

Orkuveita Reykjavíkur  
Consolidated  
Financial Statements 2010

Orkuveita Reykjavíkur  
Bæjarhálsi 1  
110 Reykjavík

reg no. 551298-3029

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## Endorsement by the Board of Directors

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Orkuveita Reykjavíkur is a partnership that complies with the Icelandic law No.139/2001 on the founding of the partnership Orkuveita Reykjavíkur. The Company is an independent service company that produces and distributes electricity and distributes geothermal water for heating and cold water for consumption. It also operates sewage systems and fibre-optic cable system in its service area.

The financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union. The financial statements comprise the consolidated financial statements of Orkuveita Reykjavíkur and subsidiaries.

Profit of the operations of Orkuveita Reykjavíkur during the year amounted to ISK 13.729 million. According to the statement of financial position the Company's assets amount to ISK 286.540 million, book value of equity at the end of the year amounted to ISK 52.847 million and the Company's equity ratio is 18.4%

At the beginning of the year and at the end of the period the Company's shareholders were the following three

	Share
Reykjavíkurborg .....	93.539%
Akraneskaupstaður .....	5.528%
Borgarbyggð .....	0.933%

The Company's Board of Directors do not propose dividend payments to the Company's shareholders in the year 2011 due to the operating year 2010.

In cooperation and in an agreement with the owners of Orkuveita Reykjavíkur, the Company's operations has been significantly strengthened with their financial involvement in the form of a subordinated loan amounting to ISK 12 billion, as well as further curtailing, delaying of new investment and maintenance investment as possible in the utilities systems. See further coverage regarding this matter in note number 29 about events after the balance sheet date.

### Statement by the Board of Directors

According to the best knowledge of the Board of Directors of Orkuveita Reykjavíkur, the company's consolidated financial statements are in accordance with International Financial Reporting Standards as adopted by the EU. It is the opinion of the Board of Directors that the consolidated financial statements give a fair view of the Company's assets, liabilities and financial position at 31 December 2010 and the company's operating return and changes in cash and cash equivalents for the year then ended.

It is the opinion of the Board of Directors that the consolidated financial statements give a fair view of the Company's operating development and results, its standing and describe the main risk factors and uncertainties faced by the Company.

The Board of Directors of Orkuveita Reykjavíkur hereby confirm the Company's consolidated financial statements for the year 2010.

Reykjavík, 29 March 2011.

The Board of Directors:  
*Haraldur Flosi Tryggvason*  
*Aðalsteinn Leifsson*  
*Brynhildur Davíðsdóttir*  
*Kjartan Magnússon*  
*Hrönn Ríkharðsdóttir*  
*Sóley Tómasdóttir*

# Independent Auditor's Report

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To the Board of Directors and owners of Orkuveita Reykjavíkur.

We have audited the accompanying financial statements of Orkuveita Reykjavíkur, which comprise the statement of financial position as at December 31, 2010, the income statement, the statement of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

## 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, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

## Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from 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 judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

## Opinion

In our opinion, the financial statements give a true and fair view of the financial position of Orkuveita Reykjavíkur as at December 31, 2010, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

## Report on the Board of Directors report

Pursuant to the legal requirement under Article 106, Paragraph 1, Item 5 of the Icelandic Financial Statement Act No. 3/2006, we confirm that, to the best of our knowledge, the report of the Board of Directors accompanying the financial statements includes the information required by the Financial Statement Act if not disclosed elsewhere in the Financial Statements.

Reykjavík, 29 March 2011.

## **KPMG ehf.**

*Hlynur Sigurðsson*

*Auðunn Guðjónsson*

# Income Statement 2010

	Notes	2010	2009
Operating revenue .....		27.915.590	26.012.828
Energy purchase .....		( 4.938.923)	( 4.695.112)
Salaries and salary related expenses .....	7	( 4.151.180)	( 3.889.190)
Other operating expenses .....		( 4.874.365)	( 4.458.125)
Depreciation and amortisation .....	8	( 7.962.448)	( 7.813.770)
Results from operating activities		5.988.675	5.156.631
Interest income .....		149.941	337.191
Interest expenses .....		( 4.030.068)	( 5.711.572)
Other (expenses) income on financial assets and liabilities .....		14.632.717	( 3.468.316)
Total financial income and expenses	9	10.752.590	( 8.842.697)
Share in profit (loss) of associated companies .....	13	24.308	( 227.685)
Profit (loss) before income tax		16.765.572	( 3.913.751)
Income tax .....	10	( 3.036.786)	1.398.122
<b>Profit (loss) for the year</b>		<b>13.728.786</b>	<b>( 2.515.629)</b>
<b>Attributable to:</b>			
Equity holders of the Company .....		13.728.669	( 2.538.839)
Minority interest in subsidiaries .....		117	23.210
<b>Profit (loss) for the year</b>		<b>13.728.786</b>	<b>( 2.515.629)</b>

The notes on pages 12 to 52 are an integral part of these Consolidated Financial Statements.

# Statement of Comprehensive Income for the year ended 31 December 2010

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	<b>2010</b>	<b>2009</b>
Profit (loss) for the year .....	<u>13.728.786</u>	<u>( 2.515.629)</u>
<b>Other comprehensive income</b>		
Effect of change in tax rate on the revaluation reserve .....	( 1.534.410)	( 4.383.466)
Revaluation reserve .....	1.032.692	0
Income tax effect of revaluation .....	( 185.884)	0
<b>Total comprehensive profit (loss) for the year</b>	<u><u>13.041.184</u></u>	<u><u>( 6.899.095)</u></u>
<b>Total comprehensive income attributable to:</b>		
Equity holders of the Company .....	13.041.067	( 6.922.305)
Minority interest in subsidiaries .....	<u>117</u>	<u>23.211</u>
<b>Total comprehensive profit (loss) for the year</b>	<u><u>13.041.184</u></u>	<u><u>( 6.899.094)</u></u>

The notes on pages 12 to 52 are an integral part of these Consolidated Financial Statements.

# Consolidated Statement of Financial Position

## 31 December 2010

	Notes	31.12. 2010	31.12. 2009
<b>Assets</b>			
Property, plant and equipment .....	11	248.030.995	240.716.068
Intangible assets .....	12	1.514.124	1.648.403
Investments in associated companies .....	13	313.364	488.569
Investments in other companies .....	14	2.062.445	2.187.047
Embedded derivatives in electricity sales contracts .....	15	18.809.205	19.036.283
Other financial assets .....	16	7.333.247	7.656.562
Deferred tax assets .....	17	206.742	1.194.314
Total non-current assets		<u>278.270.120</u>	<u>272.927.246</u>
Inventories .....	18	566.796	752.353
Trade receivables .....	19	3.661.642	3.339.309
Embedded derivatives in electricity sales contracts .....	15	1.601.900	1.127.990
Other financial assets .....	16	4.574	82.267
Other receivables .....	19	91.730	353.240
Cash and cash equivalents .....	20	2.343.648	2.943.303
Total current assets		<u>8.270.289</u>	<u>8.598.462</u>
<b>Total assets</b>		<u><u>286.540.409</u></u>	<u><u>281.525.708</u></u>

The notes on pages 12 to 52 are an integral part of these Consolidated Financial Statements.

# Consolidated Statement of Financial Position

## 31 December 2010

	Notes	31.12. 2010	31.12. 2009
<b>Equity</b>			
Revaluation reserve .....		46.882.895	49.417.335
Retained earnings (accumulated deficit) .....		5.959.171	( 8.816.337)
Equity attributable to equity holders of the Company		52.842.065	40.600.999
Minority interest .....		4.704	56.487
<b>Total equity</b>	<b>21</b>	<b>52.846.769</b>	<b>40.657.486</b>
<b>Liabilities</b>			
Loans and borrowings .....	22	207.916.910	221.254.126
Retirement benefit obligation .....	23	441.487	464.547
Other financial liabilities .....	24	23.395	50.186
Deferred tax liabilities .....	17	3.780.403	10.963
Total non-current liabilities		212.162.196	221.779.822
Accounts payable .....	24	1.981.573	2.368.066
Loans and borrowings .....	22	17.273.990	15.314.040
Other financial liabilities .....	24	17.130	24.977
Other current liabilities .....	24	2.258.751	1.381.317
Total current liabilities		21.531.444	19.088.400
<b>Total liabilities</b>		<b>233.693.640</b>	<b>240.868.222</b>
<b>Total equity and liabilities</b>		<b>286.540.409</b>	<b>281.525.708</b>

The notes on pages 12 to 52 are an integral part of these Consolidated Financial Statements.

# Consolidated Statement of Changes in Equity for the year 2010

	Revaluation reserve	Retained earnings (Accumulated deficit)	Attributable to equity holders of the Company	Minority interest	Total equity
<b>The year 2010</b>					
Equity at 1 January 2010 .....	49.417.335	( 8.816.337)	40.600.998	56.487	40.657.485
Effect of change in tax rate .....	( 1.534.410)		( 1.534.410)		( 1.534.410)
Revaluation .....	1.032.692		1.032.692		1.032.692
Income tax effect of revaluation .....	( 185.885)		( 185.885)		( 185.885)
Depreciation transferred to retained earnings (deficit) .....	( 1.846.838)	1.846.838	0		0
Profit for the year .....		13.728.669	13.728.669	117	13.728.786
Total comprehensive income .....	( 2.534.441)	15.575.507	13.041.066	117	13.041.183
Other changes .....			0	( 51.899)	( 51.899)
Dividends paid .....		( 800.000)	( 800.000)		( 800.000)
Equity at 31 December 2010 .....	46.882.894	5.959.170	52.842.064	4.705	52.846.769

## The year 2009

Equity at 1 January 2009 .....	55.842.384	( 7.517.523)	48.324.861	33.770	48.358.631
Effect of change in tax rate .....	( 4.383.466)		( 4.383.466)		( 4.383.466)
Solvency of revaluation due to depreciation .....	( 2.041.583)	2.041.583	0		0
Loss for the year .....		( 2.538.839)	( 2.538.839)	23.211	( 2.515.628)
Total comprehensive income .....	( 6.425.049)	( 497.256)	( 6.922.305)	23.211	( 6.899.094)
Other changes .....		( 1.557)	( 1.557)	( 494)	( 2.051)
Dividends paid .....		( 800.000)	( 800.000)		( 800.000)
Equity at 31 December 2009 .....	49.417.335	( 8.816.336)	40.600.999	56.487	40.657.486

The notes on pages 12 to 52 are an integral part of these Consolidated Financial Statements.

# Consolidated Statement of Cash Flows for the year 2010

	Notes	2010	2009
<b>Cash flows from operating activities</b>			
Cash generated from operations before interest and taxes .....	26	14.905.234	13.264.807
Received interest income .....		147.930	270.731
Paid interest expenses .....	(	3.230.597)	( 4.945.767)
Dividend received .....		16.159	5.888
Paid due to other financial income and expenses .....	(	250.463)	( 166.617)
Net cash from operating activities		11.588.262	8.429.042
<b>Cash flows from investing activities</b>			
Acquisition of property, plant and equipment .....	(	14.305.870)	( 20.838.694)
Acquisition of intangible assets .....	(	96.926)	( 179.896)
Acquisition of subsidiaries .....	(	150.000)	0
Acquisition of other financial assets .....	(	93.176)	( 3.488.475)
Proceeds from sale of other companies .....		4.708	4.052.906
Proceeds and repayment of other financial assets .....		99.228	( 16.175)
Net cash used in investing activities		( 14.542.036)	( 20.470.334)
<b>Cash flows from financing activities</b>			
Proceeds from new borrowings .....		17.800.643	20.039.175
Repayment of borrowings .....	(	4.592.913)	( 5.722.547)
Dividends paid .....	(	800.000)	( 800.000)
Credit facility, change .....	(	5.494.835)	( 1.365.277)
Current liabilities, (decrease) increase .....	(	4.693.303)	981.303
Net cash from financing activities		2.219.591	13.132.654
<b>Decrease in cash and cash equivalents</b> .....	(	734.183)	1.091.362
<b>Cash and cash equivalents at year beginning</b> .....		2.943.303	1.243.639
<b>Changes in the Group</b> .....		0	( 5.907)
<b>Effect of currency fluctuations on cash and cash equivalents</b> .....		134.528	614.208
<b>Cash and cash equivalents at year end</b> .....		2.343.648	2.943.302
<b>Investments and financing without payment effects:</b>			
Acquisition of property, plant and equipment .....	(	723.246)	( 1.017.469)
Acquisition of other companies, change .....	(	23.898)	( 3.264.745)
Proceeds from sale of other companies .....		0	7.983.515
Other financial assets, change .....		23.898	( 7.612.525)
Proceeds from new borrowings .....		0	3.539.000
Receivables, change .....		0	( 645.245)
Current liabilities, change .....		723.246	1.017.469
<b>Other information:</b>			
Working capital from operation .....		10.594.560	9.035.941

The notes on pages 12 to 52 are an integral part of these Consolidated Financial Statements.

# Notes to the Financial Statements

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# Notes

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## 1. Reporting entity

Orkuveita Reykjavíkur is a partnership that complies with the Icelandic law no. 139/2001 on the founding of the partnership Orkuveita Reykjavíkur. The Company's headquarters are at Bæjarháls 1 in Reykjavik. The Company's consolidated financial statements include the financial statements of the parent company and its subsidiaries, (together referred to as "the Company") and a share in associated companies.

The Company is an independent service company that produces and distributes electricity, distributes geothermal water for heating, cold water for consumptions, sewer systems, and operates fibre-optic cable systems.

## 2. Basis of preparation

### a. Statement of compliance

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

The consolidated financial statements were approved by the Board of Directors on 29 March 2011.

### b. Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for the following:

- A part of property, plant and equipment have been revalued at fair value.
- Derivative agreements are stated at fair value.
- Assets held for sale are stated at fair value.
- Financial instruments at fair value through profit and loss are stated at fair value.

The methods used to measure fair values are discussed further in note 4.

### c. Functional and presentation currency

These consolidated financial statements are presented in Icelandic kronas, which is the Company's functional currency. All financial information presented in Icelandic kronas has been rounded to the nearest thousand unless otherwise stated.

### d. Use of estimates and judgements

The preparation of the financial statements in conformity with IFRSs 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.

In particular, 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 11 - Property, plant and equipment
- note 14 - Investments in other companies
- note 15 - Embedded derivatives in electricity sale contracts
- note 16 - Other financial assets
- note 17 - Deferred tax assets and liabilities
- note 23 - Retirement benefit obligations

# Notes

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## 3. Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by Group entities. Certain comparative amounts have been reclassified in note 5.

### a. Basis of consolidation

#### i) Subsidiaries

Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that currently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries have been changed when necessary to align them with the policies adopted by the Group.

#### ii) Associates

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Significant influence is presumed to exist when the Group holds between 20 and 50 percent of the voting power of another entity. Associates are entered in the Group's financial statements by using the equity method.

The Group's financial statements include a share in the profit or loss of associates and jointly controlled entities based on the equity method. When the Group's share of losses exceeds its interest in an equity accounted investee, the carrying amount of that interest is reduced to nil and the recognition of further losses is discontinued except to the extent that the Group has an obligation or has made payments on behalf of the investee. In case of a profit on the operation of associates or jointly controlled entities in later periods a share in the profit is not recognised until the recognised share in the loss has been set off.

#### iii) Transactions eliminated on consolidation

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

### b. Foreign currency

Transactions in foreign currencies are recognised at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date and the Company uses the mid foreign exchange rate at the end of the day according to Reuters. Other assets and liabilities stated at fair value in foreign currencies are recognised at the exchange rate ruling when their fair value was determined. Exchange difference is recognised in the income statement.

# Notes

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## 3. Significant accounting policies, contd.

### c. Financial instruments

#### i) Non-derivative financial instruments

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

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

Financial instruments are recognised in the financial statements when the Company becomes a party of contractual provisions of the relevant financial instruments. Financial assets are eliminated from the financial statements if the Company's contractual right to cash flow due to the financial asset expires or if the Group transfers the assets to another party without retaining control or nearly all risk and gain inherent with their ownership. Recognition of ordinary purchase and sale of financial assets is made on the date that the Group enters into an obligation to purchase or sell the asset. Financial liabilities are eliminated from the financial statements if the Group's obligations defined in an agreement are paid, expired or dismissed.

Financial assets and liabilities are netted out and the net amount is entered in the balance sheet when the legal right of off-setting exists and financial assets and liabilities are recognised by off-setting.

Cash and cash equivalents comprise cash balances and call deposits.

Note 3. m discusses on accounting methods for financial income and expenses.

#### Held-to maturity investments

When the Group has both the intention and the ability to hold debt securities to maturity, then they are classified as held-to-maturity. Such investments are recognised in the financial statements at amortised cost using the effective interest method, less any impairment losses.

#### Available-for sale financial assets

The Group's investments in equity securities and certain debt securities are classified as available-for-sale financial assets. Subsequent to initial recognition, they are measured at fair value and changes therein, other than impairment losses (see note 3.h.i.), and foreign exchange gains and losses on available-for-sale monetary items (see note 3.b.), are recognised directly in equity. When an investment is derecognised, the cumulative gain or loss in equity is transferred to profit or loss. Fair value changes recognised under equity are derecognised when the available-for-sale asset is derecognised.

#### 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 purchase and sale decisions are based on their fair value. Financial instruments at fair value through profit or loss are measured at fair value, and changes therein are recognised in profit or loss. Direct transaction cost is recognised in the income statement as it is incurred.

# Notes

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## 3. Significant accounting policies, contd.

### c. Financial instruments, contd.

#### Other financial instruments

Other non-derivative financial instruments are measured at amortised cost using the effective interest method, less any impairment losses.

#### ii) Derivative financial instruments

The Group holds derivative financial instruments, not in a hedging relationship. Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through profit or loss.

Derivatives are recognised initially at fair value; attributable transaction costs are recognised in profit or loss when incurred. Subsequent to initial recognition, derivatives are measured at fair value in the balance sheet and fair value changes are recognised in the income statement.

#### Other embedded derivatives

Fair value changes in separate embedded derivatives are recognised in the income statement.

# Notes

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## 3. Significant accounting policies, contd.

### d. Property, plant and equipment

#### i) Recognition and measurement

Items of property, plant and equipment, except distribution, production systems and fibre-optic systems, are measured at cost less accumulated depreciation and accumulated impairment losses.

Cost includes expenditure that is 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 and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

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 and depreciated over their useful lives.

Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment and are recognised net within "other income" in the income statement. When revalued assets are sold, the amounts included in the revaluation surplus reserve are transferred to retained earnings.

Interest expenses on loans used to finance cost of buildings in construction are capitalised over the construction period. Interest is not calculated on preparation cost. After the assets have been taken into use interest expenses are expensed in the income statement.

The Group's distribution, production systems and fibre-optic system, are stated at revalued carrying amount in the balance sheet, which is their fair value at the revaluation date less additional depreciation from that date. Revaluation of those assets is made on a regular basis. Value surplus due to the revaluation is recognised in a revaluation reserve among equity after taking the effect on deferred tax liability into consideration. Depreciation on the revalued carrying amount is recognised in the income statement. Upon sale or discontinuance of the asset the part of the revaluation reserve belonging to the asset is transferred from the revaluation reserve to retained earnings after taking tax effect into consideration. No recognition takes place from the revaluation reserve to retained earning unless the relevant asset is sold or discontinued.

#### ii) Subsequent costs

The cost of replacing part of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. All other cost is expensed in the income statement when incurred.

#### iii) 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 and equipment. Land is not depreciated. Estimated useful lives are specified as follows:

Production system .....	5-50 years
Electricity distribution systems .....	10-60 years
Heating distribution systems .....	10-60 years
Cold water distribution systems .....	5-80 years
Sewer distribution system .....	15-60 years
Fibre-optic distribution system .....	7-41 years
Other real estate .....	17-50 years
Other equipment .....	3-25 years

Depreciation methods, useful lives and scrap value are reviewed on the accounting date.

# Notes

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## 3. Significant accounting policies, contd.

### e. Intangible assets

#### i) Heating rights

Heating rights are recognised in the balance sheet at amortised cost as intangible assets with an indefinite lifetime. Heating rights are separated from land up on purchase.

#### ii) Preparation costs

A preparation cost is capitalised at cost. This cost arises in the preparation of specific defined projects. Cost due to those projects is only capitalised if it can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable and the Company has both the intention and the ability to finish the project and plans to profit from it or sell it. This cost is expensed when the project is discontinued or due to changed premises.

#### iii) Other intangible assets

Other intangible assets are measured at cost less accumulated depreciation and impairment losses.

#### iv) Subsequent expenditure

Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is recognised in profit or loss as incurred.

#### v) 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:

Heating rights .....	100 years
Software .....	3-7 years

### f. Leased assets

Leases in terms of which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Other lease agreements are considered as operating lease agreement and the leased assets are not capitalised.

### g. Inventories

Inventories are measured at the lower of cost and net realisable value. The cost of inventories is based on the first-in first-out principle, and includes expenditure incurred in acquiring the inventories, production or conversion costs and other costs incurred in bringing them to their existing location and condition. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

# Notes

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## 3. Significant accounting policies, contd.

### h. Impairment

#### i) Financial assets

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

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its fair value at each time. The Group defines decrease in fair value below cost as a subjective indication of impairment of available-for-sale financial assets when:

- decrease is 15% below cost or
- fair value decrease lasts for at least six months.

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. Any cumulative loss in respect of an available-for-sale financial asset recognised previously in equity is transferred to profit or loss.

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

#### ii) Non-financial assets

The carrying amounts of the Group's non-financial assets, other than inventories and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

Impairment is recognized if the carrying amount of an asset or a cash generating unit exceeds its estimated recoverable amount. A cash generating unit is the smallest separable group of assets that form a cash flow that is mostly independent of other units or groups of units. Impairment loss of revalued operating assets is recognized in equity under revaluation reserve. Impairment losses of other assets are recognized in profit or loss.

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

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

# Notes

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## 3. Significant accounting policies, contd.

### i. Employee benefits

#### i) Defined contribution plans

Obligations for contributions to defined contribution pension plans are recognised in the income statement when they are due.

#### ii) Defined benefit plans

The Group's net obligation in respect of defined benefit pension plans is calculated separately for each plan by estimating the amount of future benefit that current and former employees have earned in return for their service in the current and prior periods. The benefit is discounted to determine its present value and any unrecognised past service costs and the fair value of any plan assets are deducted. The calculation is performed annually by a qualified actuary using the projected unit credit method. Changes in the obligation are recognised in the income statement as incurred.

### j. Obligations

An obligation is recognised in the balance sheet when the Company has the legal right or has entered into an obligation due to previous events and it is likely that it will incur cost upon settling the obligation. The obligation is measured on the basis of the estimated future cash flow, discounted based on interests reflecting market interests, and the risk inherent with the obligation.

### k. Revenue

Revenue from the sale and distribution of electricity and hot water is recognised in the income statement according to measured delivery to purchasers during the period plus a fixed fee. Revenue from the sale of cold water and sewer take into account the size of housing plus a fixed fee. In addition revenue is stated for cold water according to measurement from specific industries. Other revenue is recognised when generated or upon delivery of goods or services.

The rate for the distribution of electricity has a revenue cap set by the National Energy Authority in accordance with laws on energy number 65/2003. The revenue cap is based on actual figures from prior years from the operation of distribution utilities, the depreciation of assets, real losses in the distribution system and return on equity. When setting the revenue cap financial income and expenses are not taken into account. The rate is decided from the revenue cap and projections of sale of electricity in the Company's utilities area.

Upon connection of new users to distribution systems of electricity, water and sewer or upon renewal of connection an initial fee is charged. The initial fee meets cost due to new distribution systems or their renewal. Income on connection fees is recognised in the income statement upon delivery of the service.

### l. Lease payments

Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease.

Minimum lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding liability. Interest expenses are distributed over the lease term based on effective interests.

# Notes

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## 3. Significant accounting policies, contd.

### m. *Financial income and expenses*

Finance income comprises interest income on funds invested, dividend income, changes in the fair value of financial assets at fair value through profit or loss, foreign exchange gain and gains on hedging instruments that are recognised in the income statement. Interest income is recognised as it accrues in the income statement, using the effective interest method. Dividend income is recognised in the income statement on the date that the Group's right to receive payment is established.

Finance expenses comprise interest expense on borrowings, unwinding of the discount on provisions, foreign exchange losses, impairment losses recognised on financial assets, and losses on hedging instruments that are recognised in the income statement. Borrowing cost is recognised in the income statement based on effective interests.

Effective interest is the required rate of return used when discounting estimated cash flow over the estimated useful life of a financial instrument or a shorter period when applicable, so that it equals to the book value of the financial asset or liability in the balance sheet.

Foreign currency gains and losses are reported on a net basis as either finance income or finance cost depending on whether foreign currency movements are in a net gain or net loss position.

### n. *Income tax*

Income tax expense comprises current and deferred tax. Income tax expense is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. The income tax ratio is 32.7%, but a part of the operation is exempt from tax (operation of cold water supply and sewer).

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amounts 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. Deferred tax was measured in accordance with a changed tax rate as of 1 January 2011, which is 36% for partnerships and 20% for companies with limited liability.

A deferred tax asset is only 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.

# Notes

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## **3. Significant accounting policies, contd.**

### ***o. Segment reporting***

A segment is a distinguishable component of the Group that is engaged either in providing related products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and returns that are different from those of other segments. Segment information is presented in respect of the Group's business and is presented on the one hand by business division and on the other, by business sectors. The business segments are determined based on the Group's management and internal reporting structure. The Company does not present a segment report by geographical segments as its operation is by far mostly carried out in Iceland.

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

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly investments (other than investment property) and related revenue, loans and borrowings and related expenses, corporate assets and related expenses, and income tax assets and liabilities.

Segment investments are investments in property, plant and equipment and intangible assets.

### ***p. New standards and interpretations***

The Group has implemented all international accounting standards, their interpretation and changes on existing standards that were effective at year end 2010 and are related to the Group's operation. The Group has not beforehand implemented international accounting standards, their interpretation and changes which are effective after 31 December 2010. Adoption of these standards are not considered to have a significant effect on the preparation of the Group's financial statements.

## **4. Determination of fair values**

A number of the Group'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. Property, plant and equipment***

The fair value of production systems that have undergone a revaluation is determined on the basis of the depreciated replacement cost, which consists in the assessment of changes in construction cost of comparable assets and both cost and accumulated depreciation are remeasured in accordance with those changes.

The same method is applied in the determination of the fair value of distribution systems, accounted at fair value. Revalued distribution systems are used in an operation subject to special licence and income limits are mainly based on changes in the building cost index. This is taken into account when determining the fair value.

The fair value of property, plant and equipment taken over upon a merger is based on the market value. The market value is the amount that can be obtained in transactions between unrelated, willing and informed parties. The fair value of other assets among property, plant and equipment is based on the market value of comparable assets.

# Notes

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## **4. Determination of fair values, contd.**

### **b. *Investments in equity and debt securities***

The fair value of financial assets at fair value through profit or loss is determined on the basis of their market value at the reporting date. If the market value is not known the valuation is based on generally accepted valuation methods. Valuation methods can be based on known recent financial transactions between unrelated parties. In applying these valuation methods factors are considered which would be used in the respective market concerning calculation of fair value and the methods are in accordance with generally accepted methods concerning valuation of financial assets.

### **c. *Derivatives***

The fair value of derivatives is based on their market value, if available. If the market value is not available the fair value is determined on the basis of generally accepted valuation methods.

Valuation methods may be based on prices in recent transactions between unrelated parties. The measurement is based on the value of other financial instruments comparable to the instrument in question, methods in order to evaluate the present value of cash flow or other valuation methods, which may be applied in order to reliably assess the real market value. When valuation methods are applied all factors are used, which market parties would use in price evaluations, and the methods are in accordance with generally accepted methods for the price evaluation of financial instruments. The Group verifies on a regular basis its valuation methods and tests them by using a price obtained in a transaction on an active market with the same instrument, without adjustments and changes, or are based on information from an active market.

The fair value of derivative agreements not listed in active markets is determined by use of valuation methods, which are regularly reviewed by qualified employees. All valuation models used must be approved and tested in order to ensure that the results reflect the data used.

The most reliable indication of the fair value of derivative agreements at the beginning is the purchase value, unless the fair value of the instruments is verifiable in comparison with other listed and recent market transactions with the same financial instrument or based on a valuation method where variables are only based on market data. When such data is available the Group 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 a similar instrument at the measurement date.

### **d. *Trade and other receivables***

The fair value of trade and other receivables, is estimated at the present value of future cash flows, discounted at the market rate of interest at the reporting date if applicable. This fair value is determined for disclosure purposes.

### **e. *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 interest at the reporting date.

# Notes

## 5. Segment reporting

### Business divisions and sectors

Orkuveita Reykjavíkur's service area is mainly in the Reykjavík city area, but it also extends to the southern and western parts of Iceland. The Company is divided into three separate divisions: Production and Sales, Utilities and Other Operation.

**Production and Sales** generate electricity and harness hot water from the power plants as well as selling electricity to wholesale and retail customers.

**Utilities** distribute electricity, harnessing hot water from low-temperature fields and the geothermal plants and distribute it for space heating. It also collects and distributes cold water from reservoirs, runs a sewerage system and operates a fiber-optic system.

**Other operations** cover the new construction and operation of street lighting, rental of housing and equipment, incidental sale of specialist consultancy services and more.

The Company is also divided by its sectors, **Electricity, Hot water, Cold water, Sewer and Fibre-optic system**. The sectors operate in different legal environments, both regarding income tax and value added tax, revenue targets as set forth in the electricity and earnings law. The sectors hot water, cold water, sewerage and the distribution of electricity are exclusively licensed by law, however the generation of electricity, sale of power and sale of data transfer is subject to the open market.

The Company is income taxed and collects value added tax, except for operations regarding cold water and sewer but they are regulated by law no. 33/2004 concerning cold water suppliers of municipalities and law no. 9/2009 concerning the operations of sewer. The provision of hot water supply is subject to law no. 58/1967, concerning earnings from hot water. The distribution of electricity is subject to law no. 65/2003, which stipulates revenue caps that are decided by the National Energy Authority.

Hot water	Minister approves utility rates not subject to the open market. These take effect upon publication in the Ministerial Gazette.
Electricity, distribution	The National Energy Authority is sent a rate list for authorisation. Rates are officially published.
Electricity, production	Energy sales are subject to the open market, electricity rate changes are therefore not subject to government approval.
Cold water	The legal limitation on the upper limit of the rate is 0.5% of the real estate value. Rates are officially published in the Law and Ministerial Gazette.
Sewer system	The Rates for the sewer system shall cover all costs. Rates are officially published in the Ministerial Gazette.
Fibre-optic data system	This is a competitive practice that is supervised by The Post and Telecom Administration.

### Major customers

The Company has two major customers; Norðurál Grundartangi ehf. and The City of Reykjavík.

Revenues from Norðurál Grundartangi ehf., a customer of the Company's Production and Sale's division, represents approximately ISK 5.504 or 18.1% of total revenues. (2009: ISK 4.009 million, 15.4% of total revenue.)

Revenues from The City of Reykjavík, a customer of all of the Company's divisions and sectors, represents approximately ISK 3.717 or 13.3% of total revenues. (2009: ISK 3.453 million, 13.3% of total revenue.)

# Notes

## 5. Segment reporting

Segment information is presented by the Group's business segments according to the Group's organisation and internal reporting. Business segments consist of utilities, production and sale, and other operation. In addition, information is provided on the Group's sectors, which are electricity, hot water, cold water, sewer and fibre-optic cable systems. Organisational change was implemented in the beginning of the year 2010, where a part of production, i.e. production of cold water and hot water in low-temperature geothermal areas, was merged into distribution, forming a new segment called utilities. Comparative amounts have been changed in accordance.

### Business segments - divisions

	Utilities	Production and sale	Other Operation	Adjustments	Total
<b>The year 2010</b>					
External revenue .....	17.186.751	10.677.632	51.207	0	27.915.590
Inter-segment revenue .....	303.681	2.831.725	597.100	( 3.732.506)	0
Total segment revenue .....	17.490.432	13.509.357	648.307	( 3.732.506)	27.915.590
Segment result .....	5.417.246	2.022.303	( 126.524)	0	7.313.025
Unallocated expenses .....					( 1.324.350)
Results from operating activities .....					5.988.675
Financial income and expenses .....					10.752.589
Share of profit of associated companies .....					24.308
Income tax .....					( 3.036.786)
Profit for the year .....					13.728.786
<b>The year 2009</b>					
External revenue .....	16.255.031	8.929.573	828.224	0	26.012.828
Inter-segment revenue .....	182.354	2.298.902	291.492	( 2.772.748)	0
Total segment revenue .....	16.437.385	11.228.475	1.119.716	( 2.772.748)	26.012.828
Segment result .....	2.953.703	3.055.288	( 84.063)	0	5.924.928
Unallocated expenses .....					( 768.298)
Results from operating activities .....					5.156.630
Financial income and expenses .....					( 8.842.698)
Share of loss of associated companies .....					( 227.685)
Income tax .....					1.398.124
Loss for the year .....					( 2.515.629)

# Notes

## 5. Segment reporting, contd.

### Business segments - divisions, contd.

The year 2010

#### Balance sheet (31.12. 2010)

	Utilities	Production and sale	Other Operation	Adjustments	Total
Property, plant and equipment .....	122.791.706	116.906.563	284.930	8.047.796	248.030.995
Intangible assets .....			171.862	1.342.262	1.514.124
Shares in associates .....					313.364
Other unallocated assets .....					36.681.926
Total assets .....					286.540.409

Unallocated liabilities ..... 233.693.640

#### Investments:

Property, plant and equipment .....	3.781.507	10.082.147	7.227	142.595	14.013.476
Intangible assets .....	0	0	14.372	82.555	96.927

#### Depreciation, amortization:

Property, plant and equipment .....	4.466.743	2.894.159	0	383.625	7.744.527
Intangible assets .....	0	0	90.000	127.920	217.920

The year 2009

#### Balance sheet (1.1. 2010)

Property, plant and equipment .....	121.489.455	110.676.872	284.931	8.264.810	240.716.068
Intangible assets .....	0	0	247.490	1.400.913	1.648.403
Shares in associates .....					488.569
Other unallocated assets .....					38.672.668
Total assets .....					281.525.708

Unallocated liabilities ..... 240.868.222

#### Investments:

Property, plant and equipment .....	6.486.419	14.728.179	236	132.364	21.347.198
Intangible assets .....	0	0	53.872	126.025	179.897

#### Depreciation, amortization:

Property, plant and equipment .....	3.527.110	3.747.247	0	405.675	7.680.032
Intangible assets .....	0	0	0	133.737	133.737

# Notes

## 5. Segment reporting, contd.

### Business segments - sectors

The year 2010

	Electricity	Hot water	Cold water	Sewer	Fibre-optic cable system	Adjustments	Total
<b>Income</b>							
External revenue .....	15.117.436	6.535.361	2.697.417	2.565.000	1.000.376	0	27.915.590
Inter-segment revenue .....	1.097.218	163.300	59.841	56.903	0	( 1.377.262)	0
Total segment revenue .....	16.214.654	6.698.661	2.757.258	2.621.903	1.000.376	( 1.377.262)	27.915.590
<b>Balance sheet (31.12. 2010)</b>							
Property, plant and equipment .....	126.291.579	58.562.485	17.080.343	36.394.144	9.702.444	0	248.030.995
Intangible assets .....	710.057	502.058	96.643	205.366	0	0	1.514.124
Unallocated assets .....							36.995.290
Total assets .....	127.001.636	59.064.543	17.176.986	36.599.510	9.702.444	0	286.540.409
<b>Investments</b>							
Property, plant and equipments .....	9.045.072	2.477.531	253.473	1.148.964	1.088.436	0	14.013.476
Intangible assets .....	43.341	34.764	6.026	12.796	0	0	96.927
<b>Depreciation, amortization</b>							
Property, plant and equipments .....	3.482.089	2.239.105	450.548	1.210.827	361.958	0	7.744.527
Intangible assets .....	93.874	84.857	12.276	26.913	0	0	217.920

# Notes

## 5. Segment reporting, contd.

### Business segments - sectors, contd.

The year 2009

	Electricity	Hot water	Cold water	Sewer	Fibre-optic cable system	Adjustments	Total
<b>Income</b>							
External revenue .....	13.622.431	6.490.907	2.576.649	2.526.148	796.693	0	26.012.828
Inter-segment revenue .....	977.909	327.646	29.826	29.242	0	( 1.364.623)	0
Total segment revenue .....	14.600.340	6.818.553	2.606.475	2.555.390	796.693	( 1.364.623)	26.012.828
<b>Balance sheet (31.12. 2009)</b>							
Property, plant and equipment .....	122.432.015	56.435.597	17.335.655	36.569.527	7.943.274	0	240.716.068
Intangible assets .....	739.683	582.308	105.068	221.344	0	0	1.648.403
Unallocated assets .....							39.161.236
Total assets .....	123.171.698	57.017.905	17.440.723	36.790.871	7.943.274	0	281.525.708
<b>Investments</b>							
Property, plant and equipments .....	14.309.131	3.599.388	247.332	2.516.754	674.594	0	21.347.199
Intangible assets .....	66.541	83.991	9.452	19.912	0	0	179.896
<b>Depreciation, amortization</b>							
Property, plant and equipments .....	3.449.979	2.200.309	465.160	1.248.845	315.740	0	7.680.033
Intangible assets .....	51.096	41.670	12.834	28.137	0	0	133.737

# Notes

## 6. Analysis of geothermal power plant operation

Return analysis of production of electricity and hot water, cf. Article 41, paragraph 5 of law no. 65/2003:

	Electricity 2010	Hot water 2010	Electricity 2009	Hot water 2009
<b>Power plant at Nesjavellir</b>				
Revenue .....	2.522.255	950.000	2.146.608	1.059.293
Operating expenses .....	( 615.279)	( 534.543)	( 608.837)	( 520.704)
Depreciation .....	( 649.287)	( 250.621)	( 653.673)	400.709
Profit before financial expenses .....	<u>1.257.689</u>	<u>164.837</u>	<u>884.098</u>	<u>939.298</u>
Return on investment .....	8,8%	3,2%	5,9%	2,7%

### Power plant at Hellisheidi

The Company has initiated delivery of electricity from the power plant of Hellisheiði and delivery of hot water from the plant begun early year 2011.

## 7. Salaries and salary related expenses

	2010	2009
Salaries and salary related expenses are specified as follows:		
Salaries .....	3.704.640	3.670.181
Defined contribution pension expenses .....	493.130	487.592
Defined benefit pension expenses .....	( 9.079)	24.999
Other salary related expenses .....	377.251	315.850
Expensed salaries and salary related expenses due to the resignation period of laid-off employees 2) .....	<u>246.654</u>	<u>0</u>
Total salaries and salary related expenses .....	<u>4.812.597</u>	<u>4.498.622</u>

Salaries and salary related expenses are thus stated in the financial statements:

Expensed in the income statement .....	4.151.180	3.889.190
Capitalised on projects .....	<u>661.416</u>	<u>609.433</u>
Total salaries and salary related expenses .....	<u>4.812.597</u>	<u>4.498.622</u>

Number of employees:

Number of annual working units .....	630	651
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Management's salaries and benefits for the parent company and subsidiaries are specified as follows:

Salaries to the Board of Directors of the Parent Company .....	16.190	14.348
Salaries to the Director and four Managing Directors of the Parent Company .....	73.066	93.301
Salaries to the Board of Directors and Managing Directors of subsidiaries .....	22.178	25.290
Defined contribution pension expenses .....	13.663	16.840
Termination expenses, pension expenses included 1) .....	<u>28.656</u>	<u>0</u>
	<u>153.753</u>	<u>149.780</u>

Included in salaries are car benefits and vehicle subsidy.

1) Hjörleifur B. Kvaran left his position as CEO of the parent company during the year 2010. Expenses due to the termination of his employment, salary related expenses included, were all expensed upon his departure from the company.

2) At the end of October 2010 mass lay-offs took place at Orkuveita Reykjavíkur, where 65 people were laid off due to curtailing. The employees were not required to work during the notice period and salaries and salary related expenses were all expensed in the last quarter of 2010.

# Notes

## 8. Depreciation and amortisation

	2010	2009
Depreciation and amortisation is specified as follows:		
Depreciation of property, plant and equipment, cf. note 11 .....	7.744.527	7.680.033
Amortisation of intangible assets, cf. note 12 .....	217.920	133.737
Depreciation and amortisation recognised in the income statement .....	<u>7.962.447</u>	<u>7.813.770</u>

## 9. Financial income and expenses

	2010	2009
Financial income and expenses are specified as follows:		
Interest income .....	149.941	337.191
Interest expense .....	( 3.314.077)	( 5.240.008)
Guarantee fee to owners 1) .....	( 715.990)	( 471.564)
Total interest expenses .....	<u>( 4.030.068)</u>	<u>( 5.711.572)</u>
Fair value changes of embedded derivatives in electricity sales contracts .....	246.832	11.072.823
Fair value changes of assets available for sale 2) .....	( 148.489)	( 2.675.884)
Fair value changes of financial assets and financial liabilities through P/L .....	( 542.044)	102.505
Forward currency swaps .....	( 18.817)	47.643
Foreign exchange difference .....	15.079.076	( 12.084.504)
Dividends .....	16.159	69.101
Total of other income (expenses) on financial assets and liabilities .....	<u>14.632.717</u>	<u>( 3.468.316)</u>
Total financial income and expenses .....	<u>10.752.590</u>	<u>( 8.842.697)</u>

1) Orkuveita Reykjavíkur paid a guarantee fee to current and former owners of the company for guarantees they have made on the Groups loans and borrowings according to a decision made on the annual meeting of Orkuveitu Reykjavíkur in 2005. At that meeting the guarantee fee was set to be 0.25% on yearly basis. The calculation of the fee is done at the end of each quarter. The fee was increased at the beginning of 2010 by 50% or to 0.375% on yearly basis. The guarantee fee amounted to ISK 716 million in 2010 (2009: ISK 472 million) and is accounted for among interest expenses.

2) The main reason for the great change between years for *fair value changes of assets available for sale*, is that in the year 2009 Orkuveita Reykjavíkur's share in HS Orka was sold. The proceeds from the sale was less than the book value at that time and a loss of ISK 2.3 billion was expensed.

Financing cost due to construction of a power plant to the amount of ISK 702 million is capitalised and has been recognised as reduction of financial expenses (2009: ISK 1.752 million).

Interest ratio used to calculate capitalised financing cost for the year 2010 is 3.1% (2009: 13.26%).

The interest ratio is determined from the ratio of interest expense during the year on average remainder of all Company loans calculated from the currency rate/index of the borrowing day of each loan. The interest ratio is determined this way when there has been a currency exchange gain from them during the year. The interest ratio is calculated this way for the year 2010, taking into consideration the owner's guaranty fee.

If there is exchange currency loss during the period, it is taken into consideration when determining the interest ratio. The interest ratio will not, however, be higher than the comparative interest rate in Icelandic krona. The interest ratio is calculated from an estimate of the Icelandic interest rates that would have given a good indication of the interest terms the Group would have received, if the power plant constructions were financed in ISK during the construction period. This is done to reflect that the foreign currency denominated interest rates of the Group's debt portfolio does not give a good indication of interest incurred during construction time when there is exchange currency loss. The average of monthly REIBOR fixings is used (2009: 11.76%) plus a margin that reflects the Group's terms from the Icelandic banks (2009: 1.25%). In addition the Company owner's guaranty fee is added (2009: 0.25% on yearly basis).

# Notes

## 9. Financial income and expenses, contd.

	2010	2009
Interest expenses, charged in the income statement .....	( 4.030.068)	( 5.711.572)
Capitalised finance cost .....	( 702.137)	( 1.751.701)
Interest expenses .....	<u>( 4.732.205)</u>	<u>( 7.463.273)</u>

Generally accepted valuation methods are used to determine the fair value of certain financial assets and financial liabilities, further discussed in note 4 and 25 e. Change in fair value that is recognised in the income statement amounts to expense of ISK 444 million. (2009: income ISK 8.232 million).

## 10. Income tax

Orkuveita Reykjavíkur is tax liable in accordance with Article 2 of law no. 90/2003 on income tax. The part of the Company's operation concerning operation of cold water supply and sewer is though exempt from income tax.

At year end 2010 the Icelandic Parliament approved an increase in the income tax rate from 32.7% to 36% for partnerships as of 1 January 2011. At the same time the income tax rate for limited companies increased from 18% to 20%. The effect of the increase in the tax rate on the deferred tax at year-end amount to ISK 292 million. The effect is divided on the one hand so that ISK 1.534 decrease on the deferred tax asset is stated on the revaluation reserve and on the other hand ISK 1.242 increase on the deferred tax asset is recognised in the income statement.

Income tax recognised in the income statement is specified as follows:	2010	2009
Change in deferred income tax .....	3.036.786	( 1.398.122)
Income tax recognised in the income statement .....	<u>3.036.786</u>	<u>( 1.398.122)</u>

Reconciliation of effective tax rate:	2010		2009	
Profit (loss) before income tax .....		<u>16.765.572</u>		<u>( 3.913.751)</u>
Income tax according to current tax ratio .....	32.7%	5.482.342	23.5%	( 919.732)
Effect of change in tax rate .....	( 7.3%)	( 1.228.722)	151.8%	( 5.940.140)
Effect of valuation of exploitation of deferred tax losses .....	0.0%	0	( 112.4%)	4.400.000
Non-taxable operation of water supply and sewer .....	( 7.8%)	( 1.304.633)	( 10.1%)	395.708
Effect of various tax rates in the Group .....	( 0.1%)	( 14.386)	( 0.9%)	35.451
Other items .....	0.6%	102.185	( 16.1%)	630.590
Effective income tax .....	<u>18.1%</u>	<u>3.036.786</u>	<u>35.8%</u>	<u>( 1.398.123)</u>

# Notes

## 11. Property, plant and equipment

Property, plant and equipment is specified as follows:

The year 2010	Production system	Utility system	Other real estates	Other equipment	Total
<b>Cost or deemed cost</b>					
Balance at year beginning .....	181.419.827	189.223.393	8.338.751	5.391.704	384.373.675
Reclassification of assets .....	0	0	0	13.285	13.285
Additions during the year .....	10.579.537	3.288.896	29.189	115.854	14.013.476
Revaluation .....	0	1.227.348	0	0	1.227.348
Balance at year end .....	191.999.364	193.739.637	8.367.940	5.520.843	399.627.784
<b>Depreciation</b>					
Balance at year beginning .....	49.965.530	89.853.132	1.549.340	2.289.605	143.657.607
Depreciated during the year .....	3.951.970	3.499.331	141.921	151.305	7.744.527
Revaluation .....	0	194.656	0	0	194.656
Balance at year end .....	53.917.500	93.547.119	1.691.261	2.440.910	151.596.790
<b>Carrying amounts</b>					
At 1.1. 2010.....	131.454.297	99.370.261	6.789.411	3.102.099	240.716.068
At 31.12. 2010.....	138.081.864	100.192.518	6.676.679	3.079.933	248.030.994
Thereof assets in construction at year end.....	28.392.186	2.271.439	0	0	30.663.625
<b>The year 2009</b>					
<b>Cost or deemed cost</b>					
Balance at year beginning .....	164.856.768	184.796.025	8.283.140	4.407.876	362.343.809
Reclassification of assets .....	0	0	0	( 809.125)	( 809.125)
Additions during the year .....	16.563.059	3.850.561	43.454	890.125	21.347.199
Sold or disposed of .....	0	576.807	12.157	902.828	1.491.792
Balance at year end .....	181.419.827	189.223.393	8.338.751	5.391.704	384.373.675
<b>Depreciation</b>					
Balance at year beginning .....	46.181.542	85.742.803	1.391.818	2.057.215	135.373.378
Reclassification of assets .....	0	0	0	( 887.574)	( 887.574)
Depreciated during the year .....	3.783.988	3.533.522	145.387	217.136	7.680.033
Sold or disposed of .....	0	576.807	12.135	902.828	1.491.770
Balance at year end .....	49.965.530	89.853.132	1.549.340	2.289.605	143.657.607
<b>Carrying amounts</b>					
At 1.1. 2009.....	118.675.226	99.053.222	6.891.322	2.350.661	226.970.431
At 31.12. 2009.....	131.454.297	99.370.261	6.789.411	3.102.099	240.716.068
Thereof assets in construction at year end.....	23.772.336	1.699.301	0	0	25.471.637

# Notes

## 11. Property, plant and equipment, contd.

### Revaluation

Revaluation was carried out for the fibre-optic cable system at the end of September 2010 as a part of the regular revaluation of the group's assets. The revaluation for the fibre-optic cable system led to an increase of book values of those assets that amounted to ISK 1.033 million. This is the first time revaluation is executed for the fibre-optic system, other systems have been revaluated at other times.

When revaluating, the relevant asset groups are measured at fair value. The aforementioned increases are recognised in a revaluation reserve among equity taken into account effects of deferred income tax.

The fair value of fibre-optic cable assets is determined on the basis of the depreciated replacement cost. This consists in that an assessment is made on changes in the construction cost of comparable assets and both cost and accumulated depreciations are revalued in accordance with those changes. The calculation is based on official information and actual statistics from the Group's books on value changes of cost of items and takes into account an estimate on the weight of each cost item in the total cost of construction of comparable assets. Cost items and their proportional weight were determined by experts within and outside of the Company.

Revaluation regarding other systems of the Company was not done in the year 2010.

Impairment tests were performed at year end in order to confirm both carrying amounts of assets and main assets under construction would meet estimated future cash flows of these assets. The impairment tests are carried out for every sector in the utilities and production systems. The impairment are based on several assumptions, the main assumptions are:

- i) weighted average cost of capital (WACC) is 3.8% to 6.85%,
  - ii) the future growth is between 0% to 2.5%
  - iii) weighted probability of different results regarding negotiations with buyers of power.
- Further explanation on impairment test is in note 3 h.

### Information on revalued assets at year end

	Production system	Distribution system	Total
<b>The year 2010</b>			
Revalued carrying amount .....	138.081.864	100.192.518	238.274.382
Thereof effect of revaluation .....	( 32.678.679)	( 31.130.251)	( 63.808.930)
carrying amount before effect of revaluation .....	105.403.185	69.062.267	174.465.452
<b>The year 2009</b>			
Revalued carrying amount .....	131.454.297	91.426.987	222.881.284
Thereof effect of revaluation .....	( 33.930.052)	( 31.073.178)	( 65.003.230)
carrying amount before effect of revaluation .....	97.524.245	60.353.809	157.878.054

### Rateable value and insurance value

The rateable value of the Group's assets measured in the rateable value assessment amounted to ISK 27.412 million at year end 2010 (31.12.2009: ISK 27,843 million). The fire insurance value of the Group's assets amounted to ISK 32.360 million at the same time (31.12.2009: ISK 31.223 million). Among those assets are real estates capitalised among production and distribution systems.

### Obligations

In May 2008 the Company entered into a contract concerning purchase of equipment for power plants. The equipment will be delivered 2011 to 2014. The contract and other contracts regarding developments at Hellisheiði amount to ISK 32.5 billion as per exchange rate at year end (31.12.2009: ISK 41.0 billion). Furthermore, the Company has entered into contracts and placed purchase orders with suppliers and developers concerning work on production and distribution systems. The balance of these contracts and purchase orders at year end 2010 is estimated at ISK 1.8 billion (31.12.2009: ISK 2.4 billion).

# Notes

## 12. Intangible assets

Intangible assets are specified as follows:

	Heating rights	Preparation cost	Software	Total
<b>The year 2010</b>				
<b>Cost</b>				
Balance at year beginning .....	1.427.031	247.492	2.895.665	4.570.188
Reclassification of assets .....	0	0	( 13.285)	( 13.285)
Additions during the year .....	0	14.372	82.554	96.926
Balance at year end .....	1.427.031	261.864	2.964.934	4.653.829
<b>Amortisation</b>				
Balance at year beginning .....	424.631	0	2.497.153	2.921.784
Amortisation during the year .....	13.939	90.000	113.981	217.920
Balance at year end .....	438.570	90.000	2.611.134	3.139.704
<b>Carrying amounts</b>				
At 1.1. 2010.....	1.002.400	247.492	398.512	1.648.404
At 31.12. 2010.....	988.461	171.864	353.800	1.514.125
<b>The year 2009</b>				
<b>Cost</b>				
Balance at year beginning .....	1.427.031	193.620	1.746.214	3.366.865
Reclassification of assets .....	0	0	809.124	809.124
Additions during the year .....	0	53.872	126.025	179.897
Sold or disposed of .....	0	0	214.302	214.302
Balance at year end .....	1.427.031	247.492	2.895.665	4.570.188
<b>Amortisation</b>				
Balance at year beginning .....	410.674	0	1.275.497	1.686.171
Reclassification of assets .....	0	0	887.574	887.574
Amortisation during the year .....	13.957	0	119.780	133.737
Sold or disposed of .....	0	0	214.302	214.302
Balance at year end .....	424.631	0	2.497.153	2.921.784
<b>Carrying amounts</b>				
At 1.1. 2009.....	1.016.357	193.620	470.717	1.680.694
At 31.12. 2009.....	1.002.400	247.492	398.512	1.648.403

# Notes

## 13. Investments in associated companies

Investments in associated companies are specified as follows:

	2010		2009	
	Share	Carrying amount	Share	Carrying amount
Enex-Kína ehf. ....	19.53%	174.946	19.53%	174.946
Envent Holdings ehf. ....	24.5%	45.000	24.5%	129.804
Iceland American Energy Inc. ....	83.7%	0	83.7%	110.000
Vistorka ehf. ....	28.95%	42.591	28.95%	24.055
Metan hf. ....	35.4%	13.730	35.4%	15.685
Netorka hf. ....	22.6%	30.416	22.6%	28.966
Reykjavik Energy Grad. School hf. ....	33.3%	6.681	33.3%	5.112
Total .....		<u>313.364</u>		<u>488.568</u>

The Company's share in the profit of its associated companies amounted to ISK 24,3 million in the year 2010 (2009: loss of ISK 227,7 million). A provision was made through profit and loss on the Company's shares in Iceland American Energy Inc. ISK 110 million and Envent Holdings ehf., ISK 85 million.

## 14. Investments in other companies

Investments in other companies are specified as follows at year end:

	2010	2009
HS Veitur hf. ....	1.566.631	1.566.631
Landsnet hf. ....	400.000	400.000
Other shares in companies .....	<u>95.814</u>	<u>220.416</u>
Other shares in companies, total .....	<u>2.062.445</u>	<u>2.187.047</u>

The value of financial assets at fair value through profit or loss is based on market value. Fair value of financial assets available for sale is based on generally accepted valuation methods of independent experts, unless where it is possible to base it on recent commercial transactions.

## 15. Embedded derivatives in electricity sales contracts

Four electricity sales contracts have been made, originally to the next 20 years. One with Landsvirkjun in regards of Norðurál and three with Norðurál in regards of the aluminium plant at Grundartangi, in addition to contracts with Landsnet hf. on distribution of electricity. Orkuveita Reykjavíkur and Norðurál have also made an electricity sales contract due to sale of electricity to a pending aluminium plant in Helguvík, where delivery of electricity for the first stage is estimated to begin in the year 2011 and the contract is to 25 years. These electricity sales contracts are made in USD and the price of the electricity is connected to the world market price of aluminium.

The aforementioned electricity sales contracts include embedded derivatives as income thereon is subject to changes in the future world market price of aluminium. In accordance with provisions of IAS 39 on financial instruments, the fair value of those embedded derivatives has been measured and recognised in the financial statements.

As the market value of the embedded derivatives is not available their fair value has been measured with generally accepted evaluation methods. The expected net present value of the cash flow of an contract on the accounting date has been measured, based on the future price of aluminium on LME (London Metal Exchange) on the accounting date and expectations of price development of aluminium for the next 30 years according to the assessment of CRU, an independent evaluation party, as available on the accounting date. From the expected net present value of cash flow of the contract on the accounting date the expected net present value based on premises on aluminium price on the initial date of the contract is deducted. The difference is the fair value change of the derivative. The valuation is based on the premises that the derivative has no value at the initial date of the contract.

# Notes

## 15. Embedded derivatives in electricity sales contracts, contd.

Embedded derivatives of the electricity sales contracts recognised in the financial statements are capitalised in the balance sheet at fair value at the accounting date and fair value changes during the period are recognised in the income statement among income on financial assets.

The fair value of embedded derivatives in electricity sales contracts is specified as follows:

	2010	2009
Fair value of embedded derivatives at the beginning of the year .....	20.164.272	9.091.449
Fair value changes during the period .....	246.832	11.072.823
Fair value of embedded derivatives at the end of the period .....	<u>20.411.104</u>	<u>20.164.272</u>

The allocation of embedded derivatives in electricity sales contracts is specified as follows:

Non-current embedded derivatives .....	18.809.205	19.036.283
Current embedded derivatives .....	1.601.900	1.127.990
Total embedded derivatives at the end of the period .....	<u>20.411.105</u>	<u>20.164.273</u>

## 16. Other financial assets

	2010	2009
<b>Non-current assets</b>		
Financial assets at fair value through profit or loss:		
Bonds .....	7.184.527	7.396.701
Bonds and other receivables:		
Bonds .....	148.720	259.861
	<u>7.333.247</u>	<u>7.656.562</u>
<b>Current assets</b>		
Bonds .....	4.574	82.267

The bond among non-current assets is issued in USD and carries 1.5% interest. It has one settlement date in the year 2016. The bond is linked to aluminium prices to certain extent and is pledged with shares in HS Orka hf. The bond is stated at fair value through P/L and derivatives are not separated from the bond. All of the Company's bonds are determined to be third level in the fair value hierarchy as further is explained in note 25 e.

# Notes

## 17. Deferred tax assets and liabilities

Deferred tax assets and liabilities is specified as follows:

	Tax assets	Tax liabilities	Net amount
<b>2010</b>			
Deferred tax assets/liabilities at the beginning of the year .....	1.194.314	10.963	1.183.351
Effect of change in income tax rate on revaluation account .....	( 20.435)	1.513.975	( 1.534.410)
Calculated income tax for the year .....	( 781.321)	2.255.465	( 3.036.786)
Other changes .....	( 185.817)	0	( 185.817)
Deferred tax assets/liabilities at year end .....	<u>206.741</u>	<u>3.780.403</u>	<u>( 3.573.662)</u>
<b>2009</b>			
Deferred tax assets/liabilities at the beginning of the year .....	4.169.441	0	4.169.441
Effect of change in income tax rate on evaluation .....	( 4.385.022)	0	( 4.385.022)
Calculated income tax for the year .....	1.409.087	10.963	1.398.124
Other changes .....	808	0	808
Deferred tax assets/liabilities at year end .....	<u>1.194.314</u>	<u>10.963</u>	<u>1.183.352</u>

Deferred tax assets and liabilities are attributable to the following:

	31.12. 2010		31.12. 2009	
	Tax assets	Tax liabilities	Tax assets	Tax liabilities
Property, plant and equipment .....	( 433.321)	17.023.296	( 15.612.117)	13.983
Embedded derivatives .....	0	7.347.998	( 6.593.717)	0
Other items .....	( 25.549)	1.286.811	2.274.492	( 848)
Effect of carry forward taxable loss .....	665.612	( 21.877.702)	21.125.656	( 2.172)
Deferred tax assets/liabilities at year end .....	<u>206.742</u>	<u>3.780.403</u>	<u>1.194.314</u>	<u>10.963</u>

### Carry forward taxable loss

Based on current tax law, a carry forwards taxable loss can be used against taxable profit within 10 years from when it was incurred. Carry forwards taxable loss at year end can be used as follows:

	2010	2009
Unadjusted taxable loss for the year 2006, usable until year 2016 .....	2.896.521	4.368.981
Unadjusted taxable loss for the year 2007, usable until year 2017 .....	76.416	76.416
Unadjusted taxable loss for the year 2008, usable until year 2018 .....	70.920.224	70.931.999
Unadjusted taxable loss for the year 2009, usable until year 2019 .....	5.179.713	5.179.713
Unadjusted taxable loss for the year 2010, usable until year 2020 .....	182.079	0
Carry forwards taxable loss at year end 2010 .....	<u>79.254.953</u>	<u>80.557.109</u>

Management has concluded based on their projections that there will be sufficient taxable profit in the future to use the stated deferred taxable asset.

# Notes

## 18. Inventories

Inventories are specified as follows at year end:	<b>2010</b>	<b>2009</b>
Inventory of materials .....	566.796	752.353

The Group's material inventories consist of material for maintenance, renewal and construction of the Group's production and distribution systems.

Purchase of inventories amounting to ISK 692 million (2009: ISK 944 million) through a two-year leasing agreement was entered into at the end of 2008. At the end of the leasing period legal ownership of the inventories will be with Orkuveita Reykjavíkur. The leasing agreement is accounted for in non-current liabilities.

## 19. Other financial assets

Trade receivables is specified as follows at year end:	<b>2010</b>	<b>2009</b>
Trade receivables, industrial consumers .....	451.120	682.585
Trade receivables, retail .....	3.511.002	2.947.351
Trade receivables, receivables .....	3.962.122	3.629.936
Allowance for doubtful accounts .....	( 300.481)	( 290.627)
	<u>3.661.641</u>	<u>3.339.309</u>

Other current receivables are specified as follows at year end:

Value added tax .....	16.457	61.077
Pre-paid expenses .....	6.712	222.509
Capital income tax .....	15.159	10.242
Accrued interest income .....	43.789	44.965
Receivables from employees .....	9.520	11.495
Other receivables .....	92	2.951
	<u>91.730</u>	<u>353.239</u>

## 20. Cash and cash equivalents

Cash and cash equivalents at year end are specified as follows:	<b>2010</b>	<b>2009</b>
Bank balances .....	2.343.648	2.943.303

## 21. Equity

Equity ratio of the Group at year end is 18.4% (31.12.2009: 14.4%). Return on equity was positive by 34.4% in the year 2010 (2009: negative by 5.5%).

In the year 2010, dividends were paid to the parent company's owners. The dividend payment amounted to a total of ISK 800 million (2009: ISK 800 million.)

The Company's Board of Directors do not propose dividend to be paid to the owners of the parent company in the year 2011 due to the operating year 2010. The owners of the parent company decide on dividend payments.

# Notes

## 22. Loans and borrowings

This note provides information about the contractual terms of the Group's interest-bearing loans and borrowings, which are measured at amortised cost. For more information about the Group's exposure to interest rate, foreign currency and liquidity risk, see note 25.

<b>Non-current liabilities</b>	<b>31.12. 2010</b>	<b>31.12. 2009</b>
Bank loans .....	193.902.191	199.828.760
Credit facilities .....	8.766.600	14.988.936
Bond issuance .....	21.692.110	16.527.168
	<u>224.360.901</u>	<u>231.344.864</u>
Current portion on non-current liabilities .....	( 16.443.990)	( 10.090.738)
	<u>207.916.911</u>	<u>221.254.126</u>
<b>Current liabilities</b>		
Current portion on non-current liabilities .....	16.443.990	10.090.738
Short-term bank loans .....	830.000	5.223.303
	<u>17.273.990</u>	<u>15.314.041</u>
Total interest bearing loans and borrowings .....	<u>225.190.901</u>	<u>236.568.167</u>

### Terms of interest-bearing loans and borrowings

Liabilities in foreign currencies:

	Date of maturity	2010		2009	
		Average interest rate	Carrying amount	Average interest rate	Carrying amount
Liabilities in CHF .....	26.6.2036	0.58%	41.746.713	0.72%	41.607.299
Liabilities in EUR .....	26.6.2036	1.29%	75.620.884	1.30%	84.089.942
Liabilities in USD .....	8.11.2030	1.37%	37.772.740	0.92%	44.716.978
Liabilities in JPY .....	26.6.2036	0.57%	21.949.837	0.69%	21.613.747
Liabilities in GBP .....	26.6.2036	1.69%	7.078.811	1.62%	8.202.315
Liabilities in SEK .....	5.10.2027	1.61%	13.548.619	0.81%	14.079.999
			<u>197.717.605</u>		<u>214.310.280</u>
Liabilities in Icelandic kronas:					
Indexed .....	10.1.2037	4.92%	26.643.296	4.88%	16.734.583
Non-indexed .....	15.1.2011	7.5%	830.000	10.5%	5.523.303
			<u>27.473.296</u>		<u>22.257.886</u>
Total interest-bearing loans and borrowings .....			<u>225.190.901</u>		<u>236.568.166</u>

# Notes

## 22. Loans and borrowings, contd.

Repayment on non-current liabilities are specified as follows on the next years:	<b>31.12. 2010</b>	<b>31.12. 2009</b>
The year 2010.....	-	10.090.738
The year 2011.....	16.443.990	17.689.392
The year 2012.....	12.605.836	13.307.154
The year 2013.....	27.976.909	30.606.873
The year 2014.....	14.881.311	14.904.521
The year 2015.....	12.369.891	12.237.860
Later .....	140.082.963	132.508.326
Total non-current liabilities, including next year's repayment .....	224.360.901	231.344.864

### Guarantees and pledges

The owners of the parent company are responsible, pro rata, for all of the Parent company's liabilities and obligations. The Group has not pledged its assets as guarantee for its liabilities.

### Covenants

Loans for the amount of ISK 14.313 million have certain covenants. Management regularly evaluate the covenants and in their view there is not danger of them being breached.

### Uncertainty regarding finance lease contracts

Among current liabilities is a finance lease contract in foreign currency, from an Icelandic leasing firm, amounting to ISK 246.7 million. This type of lease was ruled illegal in Iceland and the Company awaits recalculation of the debt as if the loan had been made in ISK. There is uncertainty regarding the final result of the calculation and the lease is booked according to initial terms of the contract.

## 23. Retirement benefit obligation

Upon the establishment of Orkuveita Reykjavíkur, an accrued retirement benefit obligation due to employees at that time was settled. The Company has retirement benefit obligation due to benefits of current and former employees in pension benefit plans. This obligation is due to companies merged with Orkuveita Reykjavíkur and due pension fund obligation has been taken over in relation to the merger.

The Company's accrued retirement benefit obligation amounted to ISK 457.3 million at year end 2010, discounted based on 2% interests and taken into account the share in the net asset of the pension fund (2009: ISK 480.4 million). The Company updates the obligation according to an assessment from an actuary each year when that assessment is available. Premises for life expectancy are in accordance with provisions of Regulation no. 391/1998 on obligatory insurance of pension benefits and operation of pension funds. The estimated increase in the obligation in the year is based on general increase in salaries taken into account interests. The increase of the obligation during the year is expensed in the income statement among salaries and salary related expenses. The part of the obligation that is estimated to be payable in the year 2010 is recognised among current liabilities.

Retirement benefit obligation is specified as follows:	<b>2010</b>	<b>2009</b>
Retirement benefit obligation at the beginning of the year .....	480.367	471.627
Contribution due to pension payments during the year .....	( 13.981)	( 16.260)
Increase in the pension fund obligation during the year .....	( 9.079)	25.000
Retirement benefit obligation at year end .....	457.307	480.367
Non-current component of retirement benefit obligation .....	441.488	464.547
Current component of retirement benefit obligation .....	15.820	15.820
	457.308	480.367

# Notes

## 24. Other financial liabilities

<b>Non-current liabilities</b>	<b>2010</b>	<b>2009</b>
Other financial liabilities at fair value through profit or loss:		
Currency swaps .....	23.395	50.186
<b>Current liabilities</b>		
Accounts payable .....	1.981.573	2.368.066
Other financial liabilities at fair value through profit or loss:		
Currency swaps .....	17.130	24.977
Other current liabilities:		
Unpaid taxes .....	265.395	797
Unpaid salaries and salary related items .....	715.844	518.804
Accrued interest expenses .....	656.553	664.509
Current component of retirement benefit obligation .....	15.820	15.820
Other liabilities .....	605.138	181.387
	<u>2.258.751</u>	<u>1.381.317</u>

## 25. Risk management and financial instruments

### a. Overview

Orkuveita Reykjavíkur has approved a policy on objectives and execution of risk management. The main objectives with risk management according to the policy is to contribute to a stable return and limit financing cost by limiting fluctuations in currency exchange and aluminium prices and to contribute to a low interest rate.

The Group's currency risk is related to cash flow risk and risk in the balance sheet. Interest rate risk is related to the variance of variable interests and fixed interests and can relate to both cash flow and the balance sheet. Risk due to variance of aluminium prices is due to the relation between electricity price to industries and aluminium price level and can relate both to the cash flow or the balance sheet.

The Group's currency risk is monitored both in cash flow and in the balance sheet with generally accepted calculation methods. Annual standards deviation and daily value at risk for liabilities and estimated cash flow in foreign currencies is measured. Risk in cash flow due to changes in aluminium prices and interests is measured based on the same method.

The policy defines risk and sets performance levels. The Company's Board of Directors receives on a regular basis a statement on the standing and performance of the Group's risk management.

Decision making and control on the execution of the risk management is in the hands of a risk committee. The risk committee consists of the Director, Managing Director of finance, Head of financial and risk management and Head of the financial department.

Financial risk is divided into:

- Market risk
- Liquidity risk
- Credit risk

# Notes

## 25. Risk management and financial instruments, contd.

### b. Market risk

Market risk is the risk that changes in the market price of foreign currencies, aluminium price and interests will affect the Group's income or the value of its financial instruments. This is the risk that weighs the most in the Group and is divided into:

- Currency risk due to liabilities in the balance sheet and cash flow in foreign currencies.
- Interest rate risk due to loans.
- Risk due to changes in the world market price of aluminium.

### i) Currency risk

The Group is exposed to currency risk on sales, purchases and borrowings that are denominated in a currency other than Icelandic kronas (ISK). Currencies mainly creating risk are Euro (EUR), Swiss Francs (CHF), Japanese Yens, (JPY), United States dollar (USD) and Swedish kronas (SEK).

Due to the economic situation in Iceland the Company has limited or no possibility to hedge against foreign currency risk since counterparties in forward contracts and other derivatives are not available in the Icelandic

Approx. 87.8% of the Group's non-current loans are in foreign currencies. The currency risk is hedged in accordance with the Company's policy on risk management where the interest cost of the loans is assessed together with the currency risk. Interest rate of loans in foreign currencies was considerably lower than for loans in Icelandic kronas. The Group has entered into long term electricity sales contracts in a foreign currency (USD). The expected future revenues from these contracts on the accounting date amount to approx. ISK 162.517 millions. That amount is based on the future price of aluminium on LME (London Metal Exchange) on the accounting date and expectations of price development of aluminium for the next 25 years according to the assessment of CRU, an independent evaluation party, as available on the accounting date.

Foreign exchange rate of the main currencies during the year is specified as follows:

	2010	2009	31.12. 2010	31.12. 2009
	Average exchange rate		Exchange rate at year end	
CHF .....	116,827	114,325	122,845	121,215
EUR .....	161,341	172,665	153,8	179,8
USD .....	122,193	123,601	114,91	124,81
JPY .....	1,465	1,325	1,413	1,35075
GBP .....	188,535	193,893	178,43	202,165
SEK .....	17,351	16,306	17,135	17,52
CAD .....	118,484	109,041	115,16	119,01
TWI .....	216,303	223,324	207,09	232,83

# Notes

## 25. Risk management and financial instruments, contd.

### b. Market risk, contd.

#### i) Exposure to currency risk

The Group's exposure to currency risk based on the nominal amounts is specified as follows (in ISK thousand):

2010	CHF	EUR	USD	JPY	GBP	CAD	SEK	DKK	Total
Loans and borrowings .....	( 41.746.713)	( 75.620.884)	( 37.772.740)	( 21.949.837)	( 7.078.811)	0	( 13.548.619)	0	( 197.717.605)
Accounts payables .....	( 139.201)	( 63.820)		( 85)		( 1.902)	( 665)		( 205.673)
Trade receivables .....			504.502						504.502
Bank deposits .....	55	474.769	669.812	79	998	347	7.867		1.153.928
Aluminium derivatives .....			20.411.105						20.411.105
Other financial assets .....			7.184.527						7.184.527
Balance sheet risk .....	( 41.746.657)	( 75.285.316)	( 9.066.614)	( 21.949.758)	( 7.077.898)	347	( 13.542.654)	( 665)	( 168.669.215)
Estimated sale in 2010 ....			6.853.028						6.853.028
Estim. Purch. in 2010 .....	( 1.385.737)	( 30.098)	( 853.697)				( 536)	( 2.270.068)	
Balance sheet risk .....	0	( 1.385.737)	6.822.930	( 853.697)	0	0	0	( 536)	4.582.960
Swaps .....	( 538.046)			497.521					( 40.525)
Net risk .....	( 42.284.703)	( 76.671.053)	( 2.243.684)	( 22.305.934)	( 7.077.898)	347	( 13.542.654)	( 1.201)	( 164.126.780)

# Notes

## 25. Risk management and financial instruments, contd.

### b. Market risk, contd.

#### i) Exposure to currency risk, contd.

2009	CHF	EUR	USD	JPY	GBP	CAD	SEK	DKK	Total
Loans and borrowings .....	( 41.607.299)	( 84.089.942)	( 44.716.978)	( 21.613.747)	( 8.202.315)	0	( 14.079.999)	0	( 214.310.280)
Accounts payables .....	( 12.374)	( 18.066)	( 37.368)						( 67.808)
Trade receivables .....			530.440		12	1.426	20	1.691	533.588
Bank deposits .....	234	7.084	2.556.769	308	3.251	230	106	0	2.567.982
Aluminium derivatives .....			20.164.273						20.164.273
Other financial assets .....			7.396.701						7.396.701
Balance sheet risk .....	( 41.619.439)	( 84.100.924)	( 14.106.163)	( 21.613.439)	( 8.199.053)	1.656	( 14.079.873)	1.691	( 183.715.544)
Estimated sale in 2011 .....			5.921.599						5.921.599
Estim. Purch. in 2011 .....		( 2.297.992)	( 135.676)	( 1.593.073)					( 4.026.741)
Balance sheet risk .....	0	( 2.297.992)	5.785.923	( 1.593.073)	0	0	0	0	1.894.859
Swaps .....	( 709.012)			633.849					( 75.163)
Net risk .....	( 42.328.451)	( 86.398.916)	( 8.320.240)	( 22.572.663)	( 8.199.053)	1.656	( 14.079.873)	1.691	( 181.895.849)

#### Sensitivity analysis

Strengthening by 10% of the Icelandic krona against the following currencies at year end 2010 would have increased (decreased) equity and profit or loss by the amounts shown below, taking into account tax effects.

	Profit or (loss)								
	CHF	EUR	USD	JPY	GBP	CAD	SEK	DKK	Total
The year 2010	2.671.786	4.818.260	580.263	1.404.785	452.985	( 22)	866.730	43	10.794.830
The year 2009	2.800.988	5.659.992	949.345	1.454.584	551.796	( 111)	947.575	( 114)	12.364.055

This analysis assumes that all other variables, in particular interest rates, remain constant. The analysis was performed on the same basis for 2009. Weakening by 10% of the Icelandic krona against the above currencies would have had the equivalent, but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

# Notes

## 25. Risk management and financial instruments, contd.

### b. Market risk, contd.

#### ii) Interest rate risk

A majority of the Company's loans bear variable rates. Due to present market conditions in Iceland the Company does barely hedge against interest rate risk.

Interest-bearing financial assets and liabilities are specified as follows at year end:

	31.12. 2010	31.12. 2009
<b>Fixed rate instruments</b>		
Financial assets .....	7.337.821	7.738.829
Financial liabilities .....	28.229.743	26.792.325
	20.891.922	19.053.496
 <b>Variable rate instruments</b>		
Financial liabilities .....	197.001.682	209.851.004
	197.001.682	209.851.004

#### Fair value sensitivity analysis for fixed rate instruments

The Group does not account for any fixed rate financial assets and liabilities at fair value through profit or loss, and the Group does not designate derivatives (interest rate swaps) as hedging instruments under a fair value hedge accounting model. Therefore a change in interest rates at the reporting date would not affect profit or loss.

#### Cash flow sensitivity analysis for variable rate instruments

A change of 100 basis points in interest rates at the reporting date would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular foreign currency rates, remain constant. Presentation has been changed from the financial statements 2009, by taking out of the calculations the effect of the embedded aluminium electric sale contract derivative. Comparative amounts have been changed in accordance.

	Profit or (loss)	
	100 p increase	100 p decrease
<b>1.1.-31.12. 2010</b>		
Variable rate instruments .....	( 1.255.499)	1.255.499
Cash flow sensitivity, net .....	( 1.255.499)	1.255.499
 <b>1.1.-31.12 2009</b>		
Variable rate instruments .....	( 1.410.794)	1.410.794
Cash flow sensitivity, net .....	( 1.410.794)	1.410.794

# Notes

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## 25. Risk management and financial instruments, contd.

### b. *Market risk, contd.*

#### iii) Aluminium price risk

The Group has entered into electricity sales contracts where the sales price of electricity is based on among other things the world market price of aluminium. The Group has not hedged specifically against aluminium price changes. Revenue from the electricity sales contracts related to aluminium price level amounted to 20.4% in the year 2010 (2009: 17.6%) of the Group's total revenue for the year.

#### **Sensitivity analysis**

A change in the aluminium price level by 10% at year end, whether by increase or decrease, would have the following effect on the Group's profit or loss after taxes.

	Profit or (loss)	
	31.12. 2010	31.12. 2009
Increase by 10% .....	6.797.375	7.224.300
Decrease by 10% .....	( 6.827.243) (	7.293.999)

#### iv) Other market risk

Other market risk is limited as investments in bonds and shares are an insubstantial part of the Group's operation.

### c. *Liquidity risk*

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses.

The Group's cash and cash equivalents at year end amounted to ISK 2.3 billion. Furthermore, the Group had unused loan authorisations and a open credit line to the total amount of approx. ISK 6.0 billion. The Group had thus in total ensured capital at year end to the amount of approx. ISK 8.3 billion. The corresponding amount at year end 2009 amounted to ISK 16.7 billion.

# Notes

## 25. Risk management and financial instruments, contd.

### c. Liquidity risk, contd.

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

31.12. 2010

#### Non-derivative financial instruments

	Carrying amount	Contractual cash flows	Less than 1 year	1 - 2 years	2 - 5 years	More than 5 years
Interest-bearing liabilities .....	225.190.900	( 287.602.690)	( 20.199.148)	( 16.505.776)	( 70.305.962)	( 180.591.804)
Accounts payable .....	1.981.573	( 1.981.573)	( 1.981.573)			
Other liabilities ...	2.258.751	( 2.258.751)	( 2.258.751)			

#### Derivative financial instruments

Currency swaps .....	40.525	( 42.350)	( 17.086)	( 14.079)	( 11.185)	
	229.471.750	( 291.885.364)	( 24.456.558)	( 16.519.855)	( 70.317.147)	( 180.591.804)

31.12. 2009

#### Non-derivative financial instruments

Interest-bearing liabilities .....	236.568.166	( 264.168.863)	( 18.307.776)	( 36.219.530)	( 64.152.032)	( 145.489.525)
Accounts payable .....	2.368.066	( 2.368.066)	( 2.368.066)			
Other liabilities ...	1.381.317	( 1.381.317)	( 1.381.317)			

#### Derivative financial instruments

Currency swaps .....	75.163	( 81.803)	( 24.876)	( 21.983)	( 34.944)	0
	240.392.712	( 268.000.049)	( 22.082.035)	( 36.241.513)	( 64.186.976)	( 145.489.525)

Non-current loans will presumably be refinanced in order to prolong the loan term. Therefore, the distribution of the repayments will presumably be different from the above.

# Notes

## 25. Risk management and financial instruments, contd.

### d. Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's receivables from customers. Losses due to unpaid receivables are insubstantial and have limited effect on the Group's return.

The carrying amount of financial assets represents the maximum credit exposure, which is specified as follows at year end:

	31.12. 2010	31.12. 2009
Trade receivable .....	3.661.642	3.339.309
Other current receivables .....	91.730	353.240
Other financial assets .....	7.337.821	7.738.829
Cash and cash equivalents .....	2.343.648	2.943.303
	13.434.840	14.374.681

The maximum exposure to credit risk for trade receivables at the reporting date by type of customer was:

Trade receivable, industrial consumers .....	451.120	682.585
Trade receivable, retail .....	3.210.522	2.656.724
	3.661.642	3.339.309

### Impairment

The aging of trade receivables and allowance for doubtful accounts at the reporting date was:

	31.12. 2010		31.12. 2009	
	Gross balance	Allowance	Gross balance	Allowance
Not past due receivables .....	2.902.451	81.489	2.573.050	36.917
Past due, 1 to 30 days .....	141.469	7.004	105.467	0
Past due, 31 to 90 days .....	281.275	8.319	328.720	241.038
Past due, 91 days and older .....	636.928	203.669	622.699	12.672
	3.962.123	300.481	3.629.936	290.627

### e. Fair value

#### Fair values versus carrying amounts

The carrying amounts of financial assets and financial liabilities is equal to their fair value with the exception that interest bearing loans are stated at amortised cost. The fair values of financial assets and liabilities, together with the carrying amounts are specified as follows:

	31.12. 2010		31.12. 2009	
	Carrying amount	Fair value	Carrying amount	Fair value
Interest-bearing liabilities .....	( 225.190.900)	( 217.643.060)	( 236.568.166)	( 218.876.273)

The fair value of interest-bearing liabilities are based on the present value of future principal and interest payments, discounted with the market rate of interest and an appropriate risk premium on the accounting date.

# Notes

## 25. Risk management and financial instruments, contd.

### e. Fair value, contd.

#### Interest rates used for determining fair value

Where applicable, the interest yield curve at the reporting date is used in discounting estimated cash flow. The interests are specified as follows:

	31.12. 2010	31.12. 2009
Embedded derivatives in electr. sales contr. ....	1.68% to 7.74%	1.23% to 6.54%
Other financial assets .....	5.44% to 7.22%	4.64% to 7.26%
Interest bearing loans .....	1.54% to 5.57%	2.05% to 11.0%

#### Fair value hierarchy

The table below analysis financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

Level 1: Quoted prices (unadjusted) in active markets for identical assets og liabilities.

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

Level 3: Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

31.12. 2010	Level 2	Level 3	Total
Shares in companies .....		2.062.445	2.062.445
Embedded derivatives in sales contracts .....		20.411.105	20.411.105
Other financial assets .....		7.184.527	7.184.527
Other financial liabilities .....	( 40.525)	( 40.525)	
	( 40.525)	29.658.077	29.617.552
<b>31.12. 2009</b>			
Shares in companies .....		2.187.047	2.187.047
Embedded derivatives in sales contracts .....		20.164.273	20.164.273
Other financial assets .....		7.396.701	7.396.701
Other financial liabilities .....	( 75.163)	( 75.163)	
	( 75.163)	29.748.021	29.672.858

Embedded derivatives in electric sales contracts that have more than 10 year duration er classified under level 3 due to the fact that the forward market for aluminium only reaches maximum of ten years.

# Notes

## 25. Risk management and financial instruments, contd.

### f. Overview of financial instruments

Financial assets and financial liabilities are specified in the following financial groups:

	31.12. 2010			31.12. 2009		
	Loans and receivables	Financial asset/ financial liability at fair value through P/L	Available for sale	Loans and receivables	Financial asset/ financial liability at fair value through P/L	Available for sale
Shares in other companies .....			2.062.445			2.187.047
Embedd. electr. sales contracts ..		20.411.104			20.164.273	
Other financial assets .....	153.293	7.184.527		342.128	7.396.701	
Trade receivabl. .	3.661.642			3.339.309		
Other receivabl. ..	91.730			353.240		
Cash .....	2.343.648			2.943.303		
Interest-bearing .. liabilities .....	( 225.190.900)		( 236.568.166)			
Other financial liabilities .....	( 40.525)			( 75.163)		
Account payabl. . (	1.981.573)		( 2.368.066)			
Other current liabilities .....	( 2.258.751)		( 1.381.317)			
	( 223.180.912)	27.555.106	2.062.445	( 233.339.569)	27.485.811	2.187.047

## 26. Statement of cash flows, details

Cash from operations before interests and taxes according to the statement of cash flows is specified as follows:

	2010	2009
Profit (loss) for the year .....	13.728.669 (	2.538.839)
Adjusted for:		
Financial income and expenses .....	( 10.752.590)	8.842.699
Minority interest .....	117	23.211
Share of (loss) profit of associated companies .....	( 24.308)	227.685
Income tax .....	3.036.718 (	1.398.124)
Depreciation and amortisation .....	7.962.448	7.813.770
Retirement benefit obligation, (decrease) increase .....	( 23.059)	8.739
Working capital from operation before interest and taxes	13.927.995	12.979.141
Inventories, decrease .....	241.395	305.533
Trade and other receivables, (increase), decrease .....	( 46.098)	85.957
Payables and other current liabilities, increase, (decrease) .....	781.942 (	105.824)
Cash generated from operations before interests and taxes	14.905.234	13.264.807

# Notes

## 27. Related parties

### Definition of related parties

Reykjavik city, institutions and companies ruled by the city, subsidiaries of Orkuveita Reykjavíkur, associated companies, Board members, Directors and key management of Orkuveita Reykjavíkur are considered as the Group's related parties. Spouses of the before mentioned and financially dependent children are also considered as related parties as well as companies owned by or directed by those in question.

### Transactions with related parties

The parties mentioned here above have had transactions with the Group within the last year. Terms and conditions of these transactions were equivalent with transactions with unrelated parties.

The following gives an overview of the transactions with related parties during the last two years as well as a statement of receivables and payables. This information does not include sale of conventional household supplies to the related parties.

Sale to related parties:	2010	2009
Reykjavik City .....	3.001.588	2.446.876
Institutions and companies controlled by Reykjavik City .....	501.275	603.781
Subsidiaries .....	152.673	381.033
Associates .....	21.944	20.499
Board members and key employees .....	71	1.310
	<u>3.677.551</u>	<u>3.453.499</u>

Purchases from related parties:	2010	2009
Reykjavik City .....	27.212	57.080
Institutions and companies controlled by Reykjavik City .....	25.183	53.309
Subsidiaries .....	52.978	245.284
Associates .....	59.868	66.983
Board members and key employees .....	484	2.999
	<u>165.724</u>	<u>425.655</u>

Receivables for related parties:	2010	2009
Reykjavik City .....	165.142	104.062
Institutions and companies controlled by Reykjavik City .....	3.164	176.027
Subsidiaries .....	26.999	72.716
Associates .....	1.380	15.185
Board members and key employees .....	0	2.301
	<u>196.685</u>	<u>370.290</u>

Payables for related parties:	2010	2009
Reykjavik City .....	14.001	13.822
Institutions and companies controlled by Reykjavik City .....	162	6.914
Subsidiaries .....	1.340	41.275
Associates .....	114	1.489
Board members and key employees .....	0	15
	<u>15.616</u>	<u>63.515</u>

### Guarantee fee to owners

Orkuveita Reykjavíkur paid a guarantee fee to Reykjavik City and other present and former owners of the company for guarantees they have granted on the Groups loans and borrowings. For further information regarding amounts and the guarantee fee, see note 9.

# Notes

## 28. Group entities

Shares in subsidiaries included in the consolidated financial statements are specified as follows:

Subsidiaries	Main operation	Nominal value	Share	
			31.12. 2010	31.12. 2009
Gagnaveita Reykjavíkur ehf.	Data transfer .....	4.736.841	100.0%	100.0%
Hitaveita Akraness og Borgarfj	Heating supplier .....			79.3%
Reykjavík Energy Invest ehf.	Investments .....	3.004.723	100.0%	100.0%
Úlfjótsvatn frítímabyggð ehf.	Preperation company .....	225.000	100.0%	100.0%
Hrafnabjargavirkjun	Preperation company .....	6.000	60.0%	60.0%

### Main changes in the Group during the year

In January 2010 Orkuveita Reykjavíkur purchased 20.7% share in Hitaveita Akraness og Borgarfjarðar (HAB) from the state. With the purchase Orkuveita Reykjavíkur became the only owner of HAB. HAB was intergrated into Orkuveita Reykjavíkur as of 1 January 2010.

## 29. Events after the Balance Sheet date

At the meetings of the regional councils of the City of Reykjavík, Akranes and Borgarnes, 28 and 29 March 2011, it was agreed to grant Orkuveita Reykjavíkur a subordinated loan amounting to ISK twelve billion. ISK Eight billion in the year 2011 and ISK four billion in the year 2013.

In conjunction with the loan, Orkuveita Reykjavíkur will take various actions, mainly the following:

- i) Certain new investments in the sewer system in the western part of Iceland and in Kjalarnes will be postponed for three years. Also there will be a change of emphasis regarding maintenance and new investments where maintenance will be postponed where possible and new investments will be significantly limited.
- ii) Further curtailing in the operations amounting to ISK five billion during the years 2011 through 2016. This curtailing is additional to curtailing carried out in the years 2009 and 2010.
- iii) Rates will be increased for hot water and sewer. The increase in revenue due from this is approximately ISK eight billion during the years 2011 through 2016. iv) Sales of assets are expected to raise ISK ten billion in the next three to four years.

The objective of the actions mentioned above is to secure the financing of Orkuveita Reykjavíkur in the year 2011, and for the years 2012 through 2016 without further involvement of credit institutions. Additionally the Company only intends to use existing credit facilities to meet market risk and other unforeseeable events.

## 30. Other issues

### Delays of power plant constructions

Due to delays in meeting contractual conditions in energy sales contracts between Orkuveita Reykjavíkur and Norðurál Helguvík, an uncertainty is present about the continuation of energy production projects. Review of energy sale contracts is ongoing with Norðurál. The review has not been completed. Therefore there have also been delays in the performance of contracts with other parties, such as machine producers and contractors. Negotiations have been conducted about compensations due to such delays. The most extensive are contracts with Mitsubishi Heavy Industries (MHI) and Balce Dürr (BD), regarding delivery of machinery. Since there is still uncertainty regarding investments, the amount of compensation to MHI and BD is not known. It is the view of the management that there is no reason to make provisions in the financial statements regarding the matter at this point.

An agreement was made with Jarðboranir regarding compensation in the year 2010, for time delays of drilling for power plant projects, in the amount of ISK 675 million. That amount has been expensed in the financial statements for the year 2010. If the contract with Jarðboranir will be terminated, parties have agreed on compensation in the amount of ISK 65 million.

# Notes

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## 30. Other issues, contd.

### **Effect of fluctuations in foreign exchange rates and aluminium prices on the Company's standing**

29 March 2011, the day Orkuveita Reykjavíkur's financial statements for the year 2010 were authorised for issues, the TWI is 216.0046 but was 207.409 at the reporting date 31 December 2010. If interest bearing loans and borrowings would be accounted for according to the foreign exchange rates on 29 March 2011 they would have amounted to ISK 230.0 billion or ISK 5.6 billion higher than accounted for at the end of the accounting period. Embedded derivatives in sales contracts, when taken into consideration changes in aluminium price and currency exchange rates, would have amounted to ISK 27.1 billion on the reporting date or 6.7 billion higher than on the accounting date. Further information about the effect of changes in the exchange rates and aluminium prices can be found in note 25.

### **Derivative contracts in default**

After the collapse of the Icelandic banks trading in the foreign exchange market in Iceland has been little and it can hardly be stated that the foreign exchange market is active. Due to the collapse, the Central Bank of Iceland issued rules on foreign exchange based on authority contained in the Act amending the Foreign Exchange Act No. 87/1992, which imposed restrictions on investment and transactions in foreign exchange.

Derivative contracts in default according to agreements with Glitnir banki hf. (old bank) are accounted for amongst other current liabilities. The agreements have not been calculated to date due to uncertainties both with Orkuveita Reykjavíkur and the Receivership Committees of the old banks concerning how to handle these calculations. It was decided, as a precaution, to refer to the mid rate of the Central Bank of Iceland as at 7 October 2008 which is the latest exchange rate before the Receivership Committee took over Glitnir banki hf.'s operations. The trade weighted index at that time was 175 and accordingly derivative contracts in default as accounted for in the financial statements are negative amounting to ISK 181.2 million. The contracts were accounted for amongst other financial assets or other financial liabilities but are now amongst other current liabilities.