functions as well as ethical rules for staff and officers that form part of the 'Handbook for staff and officers'. The handbook was first approved in 2002 and can be found on the Institute's website, byggdastofnun.is. Rules of operation have also been established for the auditing committee and the board has defined the functions of the compliance officer. During the year 2014 rules were established on the general competence and qualifications of key staff members and an ownership policy agreed for the Institute's holdings in limited companies. Operating within the Institute there is a loans committee which discusses all loan applications and the sale of appropriated assets, along with making proposals to the board on the sale of shares. Operational procedures on loan granting activities and financial and asset management have been updated regularly, covering among other matters the authorisational powers of the loans committee.

## **Announcement of the board of directors and officers**

A bond issued by the Institute in 2003 matured on 10 March. The Institute issued a new class of bonds for ISK 4 billion for 15 years which was listed on the Nasdaq OMX 6 Iceland Stock Exchange on 6 March last.

## **Future prospects**

The Institute's capital position is strong, enabling it to provide effective and reliable support to companies in the non-metropolitan regions of Iceland. Applications for new loans rose in the year 2014 and an on-going increase in loans issued is anticipated in the year 2015.

## **Declaration of the board of directors and officers**

The annual accounts have been prepared in compliance with the Act on Annual Accounts and the Regulations on the Financial Statements of Credit Institutions.

The directors of the Icelandic Regional Development Institute, its chief executive officer and its operations manager herewith append their signatures in certification of the Institute's annual accounts for the year 2014.

Sauðárkrúkur, 13 March 2015

***Thóroddur Bjarnason***

Chairman of the Board of Directors

***Einar E. Einarsson***

***Karl Björnsson***

***Páll Baldursson***

***Halla Björk Reynisdóttir***

***Oddný María Gunnarsdóttir***

***Valdimar Hafsteinsson***

***Aðalsteinn Thorsteinsson***

Chief Executive Officer

***Magnús Helgason***

Operations Manager

## PROFIT AND LOSS ACCOUNT FOR THE YEAR 2014

	<i>Notes</i>	<b>2014</b> ISK 000s	<b>2013</b> ISK 000s
<b>INTEREST EARNED</b>			
Interest on deposits with credit institutions		104,937	134,363
Interest earned and indexation adjustment on loans issued		708,856	864,004
		<b>813,793</b>	<b>998,367</b>
<b>INTEREST EXPENSES</b>			
Interest expenses and indexation adjustment on loans received		414,210	560,419
Other interest expenses		161	583
		414,371	561,002
		<b>399,422</b>	<b>437,365</b>
<b>OPERATING INCOME</b>			
Funding received from Treasury under Budget provisions	<i>6</i>	371,400	365,500
Other Treasury funding received	<i>6</i>	1,500	0
Foreign exchange adjustment		25,316	(19,156)
Other operating income		50,724	43,727
		448,940	390,071
		<b>848,362</b>	<b>827,436</b>
<b>OPERATING EXPENSES</b>			
Disbursements to business consultants		172,400	172,200
Other subsidies granted		6,950	6,548
Salaries and wage-related expenses	<i>3, 4</i>	240,946	234,383
Other operating costs		146,156	139,173
Management costs on appropriated assets	<i>10</i>	42,754	28,089
Depreciation of operating assets	<i>14</i>	7,183	7,166
Additions to provision to meet losses on loans issued and revaluation of shareholdings	<i>2, 12</i>	(117,243)	50,960
		499,145	638,519
		<b>349,217</b>	<b>188,917</b>
		<b>Profit for year</b>	

## BALANCE SHEET

	<i>Notes</i>	<b>2014</b> ISK 000s	<b>2013</b> ISK 000s
<b>ASSETS</b>			
<b>Reserves and balances with credit institutions</b>			
Bank deposits	7	2,062,688	2,421,208
<b>Loans issued</b>			
Loans in Icelandic króna	8	5,022,716	4,545,520
Loans in foreign currencies	8	4,750,406	6,038,652
Appropriated assets	9, 11	1,048,510	986,320
		<u>10,821,632</u>	<u>11,570,492</u>
<b>Holdings in companies</b>			
Shares	13	902,395	809,599
		<u>902,395</u>	<u>809,599</u>
<b>Other assets</b>			
Debtors		68,969	14,190
Fixed operating assets	14	61,247	56,818
		<u>130,216</u>	<u>71,009</u>
<b>Assets: total</b>		<b><u>13,916,931</u></b>	<b><u>14,872,307</u></b>

## 31 DECEMBER 2014

	<i>Notes</i>	<b>2014</b> ISK 000s	<b>2013</b> ISK 000s
<b>LIABILITIES AND CAPITAL RESERVES</b>			
<b>Loans received</b>			
Index-linked securities issued		5,821,615	5,591,645
Loans from foreign institutions		5,340,160	6,866,776
	<i>16</i>	<u>11,161,775</u>	<u>12,458,421</u>
<b>Other debts and liabilities</b>			
Reserve to cover losses on guarantees provided	<i>18</i>	990	1,187
Unallocated funds received		41,349	51,696
Other liabilities		61,161	58,565
		<u>103,500</u>	<u>111,448</u>
<b>Total liabilities</b>		<u><b>11,265,275</b></u>	<u><b>12,569,868</b></u>
<b>Capital reserves</b>	<i>2, 17</i>	<u><b>2,651,656</b></u>	<u><b>2,302,439</b></u>
<b>Liabilities and capital reserves: total</b>		<u><u><b>13,916,931</b></u></u>	<u><u><b>14,872,307</b></u></u>
<b>Off-balance-sheet items</b>			
Guarantees provided	<i>18</i>	18,807	22,552

## CASH FLOW STATEMENT 2014

	<b>2014</b> ISK 000s	<b>2013</b> ISK 000s
<b>Cash in hand from operations</b>		
Profit for the year	349,217	188,917
<i>Operating items that do not affect cash in hand:</i>		
Provisions to meet losses on loans issued and revaluation of shares	(203,947)	215,481
Depreciation of operating assets	7,183	7,166
Profit on the sale of operating assets	(420)	(935)
Interest, indexation adjustment and exchange rate adjustment	404,680	377,110
Unpaid subsidies	0	215
<b><i>Cash in hand from operations</i></b>	<b>556,712</b>	<b>787,953</b>
<b>Cash flows from investment activities</b>		
Instalment payments on loans issued	1,393,050	1,149,900
New loans issued	(959,000)	(504,559)
Assets redeemed	243,352	(81,572)
Shares	(41,824)	(95,605)
Purchase of operating assets	(11,191)	(4,462)
Contingent liabilities and guarantee obligations paid	0	(156,627)
Debtors	(54,779)	17,324
<b><i>Cash flows from investment activities</i></b>	<b>569,609</b>	<b>324,400</b>
<b>Cash flows from financing activities</b>		
Instalment payments on loans received	(1,477,090)	(1,201,139)
Funding received from Treasury	0	250,000
Creditors	(7,751)	46,666
<b><i>Cash flows from financing activities</i></b>	<b>(1,484,841)</b>	<b>(904,472)</b>
<b>Increase (decrease) in cash in hand</b>	<b>(358,520)</b>	<b>207,880</b>
<b>Cash in hand at start of year</b>	<b>2,421,208</b>	<b>2,213,327</b>
<b>Cash in hand at end of year</b>	<b>2,062,688</b>	<b>2,421,208</b>

## NOTES

### 1. About the Institute

Byggðastofnun (the Icelandic Regional Development Institute), ID no. 450679-0389, is a credit institution whose main business consists in the granting of loans and other financial support, together with monitoring regional development trends in Iceland. The legal domicile of the Institute is Ártorg 1, 550 Sauðárkrókur, Iceland.

### 2. Accounting principles

#### Basis of preparation of accounts

The annual accounts have been prepared in compliance with the Act on Annual Accounts and the Regulation on the Financial Statements of Credit Institutions. They are based on historical-cost principles. They employ for the most part the same accounting procedures as in the previous year. Financial figures are in ISK (Icelandic krónur) and all such figures are given in thousands of ISK unless otherwise specified.

#### Valuation methods

Officers are required to assess and take individual decisions affecting important items in the annual accounts which by their nature are subject to valuation at any time. The valuation methods used by the officers are grounded in good accounting practice. The actual prices that items valued in this way may realise on sale or other disposal may prove different from the figures determined in the valuation.

#### Price-indexed assets and liabilities and assets and liabilities in foreign currencies

Accrued adjustments to the principal value of assets and liabilities as a result of changes in foreign exchange rates and price levels are entered in the annual accounts. Index-linked assets and liabilities are entered on the basis of price indices that came into force on 1 January 2015. Loans issued or received in foreign currencies are converted to ISK at the last listed exchange rate at the Central Bank of Iceland at the end of the year. Balances in foreign currency accounts at Icelandic banks are converted to ISK at the last listed buying rate at the relevant commercial bank. The difference that arises from exchange rate movements is entered in the profit and loss account and on the balance sheet.

#### *Central Bank of Iceland exchange rate at end of year:*

	<b>31.12.2014</b>	<b>31.12.2013</b>
EUR	154.70	158.94
USD	127.20	115.30
JPY	1.07	1.10

#### *Arion Bank exchange rate at end of year:*

EUR	153.84	158.12
DKK	20.66	21.20

#### *Landsbanki exchange rate at end of year:*

EUR	153.79	158.03
-----	--------	--------

*Íslandsbanki exchange rate at end of year:*

EUR	153.79	157.98
USD	127.07	114.67
JPY	1.06	1.09

*Price indices at start of year:*

	<b>1.1.2015</b>	<b>1.1.2014</b>
Consumer prices index for purposes of price indexation	421.0	416.7

### **Operating assets**

Permanent operating assets are entered at acquisition cost less depreciation. Improvements and enhancements are entered as assets if it is likely that they will yield a future profit to the Institute and it is possible to make a reliable estimate of the cost. All maintenance costs are debited to the profit and loss account as and when they are incurred. Depreciation is based on the estimated useful life of individual operating assets and calculated as a fixed annual percentage of the initial acquisition cost, less estimated residual value, based on the period of ownership during the year.

### **Reserve to cover losses on loans issued**

A depreciation account to cover losses on loans issued is created to cover the exposure that is inherent in lending activities but does not imply that the assets are irrevocably written off. Additions to the depreciation account for loans issued are entered as costs on the profit and loss account, reduced by any repayments arising from loans previously written off.

### **Holdings in companies**

Holdings in companies are entered at purchase cost less impairment. Affiliate companies are companies in which the Institute typically holds a 20-50% share. The Institute's interests in affiliate companies are entered initially at purchase price and after the initial entry according to the equity position of the relevant company based on the most recent available information from such companies. Revaluations are entered on the profit and loss account and the balance sheet.

### **Appropriated assets**

Appropriated assets are entered at their estimated sale value. Revaluations are entered on the profit and loss account and the balance sheet.

### **Loans issued**

Loans issued by the Institute are broken down into loans to clients and appropriated assets. They are originally measured at fair value, i.e. the amount of the loan inclusive of all transaction costs, and subsequently valued at amortised cost. All transactions undertaken by the Institute arising from its investments are entered as at the date of transaction, which is taken to be the date on which the Institute has committed itself to the transaction. Accrued interest and indexation adjustment are included in the book value of loans. Interest received on loans and deposits are entered under the item 'Interest earned' on the profit and loss account and an adjustment arising from changes in exchange rates under the item 'Foreign exchange adjustment'. Depreciation is based on an estimate of the risk of loss with respect to individual loans. Loans that are irrevocably lost are written out of the Institute's books.

## Debtors

Claims against debtors are entered according to the original transaction price, adjusted to cover currency fluctuations, less a writing-down allowance made to cover potentially lost claims. The writing-down allowance is based on an assessment of the risk of loss with respect to each debtor. Claims that are irrevocably lost are written out of the Institute's books.

## Cash in hand

Bank deposits are included in cash in hand on the balance sheet and in the preparation of the cash flow statement.

## Income

Income is entered in the accounts when there is genuine probability that its financial benefits will accrue to the Institute and when it is possible to make a reliable estimate of the amount.

Interest income is entered on the profit and loss account as and when it arises.

Dividend income is entered when the Institute's right of collection has been established.

Rental income from the letting of appropriated assets is entered on a straight-line basis over the rental period.

### 3. Salaries and wage-related expenses

	<b>2014</b>	<b>2013</b>
	ISK 000s	ISK 000s
Salaries	194,815	176,568
Accrued holiday pay in the year	2,383	17,953
Pension contributions	24,293	21,456
Other wage-related expenses	19,454	18,405
	<hr/>	<hr/>
Salaries and wage-related expenses: total	<b>240,946</b>	<b>234,383</b>
	<hr/>	<hr/>

The Institute employed an average workforce of 23 in the year based on full-year positions, which is an increase of one over the year 2013. At the end of the year there were 23 members of staff on the Institute's payroll, with a full-day equivalent of 22.8.

### 4. Remuneration of directors and chief executive officer

Salaries paid to the directors and chief executive officer of the Icelandic Regional Development Institute break down as follows:

	<b>2014</b>	<b>2013</b>
	ISK 000s	ISK 000s
Thóroddur Bjarnason, chairman of the board of directors	2,211	2,237
Anna Guðrún Björnsdóttir (deputy)	86	0
Ásthildur Sturludóttir	683	0
Bergsteinn Einarson (deputy)	0	81
Einar E. Einarsson, deputy chairman	683	0
Guðmundur R. Gíslason	374	987
Gunnar Svavarsson	0	102
Halla Björk Reynisdóttir (deputy)	43	0
Karl Björnsson	683	0
Kolfinna Jóhannesdóttir (deputy)	43	0
Matthildur Helgadóttir Jónudóttir	331	987
Oddný María Gunnarsdóttir	683	0
Ólafía Jakobsdóttir	331	729
Ólöf Th. Hallgrímsdóttir	486	1,056
Páll Baldursson (deputy)	86	0
Reynir Arnarson (deputy)	43	0
Rögnvaldur Ólafsson	331	987
Sigríður Jóhannesdóttir	683	0
Steingerður Hreinsdóttir (deputy)	0	41
Valdímur Haftsteinsson	1,014	987
Aðalsteinn Thorsteinsson, chief executive officer	14,695	14,151
Remuneration of directors and chief executive officer: total	<b>23,487</b>	<b>22,345</b>

## 5. Auditors' fees

Auditors' fees break down as follows:

	<b>2014</b>	<b>2013</b>
	ISK 000s	ISK 000s
Audit of annual accounts and review of interim financial statements	4,972	8,602
Other professional services/internal audit	8,973	3,334
Auditors' fees: total	<b>13,766</b>	<b>11,936</b>

## 6. Treasury funding in annual Budget and other Treasury funding

	<b>2014</b>	<b>2013</b>
	ISK 000s	ISK 000s
General operations	150,200	147,900
Business consultants in the rural regions	171,200	167,600
For project <i>Brothættar byggðir</i> ('Fragile Communities')	50,000	50,000
Treasury funding as agreed in the Budget	<b>371,400</b>	<b>365,500</b>

	<b>2014</b> ISK 000s	<b>2013</b> ISK 000s
Treasury grant to Raufarhöfn research centre	1,500	0
Treasury grant towards offset of transportation costs	196,500	175,973
Treasury grant to the Ministry of Fisheries and Agriculture AVS R&D Fund	50,215	0
Other Treasury funding: total	<b>248,215</b>	<b>175,973</b>

	<b>2014</b> ISK 000s	<b>2013</b> ISK 000s
Subsidies granted out of Treasury funding		
Grant to Raufarhöfn research centre	1,500	0
Subsidies towards offset of transportation costs	154,960	169,775
Subsidies towards Ministry of Fisheries and Agriculture AVS R&D Fund	50,215	0
Subsidies granted: total	<b>206,675</b>	<b>169,775</b>

Unallocated grants and subsidies arising from other Treasury funding are entered on the balance sheet.

Costs to the Institute arising from the project *Brothættar byggðir* ('Fragile Communities') amounted to ISK 21,295,000 in the year and are entered on the profit and loss account.

## 7. Reserves and balances with credit institutions

	<b>31.12.2014</b>	<b>31.12.2013</b>
Bank deposits in Icelandic krónur	1,893,902	2,286,771
Bank deposits in foreign currencies	168,785	134,437
Reserves and balances with credit institutions: total	<b>2,062,688</b>	<b>2,421,208</b>

## 8. Loans issued to clients

	<b>31.12.2014</b>	<b>31.12.2013</b>
Broken down by recipients:		
Local authorities	0.45%	0.19%
Private individuals	8.92%	8.76%
Broken down by sector:		
Services	44.78%	47.96%
Fisheries	26.45%	25.05%
Industry	15.22%	15.24%
Agriculture	4.08%	2.69%
Financial institutions	0.10%	0.12%
	<b>100%</b>	<b>100%</b>

Loans issued inclusive of accrued interest break down by period outstanding as follows:

Claims fallen due	465,125	553,754
Up to 3 months	178,691	187,467
3 months to 1 year	776,298	833,467
1 year to 5 years	2,765,611	3,069,043
Over 5 years	5,587,396	5,940,433
	<b>9,773,122</b>	<b>10,584,172</b>

### 9. Appropriated assets

	<b>31.12.2014</b>	<b>31.12.2013</b>
	ISK 000s	ISK 000s
Real estate	1,048,510	986,320
	<b>1,048,510</b>	<b>986,320</b>

### 10. Management of appropriated assets

	<b>2014</b>	<b>2013</b>
	ISK 000s	ISK 000s
Rental income	59,341	68,030
Management costs	102,095	96,119
	<b>(42,754)</b>	<b>(28,089)</b>

## 11. Appropriated assets

	<b>Rateable value</b>	<b>Floor area m<sup>2</sup></b>
Eyrarland 1, Hvammstangi	7,170	159.2
Eyrarland 1. Hvammstangi	6,800	150.9
Guesthouse Iðufell, Laugarás	72,100	2,003.1
Grænigarður, Ísafjörður	55,843	1,366.7
Hafnarbraut 7, 11 & 15, Dalvík	52,572	1,126.7
Héðinsbraut 4, Húsavík	51,200	1,129.4
Langanesvegur 1, Thórshöfn	19,700	471.9
Nesbraut 7, Reyðarfjörður	30,400	722.4
Pálsbergsgata 3 & 5, Ólafsfjörður	31,970	1,851.4
Sandhorn, Hrísey	22,250	832.7
Seljavogur 10, Hafnir	22,450	231.8
Sindragata 27, Ísafjörður	33,050	659.6
Snartarstaðir plot no. 154334, Norður-Thingeyjarsýsla	441	14.7
Snartarstaðir plot no. 178032, Norður-Thingeyjarsýsla	348	6.4
Sólvellir 23, Breiðdalsvík	68,532	2,081.6
Steig, Mýrdalshreppur	52,440	1,641.2
Strandarvegur 29-33, 29R, Seyðisfjörður	10,050	601.0
Strandgata 37, Tálknafjörður	10,275	456.1
Sveinbjarnargerði IIC & IID, Svalbarðsstrandarhreppur	59,091	1,354.0
Valgerðarstaðir 4, Fljótsdalshérað	100,350	5,148.3
Vallarás 7-9, Borgarnes	131,400	1,919.1
Vatneyri machine workshop, Patreksfjörður	9,332	736.1
	<b>847,764</b>	<b>24,664.2</b>

Appropriated assets are entered in the annual accounts at a value of ISK 1,048,510,000.

## 12. Provision to meet losses on loans

The item Additions to provision to meet losses on loans issued on the profit and loss account covers additions to the depreciation account for loans issued and accounts receivable and the revaluation of share capital and appropriated assets. Provisions to meet losses on loans break down as follows.

	<b>2014</b>	<b>2013</b>
	ISK 000s	ISK 000s
Provision to meet losses on loans issued		
Position at 1 January	1,521,737	2,317,220
Additions in the year	49,068	(404,284)
Loans permanently written off	(401,481)	(629,286)
Recovery of loan previously written off	70,726	238,086
Position at 31 December	<b>1,240,049</b>	<b>1,521,737</b>
Provision to meet losses on loans issued as proportion of total loans issued	11.26%	12.57%

Additions to provision to meet losses on loans issued and revaluation of shareholdings	<b>2014</b> ISK 000s	<b>2013</b> ISK 000s
Addition in the year for loans issued	160,480	72,679
Sale of prawn quota	(247,100)	0
Money-market loan called in	0	(238,086)
Addition to cover guarantees provided	(197)	146,424
Addition to cover accounts receivable	2,000	4,000
Revaluation of shareholdings	(30,936)	75,842
Recovery of loans previously written off	(1,491)	(9,900)
Additions to provision to meet losses on loans as per profit and loss account	<u>(117,243)</u>	<u>50,959</u>

### 13. Shareholdings

At the end of the year the Icelandic Regional Development Institute held the following shares, broken down as follows by nominal value and share of ownership:

	<b>Share of ownership</b>	<b>Nominal value</b> ISK 000s
<b>Property management</b>		
Ámundakinn ehf	16.45%	26,000
Ásgarður hf	13.10%	15,000
Dalagisting ehf	12.11%	8,000
Fasteignafélagið Borg ehf	29.77%	18,825
Fasteignafélagið Hvammur ehf	24.85%	16,926
Fasteignafélagið Kirkjuból ehf	30.35%	7,124
Grand hótél Mývatn ehf	7.22%	10,000
Hesthólar ehf	70.99%	14,672
Fasteignafélagið Hótél Hellissandur ehf	25.49%	19,534
Fasteignafélagið HN ehf	46.40%	232
Hæðin á Höfðabraut ehf	12.28%	2,000
Tröllasteinn ehf	18.92%	7,000
Urtusteinn ehf	8.45%	32,818
<b>Property management: total</b>		<u><b>178,131</b></u>
<b>Tourism services</b>		
Hótél Flúðir hf	11.94%	3,109
Hótél Húsavík ehf	0.38%	136
Hótél Varmahlíð hf	13.04%	3,000
Hvalamiðstöðin Húsavík ehf	19.70%	2,000
Nes-Listamiðstöð ehf	35.71%	5,000
P/F Smyril-line	1.67%	DKK 1,868
Snorri Thorfinnsson ehf	19.90%	12,000
<b>Tourism services: total</b>		<u><b>25,245</b></u>

**Investment companies**

Dýralíf ehf	31.70%	4,000
Eignarhaldsfélag Suðurlands hf	40.00%	109,142
Eignarhaldsfélag Suðurnesja hf	19.03%	96,840
Eignarhaldsfélag Vestmannaeyja hf	39.10%	7,850
Fjárfestingafélagið Vör hf	41.95%	35,940
Hvetjandi ehf	39.50%	89,769
Saga eignarhaldsfélag hf	0.37%	18
Tvídrangi ehf	15.27%	4,991

**Investment companies: total**

---

**341,550**

---

**Industry**

Borg, saumastofa ehf	19.82%	170
Fánasmiðjan ehf	9.95%	4,167
Fjallalamb hf	10.68%	10,000
Molta ehf	30.00%	50,000
Raflagnir Austurlands ehf	17.56%	3,600
Trico ehf	33.33%	5,000
Ullarvinnsla Frú Láru ehf	29.76%	2,500
Vilko ehf	29.13%	21,555
Thörungaverksmiðjan hf	27.67%	7,919

**Industry: total**

---

**104,911**

---

**Agriculture**

Eðalís ehf	11.06%	3,000
Yrkjar ehf	7.29%	1,800

**Agriculture: total**

---

**4,800**

---

**Business consultancy**

Atvinnuþróunarfélag Vestfjarða hf	22.10%	1,933
-----------------------------------	--------	-------

**Business consultancy: total**

---

**1,933**

---

**Fisheries**

Bernskan ehf	34.53%	22,444
Eignarhaldsfélagið Gláma hf	30.01%	94,400
Fiskvinnslan Drangur ehf	4.08%	1,000
Fiskvinnslan Íslandssaga hf	26.57%	39,866
Tó hf	10.40%	2,667
Thórsberg ehf	21.98%	30,174

**Fisheries: total**

---

**190,551**

---

**Retail and services**

Samkaup hf	2.77%	10,801
------------	-------	--------

**Retail and services: total****10,801****Total shareholdings****864,922**

Shareholdings are entered in the annual accounts at a value of ISK 902,395,000. The value of shares obtained in connection with financial reorganisation amounts to ISK 249,318,000.

**14. Operating assets**

Operating assets break down as follows:

	<b>Land &amp; buildings</b> ISK 000s	<b>Fixtures &amp; fittings</b> ISK 000s	<b>Motor vehicles</b> ISK 000s	<b>Software</b> ISK 000s	<b>Total</b> ISK 000s
Base value at 1/1	70,388	3,219	23,968	0	96,575
Total depreciation to 1/1	(28,533)	(2,253)	(9,971)	0	(40,757)
Additions in the year	0	0	6,480	7,216	13,696
Written off in the year	(1,947)	(644)	(4,592)	0	(7,183)
Sold in the year	0	0	(2,505)	0	(2,505)
Profit on sales	0	0	420	0	420
Book value at 31/12	<u>39,908</u>	<u>322</u>	<u>13,800</u>	<u>7,216</u>	<u>61,247</u>
Total base value 31/12	70,388	3,219	23,499	7,216	104,322
Total depreciation 31/12	<u>(30,480)</u>	<u>(2,897)</u>	<u>(9,698)</u>	<u>0</u>	<u>(43,075)</u>
Book value at 31/12	<u>39,908</u>	<u>322</u>	<u>13,800</u>	<u>7,216</u>	<u>61,247</u>
Depreciation ratios	2-3%	20%	20%	20%	

The Institute's land and buildings are valued as follows. The book value of the assets is given for comparative purposes:

	<b>Rateable value</b> ISK 000s	<b>Insurance valuation</b> ISK 000s	<b>Book value</b> ISK 000s
Skagfirðingabraut 17-21, Sauðárkrókur	28,735	99,190	28,046
Háuhlíð 4, Sauðárkrókur	33,900	57,100	11,863
	<u><b>62,635</b></u>	<u><b>156,290</b></u>	<u><b>39,908</b></u>

## 15. Assets and liabilities linked to foreign currencies and subject to price indexation

	<b>2014</b> ISK 000s	<b>2013</b> ISK 000s
<b>Foreign:</b>		
Assets in foreign currencies	4,919,190	6,173,088
Liabilities in foreign currencies	5,340,160	6,866,776
Net balance of foreign assets and liabilities	<u>(420,970)</u>	<u>(693,688)</u>
<b>Index-linked:</b>		
Index-linked assets	4,581,482	4,219,886
Index-linked liabilities	5,822,031	5,591,645
Net balance of index-linked assets and liabilities	<u>(1,240,549)</u>	<u>(1,371,759)</u>

Figures are given net of depreciation of assets.

### Foreign assets and liabilities break down as follows by currency:

	<b>USD</b> ISK 000s	<b>DKK</b> ISK 000s	<b>JPY</b> ISK 000s	<b>EUR</b> ISK 000s	<b>Total</b> ISK 000s
Loans issued	779,589	0	1,412,484	2,558,332	4,750,405
Cash in hand	3,941	1,402	13,021	150,422	168,785
Assets: total	<u>783,530</u>	<u>1,402</u>	<u>1,425,505</u>	<u>2,708,754</u>	<u>4,919,190</u>
Borrowings	769,157	0	1,705,013	2,865,991	5,340,160
Net balance	<u>14,373</u>	<u>1,402</u>	<u>(279,508)</u>	<u>(157,237)</u>	<u>(420,970)</u>

Figures are given net of depreciation of assets.

## 16. Borrowings

Borrowings break down as follows by period outstanding:

	<b>2014</b> ISK 000s	<b>2013</b> ISK 000s
Fallen due	0	0
Up to 3 months	4,870,812	151,903
3 months to 1 year	984,201	1,021,267
1 year to 5 years	3,085,711	8,356,500
Over 5 years	2,221,051	2,928,751
	<u>11,161,775</u>	<u>12,458,421</u>

A bond issued by the Icelandic Regional Development Institute in 2003 matured on 10 March 2015. For refinancing purposes, the Institute issued a new class of bonds on 6 March 2015 which will be listed on the stock exchange, for 15 years, index-linked, at a fixed rate of 3.2%.

## 17. Capital reserves

Under the terms of Act no. 161/2002, the capital adequacy ratio of credit institutions may not fall below 8% of the so-called risk-weighted asset base. At the end of the year the Institute's capital adequacy ratio was 20.20%.

Capital reserves and capital adequacy ratio as per the capital provisions of Act no. 161/2002 on Financial Undertakings

	<b>31.12.2014</b> ISK 000s	<b>31.12.2013</b> ISK 000s
Tier I capital	2,651,656	2,302,439
Total	<u>2,651,656</u>	<u>2,302,439</u>
Credit risk	11,044,175	11,978,088
Exchange rate risk	436,750	695,125
Operational risk	<u>1,645,388</u>	<u>1,608,425</u>
Risk-weighted asset base	<u>13,126,313</u>	<u>14,281,638</u>
	<b>31.12.2014</b> ISK 000s	<b>31.12.2013</b> ISK 000s
Position at start of the year	2,302,439	2,113,522
Profit for the year	<u>349,217</u>	<u>188,917</u>
	<u>2,651,656</u>	<u>2,302,439</u>
Capital adequacy ratio	20.20%	16.12%

## 18. Guarantees provided

The Icelandic Regional Development Institute has entered into guarantees to the sum of ISK 19.796 million. At the end of the year an assessment was made of the risk of the Institute incurring liabilities as a result of guarantees. Guarantees to the sum of ISK 990,000 for which the Institute is likely to become liable have been entered as liabilities in the annual accounts. Off-balance-sheet guarantees thus amount to about ISK 18,807,000 at the end of the year.

## 19. Other matters

A case was heard before the District Court for the North of Iceland (West) in 2013 regarding the legality of the restructuring of index-linked loans in Icelandic krónur into loans in foreign currencies through the issue of an addendum. Judgement in this case was delivered on 29 November 2013, by which the legality of the Institute's loans restructured in this way was upheld and this judgement was not appealed to the Supreme Court. Hótel Mývatn ehf has filed a claim against the Institute regarding the legality of the same loans as were treated in the aforementioned case. A statement has been submitted to the District Court of the North of Iceland (West) and it is expected that the case will be dismissed or an acquittal entered.

A case is currently under process before the District Court of Reykjanes regarding the settlement of sales of appropriated assets but in this case the plaintiff's claims are minor.

## 20. Business with related parties

The directors of the Icelandic Regional Development Institute, its key officers and associated companies are designated as related parties, together with close family members of the above and legal entities under their control. No non-standard business took place with related parties during the year. No guarantees have been granted to related parties as a result of commercial debts or claims.

Loans provided to related parties at the end of the year amounted to ISK 811,790,000, of which ISK 30,829,000 were in arrears.

## 21. Changes to the comparative figures for the year 2013

The following changes were made to the comparative figures from the annual accounts for 2013. A correction was made on the profit and loss account to Other Treasury funding received and Subsidies granted towards the offset of transportation costs. Subsidy grants that the Icelandic Regional Development Institute is delegated to administer and disburse now go through the balance sheet. The comparative figures for the year 2013 in the annual accounts for 2014 differ as follows from the previously approved annual accounts for 2013:

Effect on profit and loss account

	<b>Accounts as approved</b> ISK 000s	<b>Correction</b> ISK 000s	<b>Corrected accounts</b> ISK 000s
Other Treasury funding received	175,973	(175,973)	0
Other operating income	37,528	6,199	43,727
Subsidies granted towards offset of transportation cost	169,775	(169,775)	0

## FUNDING GRANTS AND SUBSIDIES

### DISBURSEMENTS TO BUSINESS CONSULTANTS

	<b>Payment</b> ISK 000s
Samtök sveitarfélaga á Vesturlandi (Association of Local Authorities for the West of Iceland)	19,222
Fjórðungssamband Vestfirðinga (Federation of Westfjords Local Authorities)	38,244
Samtök sveitarfélaga á Norðurlandi vestra (Association of Local Authorities for the North of Iceland (West))	19,222
Atvinnuþróunarfélag Eyjafjarðar bs (Eyjafjörður Economic Development Agency bs)	16,019
Atvinnuþróunarfélag Þingeyinga hf (Northeast Iceland Development Agency hf)	13,015
Austurbrú (East of Iceland Bridge)	22,026
Samtök sunnlenskra sveitarfélaga (Association of Local Authorities for the South of Iceland)	24,028
Samband sveitarfélaga á Suðurnesjum	

(Federation of Local Authorities for Suðurnes)

20,624

---

**172,400**

---

## OTHERS

		<b>Payment</b> ISK 000s
Fuglarannsóknastöð á Raufarhöfn (Raufarhöfn Bird Research Centre)	Náttúrustofa Norðausturlands (NE Iceland Nature Research Centre)	2,300
Heimskautsgerði á Raufarhöfn (Arctic Henge at Raufarhöfn)	Heimskautsgerði á Raufarhöfn	650
Listahátíð í Reykjavík (Reykjavík Arts Festival)	Eyrarrósinn <i>Eyrarrós</i> award for culture in rural Iceland)	2,500
Rannsóknastöðin Rif (Research Innovation Fund Centre at Raufarhöfn)	foundation grant	1,500
		<hr/> <b>6,950</b> <hr/>