Byggðastofnun

The Icelandic Regional Development Institute

Annual Accounts 2017

Ártorg 1
550 Sauðárkrókur

ID ref.: 450679-0389

Contents

Independent Auditors' Report

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

Opinion

We have audited the accompanying annual accounts of Byggðastofnun, the Icelandic Regional Development Institute, for the year 2017. The annual accounts comprise a statement of the executive board and officers, a profit and loss account, a balance sheet, a cash-flow statement, and details of significant accounting procedures and other explanatory notes.

It is our opinion that the annual accounts give a true and fair picture of the Institute's performance in the year 2017, its financial position as at 31 December 2017, and its cash flows in the year 2017, in accordance with the Act on Annual Accounts, the Act on Financial Undertakings, and the Regulation on the Annual Accounts of Credit Institutions.

In accordance with the provisions of Article 104(2) of the Act on Annual Accounts, no. 3/2006, we certify that to the best of our knowledge the directors' statement that forms part of these annual accounts provides such information as must be provided therein under the Act on Annual Accounts and does not appear in the Notes.

Basis of opinion

The audit was carried out in accordance with international auditing standards. Our responsibility under these standards is set out more fully in the section on Auditors' Responsibility here below. We are external to the Icelandic Regional Development Institute in accordance with established ethical principles for auditors in Iceland and we have fulfilled their requirements. We believe that in the audit we have obtained sufficient and appropriate information to base our opinion upon.

Key features of the audit

The key features of the audit are those features which, in our professional judgement, have the greatest significance for our audit of the Institute's annual accounts for the year 2017. These features were scrutinised during the audit of the annual accounts and taken into account in determining an appropriate opinion of them. In our endorsement we express no particular opinion on each of them individually.

Key points

Valuation of loans issued and impairment

Loans issued to clients represent the largest single asset on the Institute's balance sheet. Loans issued as per the balance sheet amount to 10,464 billion Icelandic krónur (ISK) or 80% of the Institute's total assets at the end of the year 2017. The provision for losses on loans stood at ISK 990 billion at the end of 2017, or 8.65% of total loans issued. We refer to notes 2 and 14 in the Institute's annual accounts for details of the accounting procedure used in the valuation of impairment of loans. We consider the valuation of loans issued to be a key point in the audit on account of the size of the item on the balance sheet and because the valuation of impairment of loans is to a significant extent dependent on the judgement of the Institute's officers.

Auditors' responses to the audit

We have carried out an appraisal of the methods used by officers in the valuation, examined the principles applied in the valuation of loans, and tested the control procedures in the impairment process. A data audit was conducted on the impairment of loans issued and a sample selected where the probability of default and loan loss is greatest. The valuation of underlying guarantees was also gone over and they were verified and the basis for the officers' assumptions appraised. The Notes to the annual accounts were reviewed with a view to ensuring that the information found in them is in line with the underlying data.

Responsibility of the executive board and chief executive officer for the annual accounts

The executive board and 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 board and chief executive officer are also responsible for the internal control that is required as regards the preparation and presentation of the annual accounts, so that they may be free from material misstatement, whether due to fraud or error.

In the preparation of the annual accounts the board and chief executive officer are responsible for evaluating the Institute's status as a going concern. If applicable, the board and chief executive officer shall present relevant explanations of the Institute's capacity to act as a going concern and why it was decided to adopt the going-concern basis in the preparation and presentation of the annual accounts, unless the board and chief executive officer have decided to dissolve the Institute or cease trading, or have no viable options other than so to do.

The board and audit committee shall oversee the preparation and presentation of the annual accounts.

Auditors' responsibility in the auditing of the annual accounts

Our objective is to obtain sufficient certainty that the annual accounts are free from material misstatement, whether due to fraud or error, and to issue an endorsement that incorporates our opinion. Sufficient certainty represents a high degree of certainty but does not guarantee that an audit carried out in compliance with international auditing standards will identify all material inaccuracies if such are present. Inaccuracies can arise due to error or fraud and are considered to be material if they might influence the financial decision making of users of the annual accounts, either individually or collectively.

Our audit in accordance with international auditing standards is based on professional judgement and we apply professional scepticism throughout the audit. We also perform the following tasks:

- Identification and evaluation of the risk of material inaccuracy in the annual accounts, whether due to error or fraud; design and implementation of auditing procedures to respond to such risks; and acquisition of auditing data that is sufficient and appropriate to base our opinion upon. The danger of failure to identify material inaccuracy due to fraud is greater than that of failure to identify inaccuracy due to error, since fraud can subsume conspiracy, forgery, misleading presentation of annual accounts, and intentional omission or circumvention of internal control procedures.

- Obtaining an understanding of such internal control as applies to the audit with the purpose of designing appropriate auditing procedures but not with the purpose of providing an opinion on the effectiveness of the Institute's internal control.

- Assessment of the appropriateness of the accounting procedures used and related notes and of whether the officers' valuation for accounting purposes is realistic.

- Forming a judgement on the officers' application of the financial viability principle and assessing on the basis of the audit whether there is any significant question as to the Institute's status as a going concern or whether conditions exist that might give rise to significant doubts as to its viability as a going concern. If we believe that there is significant doubt as to the Institute's ability to act as a going concern we are obliged in our Report to draw particular attention to the relevant notes in the annual accounts. If such notes are incomplete or inadequate we must decline to give the accounts our unreserved endorsement. Our conclusion is based on the auditing data acquired up to the date of our endorsement. This notwithstanding, events or circumstances in the future may give rise to uncertainty as to the Institute's viability as a going concern.

- Assessment of whether, in their whole, the annual accounts provide a true and fair picture of the underlying business and events, and of their presentation, structure, and contents, including notes, as regards providing a true and fair picture.

We are under obligation to inform the executive board and audit committee *inter alia* of the proposed scope and date of the audit and of significant matters that arise during our audit, including, if applicable, material deficiencies in internal control that come to light during the audit.

We have also declared to the executive board and audit committee that we have met the requirements of the ethical principle of independence and have provided them with information on connections and other matters that could potentially affect our independence and, where appropriate, what preventative measures we employ to ensure our independence.

Of those matters of which we have informed the executive board and audit committee, we assessed which had the greatest significance for the audit in the current year and these constitute key points of the audit. We declare these matters in our Report unless their disclosure is forbidden by law or, in individual cases, where the auditor judges that the relevant matter should not be disclosed since the negative consequences of such disclosure are felt to outweigh public interest from the information.

Reykjavík, 16 March 2018

Endurskoðendathjónustan ehf

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

Hinrik Gunnarsson
State Authorised Public Accountant

Sveinn Reynisson
State Authorised Public Accountant

Statement of the Executive Board and Chief Executive Officer of the Icelandic Regional Development Institute

Functions

The Icelandic Regional Development Institute operates under the terms of the Icelandic Regional Development Institute Act, no. 106/1999, and Regulation no. 347/2000. The function of the Institute is to promote regional settlement and economic activity, with particular emphasis on the creation of equal opportunities to employment and settlement for all people in Iceland. In accordance with its function the Institute prepares, organises and funds projects and provides loans with the aim of supporting regional settlement, creating employment and encouraging business innovation. The financing of projects shall, where appropriate, be in collaboration with others. The Institute organises and contributes to consultancy services in collaboration with economic development agencies, local authorities, and other interested parties. The Institute monitors regional development trends in Iceland, through among other means data collection and research. The Institute may draw up or have drawn up plans for regional development and economic activity with the aim of supporting settlement and employment in the country's non-metropolitan regions.

Performance in the year 2017

According to the profit and loss account, the Institute's operating profit in the year 2017 was ISK 99.6 million; for comparison, the profit in the year 2016 was ISK 157.1 million. Capital and reserves at the end of the year as per the balance sheet stood at ISK 3,007.3 million. The capital adequacy ratio under the terms of the Act on Financial Undertakings was 23.57%, as compared to 22.74% at the end of the 2016.

According to Article 84 of Act no. 161/2002 on Financial Undertakings, the capital base may not at any time be in total less than 8% of the risk-weighted asset base; as noted above, at the end of the year the Institute's capital adequacy rate stood at 23.57%. In accordance with its authorities under Article 86.d (1 and 2) of the Act on Financial Undertakings, the Financial Supervisory Authority has set a countercyclical capital buffer for the Institute, together with a capital conservation buffer as per Article 86.e of the same Act. The aggregate capital buffer requirement at the end of the year was 3.0% but increased to 3.75% on 1 January 2018.

The Institute's balance sheet at the end of the year 2017 stood at ISK 13,133 million, down by ISK 1,007 million on the previous year. The largest individual item on the asset side of the balance sheet is loans issued to clients, amounting to ISK 10,464 million, an increase of ISK 784 million on the previous year. Cash in hand at the end of the year stood at ISK 1,090 million, as compared to ISK 2,758 million at the end of 2016. Because of the Institute's strong liquidity position no new loans were taken out or bonds issued during the year 2017. Borrowings amounted to ISK 9,920 million, a fall of ISK 1,084 million. New loans issued in the year 2017 came to ISK 2,165 million, as against ISK 1,943 million in the previous year.

Governance

Regional affairs, including the Icelandic Regional Development Institute, fall under the Ministry for Transport and Local Government.

As laid down in Article 3 of the Icelandic Regional Development Institute Act, at the annual general meeting the Minister shall appoint seven persons to the Institute's executive board for one year at a time and seven persons to act as deputies. The Minister shall appoint a chairman and deputy chairman and decide the directors' remuneration. The duties of the executive board are specified more fully in Article 4 of the same Act. The executive board has established rules for its working functions and these were last reviewed in February 2018.

At the Institute's annual general meeting on 25 April 2017, the Minister for Transport and Local Government appointed a new executive board which shall sit up until the next annual general meeting and in no case longer than up to 1 July 2018. Those appointed to the executive board were Illugi Gunnarsson chairman, Rakel Óskarsdóttir deputy chairman, Einar E. Einarsson, Ingunn Guðmundsdóttir, Karl Björnsson, Róbert Guðfinnsson and Sigríður Jóhannesdóttir. On 2 June 2017 Róbert Guðfinnsson resigned from the board and was replaced by his deputy, Sigríður Guðrún Hauksdóttir. Sigríður resigned from the board on 30 August 2017 and Gunnar Thorgeirsson was appointed in her place, with Ásthildur Sturludóttir as his deputy. The Financial Supervisory Authority assesses the competence of board members in accordance with Article 52 of the Act on Financial Undertakings. The board held 11 board meetings during the year 2017.

The board of the Icelandic Regional Development Institute seeks to maintain good governance practices and has set itself rules covering the board's working functions as well as ethical rules for staff and officers. Working procedures have also been established for the audit committee, and the executive board has defined the functions of the compliance officer. Operating within the Institute there is a loans committee which discusses all loan applications and the sale of appropriated assets, as well as making proposals to the board on the sale of shares and the treatment of loan issues beyond its maximum credit authority. The Institute also operates a risk committee, a default committee, and a security committee for which rules of procedure have been established. Operational procedures on loan granting activities and financial and asset management have been updated regularly and specify, among other things, the authorisational powers of the loans committee.

The audit committee operates under mandate from the executive board and has a statutory supervisory role over the board's auditing functions. The audit committee shall assist the board in discharging its duties by operating as an independent and impartial party monitoring the Institute's accounting process and its internal control, as well as the work of the Institute's internal and external auditors as further specified in its working procedures and in accordance with Article 108.b of Act no. 3/2006 on Annual Accounts. The executive board is responsible for the appointment of the audit committee and the committee answers directly to the board. It comprises three members, to be appointed not later than one month after the annual general meeting. The committee members shall be independent of the Institute's auditor or auditors, and a majority of the committee members shall also be independent of the Icelandic Regional Development Institute.

Under Article 3 of Act no. 46/2016 on the Auditor General and the Auditing of Government Accounts, responsibility for the auditing of the Institute's accounts lies with the Icelandic National Audit Office (Ríkisendurskoðun). The National Audit Office has appointed Endurskoðendathjónustan ehf to act on its behalf in the auditing of the Icelandic Regional Development Institute's accounts for the operating years 2013-2017.

The Icelandic Regional Development Institute is exempted from operating an internal audit department as per a ruling of the Financial Supervisory Authority from 2012. In 2016, following a tendering process, the Institute entered into a contract with KPMG to see to internal auditing for the years 2016-2020.

The Minister appoints a chief executive office for a period of five years on receipt of the board's recommendation. The functions of the chief executive officer are specified more fully in Article 5 of the Icelandic Regional Development Institute Act.

The executive board appoints a compliance officer by letter of mandate. The compliance officer shall appear before the executive board once a year and present a report on those issues that fall within his remit.

The Institute is divided into four divisions – companies division, legal division, operations division and development division. There were 26 members of staff at the end of the year, the same in full-day equivalents.

Risk management

In accordance with a ruling of the Financial Supervisory Authority from 2015, the Icelandic Regional Development Institute is exempt from the requirement to operate a risk committee as per Article 78(5) of the Act on Financial Undertakings. As a result of this exemption the prescribed duties of a risk committee lie with the Institute's executive board.

The Institute has appointed a special supervisor of risk management and in January 2017 the board agreed rules covering the supervisor of risk management in line with Article 17 of Act no. 161/2002 on Financial Undertakings. The supervisor of risk management has direct and firsthand access to the Institute's executive board.

The executive board of the Icelandic Regional Development Institute is responsible for the Institute's risk management. The board originally approved a risk policy for the Institute in 2015 and this is reviewed annually, most recently in January 2018. The Institute is under legal obligation to maintain the real value of its capital and reserves and thus has little risk appetite. The Institute's executive board determines the acceptable level of risk. The board receives information on the Institute's exposure to risk and the performance of it risk management system four times a year.

Risk management and effective internal control is one of the central pillars of the Institute's responsible management. The Institute has defined the principal risk factors in its operations, these being 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 control and most processes have been logged. These processes and risk factors are assessed regularly. Assessments have shown that the designated monitoring procedures are operating effectively.

Financing

Because of the Institute's strong liquidity position no new loans were taken out in the year to fund the Institute's lending activities. At the beginning of 2018 a new tranche of bonds was issued and listed on the Icelandic Stock Exchange. The bonds are for 15 years and carry an interest rate of 2.34%.

In July 2017 the rating agency Reitun ehf issued a credit rating for the Icelandic Regional Development Institute for the second time. The Institute was assigned a rating of i.AAA with stable outlook, i.AAA being the highest rating awarded by Reitun and unchanged from the previous assessment. Reitun's rating system is modelled on domestic ratings rather than international, hence the i. appended before the letters. The Icelandic National Treasury Ríkissjóður is given a reference rating of i.AAA for purposes of comparison, this being the highest possible, and other issuers are assessed on the basis of this rating. Reitun classes ratings from i.AAA to i.BBB3 as investable assets.

Events since the end of the accounting period

At the start of January 2018 the Icelandic Regional Development Institute issued a ISK 2 billion index-linked tranche of bonds which is listed on the Icelandic Stock Exchange. The bonds are for 15 years, with an interest rate of 2.34%.

The Icelandic Regional Development Institute aims to issue a call for tenders in the spring of 2018 for the construction of new office premises for the Institute at Sauðárkrókur. It was originally projected that it would be possible to launch the call for bids for the project in November 2017 but this was delayed for various reasons.

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 have increased and the outlook is for a continuing increase in lending during the year.

Declaration of the executive board and chief executive officer

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

To the best of our knowledge it is our opinion that the annual accounts give a true and fair picture of the Institute's performance in the year 2017, its assets, liabilities and financial position at 31 December 2017, and its cash flows in the year 2017.

The directors of the Icelandic Regional Development Institute and its chief executive officer append herewith their signatures in certification of the Institute's annual accounts for the year 2017.

It is further our opinion that the annual accounts and report of the executive board and chief executive officer present a true and fair overview of the development and outcomes of the Institute's operations, its position, and the principal risk factors and areas of uncertainty to which the Institute is exposed.

Sauðárkŕokur, 16 March 2018

Illugi Gunnarsson, Chairman of the Executive Board

Einar E. Einarsson

Ingunn Guðmundsdóttir

Rakel Óskarsdóttir

Aðalsteinn Thorsteinsson
Chief Executive Officer

Gunnar Thorgeirsson

Karl Björnsson

Sigríður Jóhannesdóttir

Profit and Loss Account 2017

	Notes	2017 ISK 000s	2016 ISK 000s
Interest Earned			
Interest on deposits with credit institutions		63,128	37,602
Interest earned and indexation adjustment on loans issued		791,978	768,286
		855,106	805,887
Interest Expenses			
Interest expenses and indexation adjustment on borrowings		428,538	375,038
Other interest expenses		290	292
		428,828	375,330
Net interest earned		426,278	430,558
Operating Income			
Funding received from Treasury under Budget provisions	6	364,600	349,900
Foreign exchange adjustment	7	(26,241)	31,282
Other operating income	8	211,229	128,198
		549,588	509,380
Net operating income		975,866	939,937
Operating Expenses			
Disbursements to business consultants		198,500	190,500
Other grants awarded		109,744	68,505
Salaries and salary-related expenses	3, 4	312,602	294,725
Other operating costs		133,678	133,455
Management of appropriated assets	12	4,676	5,215
Depreciation of fixed operating assets	16	5,856	7,236
Additions to provision for losses on loans issued, etc.	2, 14	111,179	83,184
		876,235	782,821
Profit for the year		99,631	157,116

Balance Sheet, 31 December 2017

	Notes	2017 ISK 000s	2016 ISK 000s
Assets			
Bank deposits	9	1,089,861	2,757,542
Loans issued to clients	10	10,463,653	9,679,575
Appropriated assets	11, 13	340,510	445,552
Tradable shares	15	594,926	683,414
Shares in affiliated companies	15	576,288	499,258
Debtors		14,147	18,689
Fixed operating assets	16	53,858	56,194
Assets: total		13,133,244	14,140,223
Liabilities and Capital and Reserves			
Borrowings and securities issued	18	9,920,045	11,003,741
Unallocated funds received		130,852	141,783
Other liabilities		75,053	87,037
Liabilities: total		10,125,951	11,232,561
Capital and reserves			
Capital and reserves	2, 19	3,007,293	2,907,663
Liabilities and capital and reserves: total		13,133,244	14,140,223

Cash-Flow Statement 2017

	2017 ISK 000s	2016 ISK 000s
Cash flow from operating activities		
Profit for the year	99,631	157,116
Operating items that do not affect cash in hand:		
Additions to provision for losses on loans and revaluation of shares	96,607	72,911
Depreciation of operating assets	5,856	7,236
Profit on sale of fixed operating assets	(20,141)	(3,730)
Loss (profit) on shares	(55)	0
Profit on sale of appropriated assets	0	(6,198)
Interest, indexation adjustment and exchange rate adjustment	108,177	14,433
Cash flow from operating activities	290,075	241,768
Cash flow from investment activities		
Instalment payments on loans issued	1,435,757	1,196,164
Loans issued	(2,188,922)	(1,943,933)
Assets redeemed	(12,386)	5,788
Shares	(21,232)	979
Fixed operating assets	16,620	(4,316)
Debtors	4,542	6,438
Cash flow from investment activities	(765,620)	(738,880)
Cash flow from financing activities		
Instalment payments on borrowings	(1,169,221)	(1,884,572)
New borrowings	0	2,000,000
Creditors	(22,914)	57,994
Cash flow from financing activities	(1,192,136)	173,422
Decrease in cash in hand	(1,667,681)	(323,690)
Cash in hand at start of year	2,757,542	3,081,232
Cash in hand at end of year	1,089,861	2,757,542

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 Institute's legal domicile is Ártorg 1, 550 Sauðárkrókur, Iceland.

2. Accounting principles

Basis of preparation of accounts

The annual accounts have been drawn up in compliance with the Act on Annual Accounts and the Regulation on the Financial Statements of Credit Institutions. They are prepared on a historical-cost basis and employ 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 stated.

Valuation methods

Officers are required to assess and take specific 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 according to 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 exchange rates and price levels are reflected in the annual accounts. Index-linked assets and liabilities are entered based on price indices that took effect on 1 January 2018. Loans issued and loans taken out in foreign currencies are converted to ISK at the last listed selling rate at the Central Bank of Iceland at the end of the year. Deposits in foreign currency accounts at Icelandic commercial banks are converted to ISK at the last listed buying rate of the relevant 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 period:	**31.12.2017**	**31.12.2016**
USD	104.67	113.09
DKK	16.84	16.07
JPY	0.93	0.97
EUR	125.40	119.46
Arion Bank exchange rate at end of the period:		
EUR	123.88	118.74
Landsbanki exchange rate at end of period:		
EUR	123.87	118.83

Íslandsbanki exchange rate at end of period:		
USD	103.08	112.53
JPY	0.91	0.96
EUR	123.84	118.81
Price indices at start of period:	**1.1.2018**	**1.1.2017**
Consumer prices index for purposes of price indexation	446.0	438.4

Operating assets

Fixed operating assets are entered at acquisition cost less depreciation. Improvements and enhancements are capitalised if it is likely 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 charged 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.

Provision for losses on loans

A provision for losses on loans issued is set up to cover the exposure that is inherent in lending activities but does not imply that assets are irrevocably written off. Additions to the provision for losses on loans are charged to the profit and loss account, reduced by any repayments on account of loans previously written off.

Holdings in companies

Affiliated companies are companies in which the Institute typically holds a 20-50% stake. The Institute's interests in affiliated 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. Holdings in other companies are entered at purchase cost less impairment. Revaluations are reflected on the profit and loss account and the balance sheet.

Appropriated assets

Appropriated assets are entered at their estimated sale value. Revaluations are reflected 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 valued at fair value, i.e. the amount of the loan inclusive of all transaction costs. Loans issued are 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 committed itself to the transaction. Accrued interest and indexation adjustments 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 the adjustment arising from changes in exchange rates under the item 'Foreign exchange adjustment'. Depreciation is based on an assessment of the risk of loss with respect to individual loans. Irrecoverable loans are written out of the Institute's books.

Debtors

Claims against debtors are entered according to the original transaction price, adjusted to cover movements in foreign exchange rates and less a writing-down allowance made to cover doubtful accounts receivable. The writing-down allowance is based on an assessment of the risk of loss with respect to each debtor. Irrecoverable claims are written out of the Institute's books.

Cash in hand

Deposits held at banks are included under 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 to 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 salary-related expenses

	2017	**2016**
	ISK 000s	ISK 000s
Salaries	248,258	238,886
Pension contributions	39,908	31,868
Social security contributions	19,528	19,434
Accrued holiday pay in the year	(77)	143
Other salary-related expenses	4,983	4,395
Salaries and salary-related expenses: total	312,602	294,725

The Institute had an average workforce of 25 in the year on a full-year basis. On 31 December 2016 there were 26 members of staff on the Institute's payroll, representing 26 full-day equivalents.

4. Remuneration of directors and chief executive officer

Salaries paid to the Institute's directors and chief executive officer break down as follows:

	2017	**2016**
	ISK 000s	ISK 000s
Illugi Gunnarsson, chairman of the board from 25.04.2017	2,005	0
Herdís Á Sæmundardóttir, chairman of the board to 25.04.2017	1,201	2.359
Anna Guðrún Björnsdóttir (deputy)	62	0
Einar E. Einarsson	2,037	1,531
Gunnar Thór Sigbjörnsson, director to 04.01.2017	75	272
Gunnar Thorgeirsson, director from 06.10.2017	352	0

Ingunn Guðmundsdóttir, director from 25.04.2017	994	0
Karl Björnsson	1,590	1,166
Lilja Sigurðardóttir, director to 25.04.2017	497	0
Oddný María Gunnarsdóttir, director to 25.04.2017	658	1,166
Páll Baldursson	0	769
Rakel Óskarsdóttir, deputy chairman from 25.04.2017	994	0
Róbert Guðfinnsson, director 25.04-03.06.2017	135	0
Sigríður Guðrún Hauksdóttir (deputy)	361	0
Sigríður Jóhannesdóttir	1,590	1,166
Sveinn Auðunn Sæland (deputy)	62	0
Valdímar Haftsteinsson, director to 25.04.2017	596	1,166
Aðalsteinn Thorsteinsson, chief executive officer	16,848	16,350
Remuneration of directors and chief executive officer: total	30,055	25,945

5. Auditors' fees

Auditors' fees break down as follows:

	2017 ISK 000s	2016 ISK 000s
Audit of annual accounts and review of interim financial statement	6,639	6,678
Other professional services/internal audit	3,404	2,360
Auditors' fees: total	10,043	9,039

6. Treasury funding as per Budget provisions and other receipts from the Treasury

	2017 ISK 000s	2016 ISK 000s
General operations	166,100	159,400
Business consultants in non-metropolitan regions	198,500	190,500
Treasury funding as per Budget	364,600	349,900

	2017 ISK 000s	2016 ISK 000s
Treasury grant to project *Brothættar byggðir* ('Fragile communities')	100,000	100,000
Treasury grant to Byggðarannsóknasjóður ('Rural Regions Research Fund')	7,000	7,000
Other Treasury funding: total	107,000	107,000

Grants made out of Treasury funding reflected on the balance sheet:

	2017	**2016**
	ISK 000s	ISK 000s
Grant to Byggðarannsóknasjóður ('Rural Regions Research Fund')	14,950	5,650
Grants to *Sóknaráætlun Landshluta* campaign ('Moving Iceland Forward: Regional Development')	0	21,071
Grants awarded: total	14,950	26,721

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 119,951,000 in the year and are entered on the profit and loss account. Income amounted to ISK 121,356,000 and is entered within Other operating income.

7. Foreign exchange adjustment

	2017	**2016**
	ISK 000s	ISK 000s
Foreign exchange adjustment on loans issued	(33,644)	(665,278)
Foreign exchange adjustment on borrowings	7,402	696,559
	(26,241)	31,282

8. Other operating income

	2017	**2016**
	ISK 000s	ISK 000s
Various outlays repaid	159,272	91,385
Dividend income and profit on sale of shares	23,780	15,432
Income and profit on sale of operating assets	23,782	6,977
Collection income	2,272	1,749
Profit on sale of appropriated assets	0	6,198
Other	2,122	6,457
	211,229	128,198

9. Reserves and balances with credit institutions

	31.12.2017	**31.12.2016**
	ISK 000s	ISK 000s
Bank deposits in Icelandic krónur	559,262	2,097,967
Bank deposits in foreign currencies	530,599	659,575
Reserves and balances with credit institutions: total	1,089,861	2,757,542

10. Loans issued to clients

Broken down by currency:	31.12.2017	31.12.2016
	ISK 000s	ISK 000s
Loans in Icelandic krónur	7,889,576	7,045,297
Loans in foreign currencies	2,564,077	2,634,278
	10,463,652	9,679,575

Broken down by borrowers:	31.12.2017	31.12.2016
Local authorities	0.00%	0.29%
Private individuals	23.71%	20,26%
Broken down by industrial sector:		
Services	39.87%	38.56%
Fisheries	18.91%	19.96%
Industry	9.00%	12.13%
Agriculture	8.51%	8.79%
Financial institutions	0.01%	0.01%
	100%	100%

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

	31.12.2017	31.12.2016
	ISK 000s	ISK 000s
Claims fallen due	103,268	153,114
Up to 3 months	149,191	372,260
3 months to 1 year	753,746	624,665
1 year to 5 years	3,202,051	2,899,512
Over 5 years	6,255,398	5,630,024
	10,463,653	9,679,575

11. Appropriated assets

	31.12.2017	31.12.2016
	ISK 000s	ISK 000s
Real estate	340,510	437,552
Boats	0	8,000
	340,510	445,552

12. Management of appropriated assets

	2017 ISK 000s	2016 ISK 000s
Rental income	30,837	39,342
Management costs	(35,514)	(44,557)
	(4,676)	(5,215)

13. Appropriated assets

	Rateable value ISK 000s	Size m^2
Eyrarland 1, Hvammstangi	8,480	159.2
Grænigarður, Ísafjörður	64,241	1,366.7
Langanesvegur 2, Thórshöfn	9,770	170.7
Nesbraut 7, Reyðarfjörður	34,750	722.4
Pálsbergsgata 3 & 5, Ólafsfjörður	35,970	1,851.4
Sandhorn, Hrísey	21,650	832.7
Sólvellir 23, Breiðdalsvík	76,864	2,081.6
Strandarvegur 29-33, 29R, Seyðisfjörður	11,250	601.0
Strandgata 37, Tálknafjörður	11,530	456.1
Valgerðarstaðir 4, Fljótsdalshérað	114,500	5,148.3
Vatneyri machine workshop, Patreksfjörður	11,073	736.1
	400,078	14,126.2

Appropriated assets are entered in the annual accounts at a value of ISK 340,510,000.

14. Provision for losses on loans

The item 'Additions to provision for losses on loans issued etc.' on the profit and loss account covers additions to the depreciation allowance for loans issued and accounts receivable, plus the revaluation of share capital and appropriated assets. The provision for losses on loans is split between a special depreciation provision and a general depreciation provision. Under the special depreciation provision for loans issued fall borrowers with arrears of over 3 months plus those who are adjudged to be poor risks.

The provision for losses on loans breaks down as follows:

Provision for losses on loans	**Special deprecation provision** ISK 000s	**General depreciation provision** ISK 000s	**Total** ISK 000s
Position at 1 January	677,556	656,826	1,334,382
Additions in the period	(19,486)	82,068	62,582
Loans written off	(406,554)		(406,554)
Position at 31 December	251,516	738,894	990,409
Provision for losses on loans in proportion to total loans issued	2.20%	6.45%	8.65%

	2017 ISK 000s	**2016** ISK 000s
Addition in the period	61,392	248,568
Addition to cover accounts receivable	2,174	(1,887)
Revaluation of appropriated assets	14,868	72,650
Change in value of holdings in affiliated companies	(6,984)	(91,541)
Change in value of other shareholdings	39,674	(144,606)
Recovery of loans previously written off	55	0
Additions to provision for losses on loans as per profit and loss account	111,179	83,184

15. Shareholdings

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

Affiliated companies, participating interest > 20%	**Share of ownership**	**Nominal value** ISK 000s
Atvinnuthróunarfélag Vestfjarða hf	22.38%	1,933
Ámundakinn ehf	21.59%	43,815
Dýralíf ehf	33.81%	4,000
Eignarhaldsfélag Suðurlands hf	40.00%	109,142
Fasteignafélagið Hvammur ehf	24.85%	16,919
Fasteignafélagið Kirkjuból ehf	30.00%	7,124
Fjallalamb hf	21.26%	27,344
Fjárfestingafélagið Vör hf	41.95%	35,940
Hvetjandi ehf	40.16%	111,529
Molta ehf	30.00%	50,000
Nes-Listamiðstöð ehf	35.71%	5,000
Raflagnir Austurlands ehf	22.37%	3,600

Ullarvinnsla Frú Láru ehf	29.76%	2,500
Útgerðarfélagið Skúli ehf	30.00%	24,274
Vilko ehf	21.99%	21,555
Thörungaverksmiðjan hf	27.67%	7,919
Affiliated companies: total nominal value		472,595

Tradable securities, ownership share ≤ 20%	**Share of ownership**	**Nominal value** ISK 000s
Ásgarður hf	13.78%	15,000
Borg, saumastofa ehf	19.82%	170
Eðalís ehf	11.06%	3,000
Eignarhaldsfélag Suðurnesja hf	19.03%	96,840
Fánasmiðjan ehf	9.95%	4,167
Fiskvinnslan Drangur ehf	4.08%	1,000
Grand Hótel Mývatn ehf	7.22%	10,000
Hótel Flúðir hf	4.77%	1,194
Hótel Húsavík ehf	0.38%	136
Hótel Varmahlíð hf	13.04%	3,000
Hvalamiðstöðin Húsavík ehf	19.70%	2,000
Hæðin á Höfðabraut ehf	12.28%	2,000
P/F Smyril-line (DKK 1,868,000)	1.67%	31,473
Samkaup hf	2.77%	10,801
Snorri Thorfinnsson ehf	19.89%	12,000
Tröllasteinn ehf	19.72%	7,000
Urtusteinn ehf	8.45%	32,818
Yrkjar ehf	7.29%	1,800
Thórsberg ehf	16.69%	30,191
Tradable securities: total nominal value		264,589
Shareholdings: total nominal value		737,184

Shares in affiliated companies are entered in the annual accounts at a value of ISK 576,288,000. Tradable securities are entered at a value of ISK 594,926,000. The value of shares acquired in connection with financial reorganisation amounts to ISK 531,940,000.

16. Operating assets

Fixed operating assets break down as follows:

	Land & buildings ISK 000s	Motor vehicles ISK 000s	Software ISK 000s	Total ISK 000s
Base value at 1/1	70,388	30,876	7,216	108,481
Total depreciation to 1/1	(34,374)	(15,026)	(2,887)	(52,287)
Book value at 1/1	36,014	15,850	4,330	56,194
Additions in the year	25,956	5,073	0	31,030
Written off in the year	(329)	(4,083)	(1,443)	(5,856)
Sold in the year	(45,000)	(2,650)	0	(47,650)
Profit (loss) on sales	20,190	(50)	0	20,141
Book value at 31/12	36,832	14,140	2,887	53,858
Total base value at 31/12	71,535	33,250	7,216	112,001
Total depreciation to 31/12	(34,703)	(19,110)	(4,330)	(58,143)
Book value at 31/12	36,832	14,140	2,887	53,858
Depreciation ratios	2%	20%	20%	

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

	Rateable value ISK 000s	Insurance valuation ISK 000s	Book value ISK 000s
Sauðármýri 2, Sauðárkrókur	6,800	0	25,956
Háahlíð 4, Sauðárkrókur	41,200	68,700	10,876
	48,000	68.700	36,832

17. Assets and liabilities linked to foreign currencies and subject to price indexation

	31.12.2017 ISK 000s	31.12.2016 ISK 000s
Foreign:		
Assets in foreign currencies	3,094,676	3,293,854
Liabilities in foreign currencies	(3,265,843)	(4,084,953)
Net balance of foreign assets and liabilities	(171,167)	(791,100)

Index-linked:		
Index-linked assets	6,926,235	6,200,189
Index-linked liabilities	(6,654,203)	(6,918,788)
Net balance of index-linked assets and liabilities	272,032	(718,599)

Figures are given with depreciation of assets factored in.

Foreign assets and liabilities break down as follows by currency:

31.12.2017	**USD** ISK 000s	**JPY** ISK 000s	**EUR** ISK 000s	**Total** ISK 000s
Loans issued	274,625	690,518	1,598,934	2,564,077
Cash in hand	363,081	0	167,518	530,599
Assets: total	637,706	690,518	1,766,451	3,094,676
Borrowings	689,885	708,377	1,867,580	3,265,843
Net position	(52,179)	(17,859)	(101,129)	(171,167)

31.12.2016	**USD** ISK 000s	**JPY** ISK 000s	**EUR** ISK 000s	**Total** ISK 000s
Loans issued	216,210	975,942	1,442,127	2,634,279
Cash in hand	401,581	1	257,993	659,575
Assets: total	617,791	975,943	1,700,120	3,293,854
Borrowings	914,887	1,008,054	2,162,012	4,084,953
Net position	(297,097)	(32,111)	(461,892)	(791,100)

Figures are given with depreciation of assets factored in.

18. Borrowings

Breakdown by type:

	31.12.2017 ISK 000s	**31.12.2016** ISK 000s
Index-linked securities issued	6,654,203	6,918,788
Foreign loans taken out	3,265,843	4,084,953
	9,920,045	11,003,741

Borrowings break down as follows by period outstanding:

	31.12.2017	31.12.2016
	ISK 000s	ISK 000s
Fallen due	0	0
Up to 3 months	83,600	121,047
3 months to 1 year	989,889	1,388,621
1 year to 5 years	3,959,886	3,964,924
Over 5 years	4,886,671	5,529,150
	9,920,045	11,003,741

Borrowings break down as follows by currency:

	Terms of payment	Final maturity	Interest terms	31.12.2017	31.12.2016
				ISK 000s	ISK 000s
ISK	Equal payments	2030-2034	3.08-5.0% index-linked	6,654,203	6,918,788
USD	Equal instalments	2025	Libor + 1.5%	689,885	914,887
JPY	Equal instalments	2023	Libor + 1.5%	708,377	1,008,054
EUR	Equal instalments	2021-2025	Euribor + 0.2-1.45%	1,867,580	2,162,012
				9,920,045	11,003,741

19. Capital and 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 period the Institute's capital adequacy ratio was 23.57%. Under Article 84.d (1 and 2) of Act no. 161/2002 on Financial Undertakings, the Financial Supervisory Authority has authority to stipulate a countercyclical capital buffer of 0-2.5% of the risk-weighted asset base. Under Article 84.e (1) of the same Act, financing institutions are required to maintain a capital conservation buffer of 2.5%. According to a letter from the Financial Supervisory Authority, dated 1 November 2016, a capital conservation buffer of 1% is required from the date of the letter. The capital conservation buffer was increased to 1.75% on 1 January 2017 and to this was added a countercyclical capital buffer of 1% on 1 March 2017. In line with a summary issued by the Financial Supervisory Authority, the aggregate capital buffer requirement became 3.75% on 1 January 2018.

Capital and reserves and capital adequacy ratio as per the own funds requirements under Act no. 161/2002 on Financial Undertakings.

	31.12.2017	**31.12.2016**
	ISK 000s	ISK 000s
Tier I capital	3,007,294	2,907,663
Total	3,007,294	2,907,663
Credit risk	10,863,699	10,350,188
Market risk	171,098	791,100
Operational risk	1,722,321	1,642,638
Risk-weighted asset base	12,757,119	12,783,925
Position at start of the year	2,907,663	2,750,547
Profit for the year	99,631	157,116
	3,007,294	2,907,663
Capital adequacy ratio	23.57%	22.74%

20. Guarantees and commitments

The Icelandic Regional Development Institute did not act as guarantor for any loans with respect to third parties as at 31 December 2017. At the end of the year there were 79 loan commitments to the sum of ISK 3,423 million pending completion. Under the rules of the Icelandic Regional Development Institute, loan commitments lapse after 12 months from the date on which they are approved.

22. Related-party transactions

The directors of the Icelandic Regional Development Institute, its key officers and affiliated companies, together with close family members of the above and legal entities under their control, are defined as related parties. No unusual transactions took place with related parties during the period. No guarantees have been granted to related parties on account of commercial debts or claims.

Loans provided to related parties at the end of the year stood at ISK 320,136,000, of which ISK 7,445,000 were in arrears.