

2012
ANNUAL REPORT



REYKJAVIK ENERGY



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FINANCIAL STATEMENT*

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HIGHLIGHTS FROM REYKJAVIK ENERGY'S HISTORY

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1909
*Water utility
launched*
...

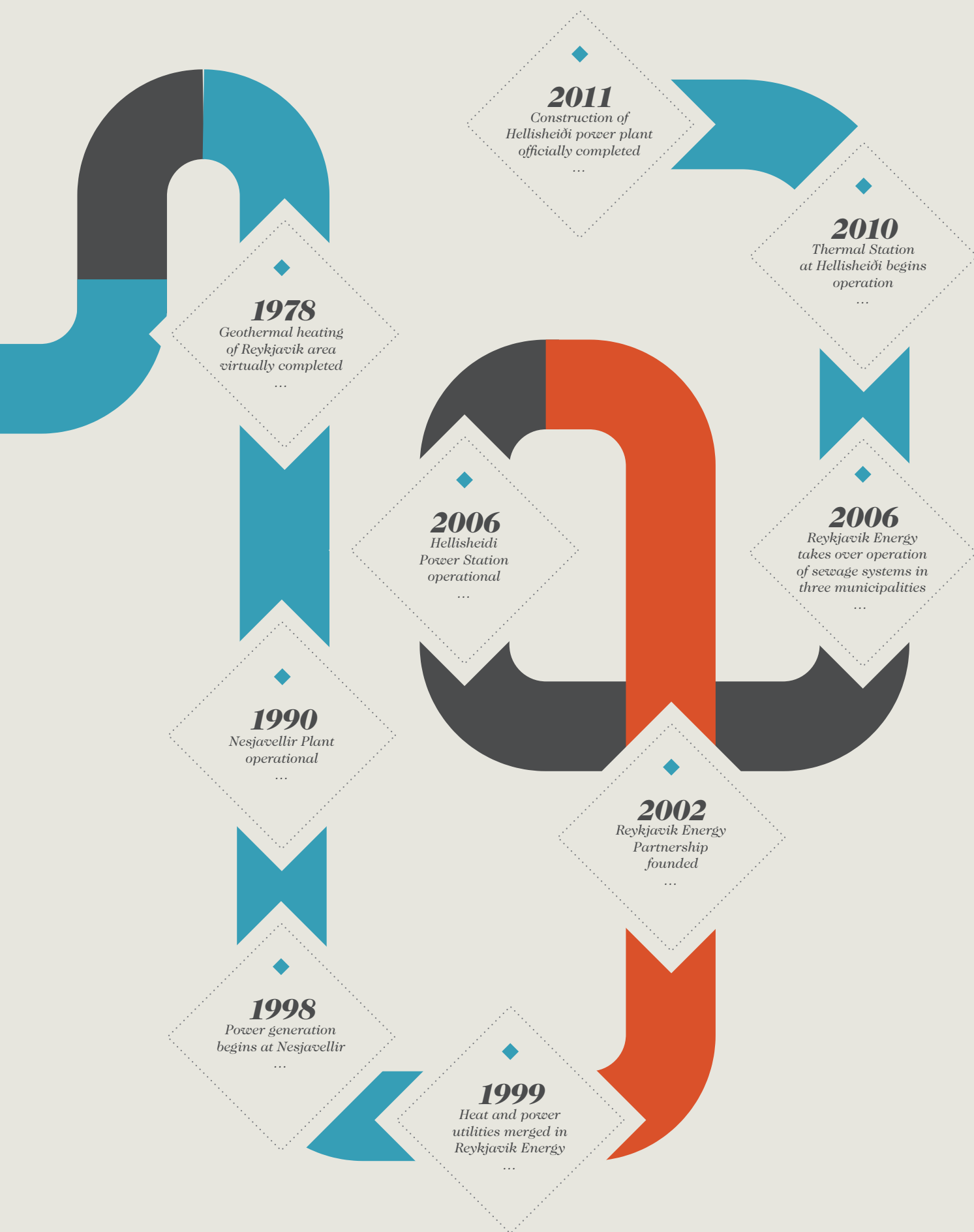
◆
1965
*Power stations
in Sogid transferred
to Landsvirkjun*
...

◆
1943
*Reykir Utility starts up
with geothermal water
from Mosfellssveit*
...

◆
1921
*Ellidaá
Power Station
inaugurated*
...

◆
1937
*Ljósafoss
Power Station goes on line
- First plant in Sogid*
...

◆
1930
*Heating utility launched
- Laugaveita*
...



1978
*Geothermal heating
of Reykjavik area
virtually completed*
...

1990
*Nesjavællir Plant
operational*
...

1998
*Power generation
begins at Nesjavællir*
...

2006
*Hellisheidi
Power Station
operational*
...

1999
*Heat and power
utilities merged in
Reykjavik Energy*
...

2011
*Construction of
Hellisheidi power plant
officially completed*
...

2002
*Reykjavik Energy
Partnership
founded*
...

2010
*Thermal Station
at Hellisheidi begins
operation*
...

2006
*Reykjavik Energy
takes over operation
of sewage systems in
three municipalities*
...



A nighttime photograph of a harbor scene. In the foreground, a blue and white boat is docked, with its railing visible. In the background, a tall crane with two bright lights at the top stands against a dark blue sky. To the left, a building with a brown roof is illuminated. To the right, a white building with a red and white striped awning and a sign that says "Elding Whale Watching" is visible. The overall scene is lit up by various lights, creating a vibrant nighttime atmosphere.

chapter

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FROM THE BOARD OF DIRECTORS

FROM THE BOARD OF DIRECTORS

According to Act No. 139/2001, Reykjavik Energy's Board of Directors is required to submit a report to the company's annual general meeting on the company's operations in the preceding year of operation. Reykjavik Energy also maintains detailed environmental accounts which are explained in the environmental report, published concurrently with the Annual Report. This introduction provides an account of the work of the Board of Directors in 2012.

The Board of Directors of Reykjavik Energy has six members, five elected by the Reykjavik City Council and one by the Municipal Government of Akranes. The municipal government of Borgarbyggð also elects an observer to attend board meetings. According to its schedule, the Board of Directors meets once a month, and 13 formal Board meetings were held in 2012. Three owners' meetings were held, in addition to the Annual General Meeting, which was held on the 14th of June, 2012. The Board has also gathered for informal working sessions for work on strategic planning. The guideline for the work on strategy was established with the approval of an Owners' Policy for Reykjavik Energy in 2012, and in the course of the year a consensus was reached on a new environmental policy for the company.

The principal challenge faced by the Board of Directors over the year were the company's finances. On the one hand this work involved the normal tasks of making plans and supervising their progress in conjunction with interim reporting. Early in the year, however, the Board agreed on a set of actions designed to reinforce its work on the company's finances for the long term. An integrated risk strategy was approved and an audit committee was appointed.

All business operations involve risk, and a risk strategy enables the company to assess risk factors in all of its operations and take action if the risk is perceived as unacceptable. The strategy includes benchmarking for use in assessing risk and lays down the principal methods, objectives and limits that need to be observed in the company's day-to-day risk management. The Board's principal aim with the risk strategy is to ensure that

Reykjavik Energy is at all times able to carry out its principal functions and meet its obligations, with minimum disruptions, resulting from unfavourable external factors.

The role of the Board's audit committee includes monitoring the company's accounting procedures and auditing its financial reports, supervising the company's internal auditing and risk management, and assessing the qualifications of the company's external auditors. The following were elected to the Audit Committee: Sigríður Ármannsdóttir, Chartered Accountant, Chairman, Gylfi Magnússon, Associate Professor, and Ingvar Garðarsson, Chartered Accountant.

When the report of the Owners' Review Committee on the operation of Reykjavik Energy from its foundation in 2002 through 2010 was published, the Audit Committee was asked to conduct an assessment of whether the reforms undertaken had addressed all the factors criticised in the report.

THE BOARD OF DIRECTORS

Haraldur Flosi Tryggvason, Chairman
Brynhildur Davíðsdóttir, Deputy Chairman
Gylfi Magnússon
Hrönn Ríkharðsdóttir
Kjartan Magnússon
Sóley Tómasdóttir
Ragnar Frank Kristjánsson, observing member



Ragnar Frank Kristjánsson, observing member, Gylfi Magnússon, Hrönn Ríkharrðsdóttir, Sóley Tómasdóttir, Brynhildur Davíðsdóttir, deputy chairman, Haraldur Flosi Tryggvason Chairman and Kjartan Magnússon.

Photo: Eyþór Árnason

ON THE WORK OF THE AUDIT COMMITTEE

Reykjavik Energy's Audit Committee was appointed by the company's Board of Directors on the 20th of January, 2012. The Board of Directors had approved rules of procedure for the Committee on the 16th of December, 2011. The Committee held 35 meetings in 2012, and six additional meetings were held with the City of Reykjavik's Audit Board.

The Committee returned four reports to the Board of Directors over the course of the the year providing an account of its work. Efforts over the year were focused on shaping the Committee's working procedures and examining the nature and operations of the company. In connection with the disclosure of the company's financial reports, the Committee met with the management and external auditors to review the company's accounts, the methods of processing financial information, and the procedures used by the company's external auditors.

One of the functions of the Audit Committee is to verify that the company's risk management is consistent with its policy and to ensure that the chief risk factors are identified, described and managed in an acceptable manner. The internal auditor has begun a review of Reykjavik Energy's risk management, with completion of the work scheduled for early 2013.

The Audit Committee assessed the independence of internal and external auditors in the course of the year. The Committee also reviewed the internal audits, including planning and prioritisation in the unit for the coming years, in addition to reviewing the management's plans for the improvement of the company's internal audit, in accordance with the advice from internal and external auditors.

Acting on a decision passed by the owners' meeting, the Audit Committee undertook preparations for the choice of external auditors, in collaboration with the City of Reykjavik's Audit Board. The Board of Directors asked the Committee to direct the work of assessing whether the reforms undertaken had covered all the factors that were criticised in the "Report of the Review Committee on Reykjavik Energy." Preparation for this work has begun.



chapter

2

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CEO'S ADDRESS





CEO'S ADDRESS

In the spring of 2011 the staff and management of Reykjavik Energy and the company's owners joined forces and worked out an elaborate action plan, which came to be known as "The Plan". The action plan was designed to resolve the company's financial difficulties. It was evident at that time that 2013 would be a particularly difficult year, as payments would need to be made in the amount of ISK 30 billion on the company's debt. Assuming an unchanged course, it would be impossible for the company to cope with its obligations.

This danger has now been averted by means of a co-ordinated effort with the participation of everyone involved in the company's operations. The staff has shown outstanding resourcefulness in cutting costs and changing working methods, while at the same time seeing off colleagues through unavoidable layoffs. Management has shown decisive leadership in bringing about the necessary changes in operations and identifying new targets. The Board of Directors has acted with cohesion in tackling the challenges and the company's owners – Reykjavik, Akranes and Borgarbyggð – have valuably contributed with subordinated loans. Not to mention Reykjavik Energy's customers, many of whom were severely affected by the financial crisis and had at the same time to cope with higher tariffs. In 2012, the full impact of The Plan became apparent. The restructuring of the operations was concluded in February, the full impact of cost cutting measures and increased income was realized and was soon followed by increased confidence among the company's creditors. Agreements were reached on reducing the payment burden of 2013, and the confidence in that the confidence in the difficult hurdle of servicing all 2013 will be cleared is reasonable. Everyone who contributed to this effort will in time benefit from the new situation.

The milestone decision was made in 2012 to transfer the Hverahlíð power project to an independent company. The Board of Directors and the company's owners also approved to sell 49% of the data utility Gagnaveita Reykjavíkur, now fully owned by Reykjavik Energy. The sale is scheduled for 2013, thus enabling the staff of Reykjavik Energy to concentrate on the company's core operations; efficient utility services to households and businesses.

In 2012 the owners of Reykjavik Energy came together and approved an Owners' Policy for the company. This is an important step in structuring a new and stronger corporate governance for Reykjavik Energy. In 2011 the owners appointed a review committee to review the operations of Reykjavik Energy during the period 2002 through 2010 to cast light on the difficult financial situation the company ran into. When the report was published in the autumn of 2012 it received close public attention. It is important to learn lessons from the mistakes of the past to avoid similar situation developing again. A new course has now been set, and the company has set sail into a more stable future.

Bjarni Bjarnason, CEO



The background image shows a person's hands holding a black handheld device, possibly a barcode scanner or a specialized terminal, in an office environment. A computer monitor is visible on the right side of the frame. The scene is brightly lit, likely from large windows in the background.

chapter

3

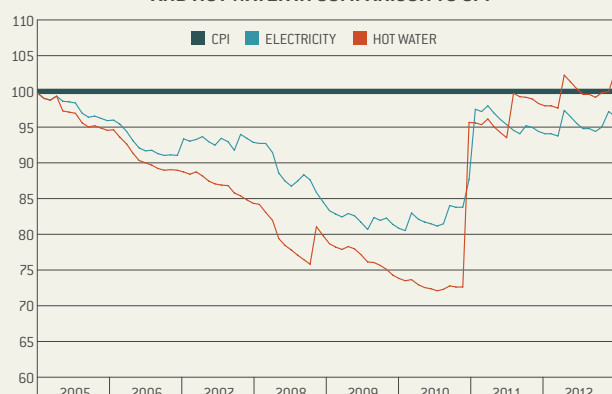
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FINANCIAL HIGHLIGHTS

FINANCIAL HIGHLIGHTS

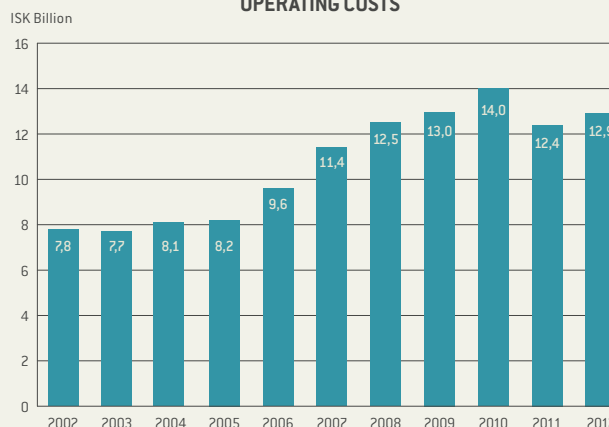
Good results in Reykjavik Energy's operations have significantly strengthened the company's ability to pay off its heavy debt burden. According to the Group's annual financial report for 2012, the operation returned ISK 25 billions in gross profit, and earnings (EBIT) amounted to ISK 15 billions for the year. The ratio of gross profit to debt is now similar to the levels before the financial collapse. The actions taken by Reykjavik Energy and its owners, referred to simply as "The Plan" and approved in March 2011, have been very successful, with the exception that sales of assets have taken longer than anticipated.

TARIFF DEVELOPMENT OF ELECTRICITY AND HOT WATER IN COMPARISON TO CPI



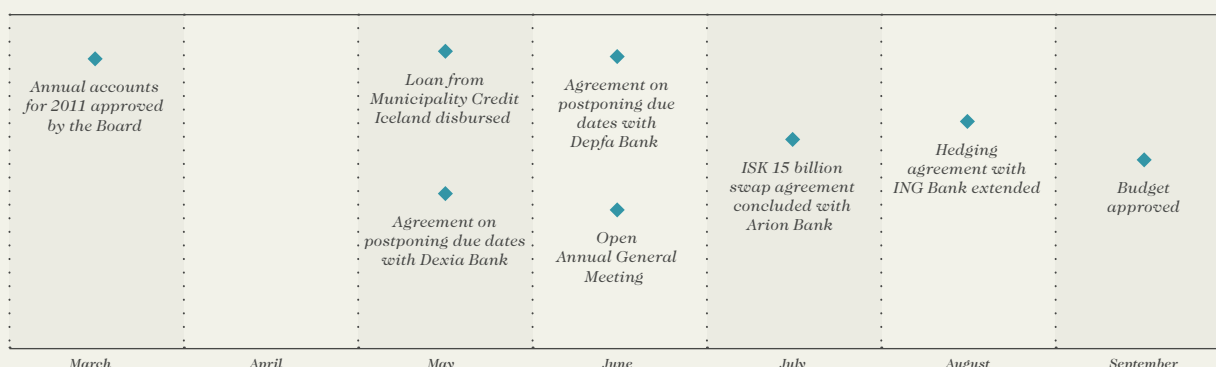
Reykjavik Energy's operating income has increased considerably in recent months. An adjustment was made to the income in connection with the Plan in the spring of 2011; real income from most service factors had fallen at that time, as tariffs had not followed price levels for several years. In 2012 tariffs for the first time reached the same real value as in 2005. The revision of tariffs was one of the actions that were necessary to strengthen the company's conditions of operation. The chart shows the trend of the tariff in comparison with the consumer price index.

OPERATING COSTS



Reykjavik Energy's operations have been undergoing a thorough review, where every single detail has been scrutinised. Continuous cost containment and monitoring have returned good results, with every single employee contributing to the effort. Operating expenses have been reduced in real terms and are now close to 2005 levels. The number of employees has been reduced by 181 since 2008, when construction work in the company was at peak levels; construction work is now at a minimum level.

THE FINANCIAL YEAR 2012 AT A GLANCE

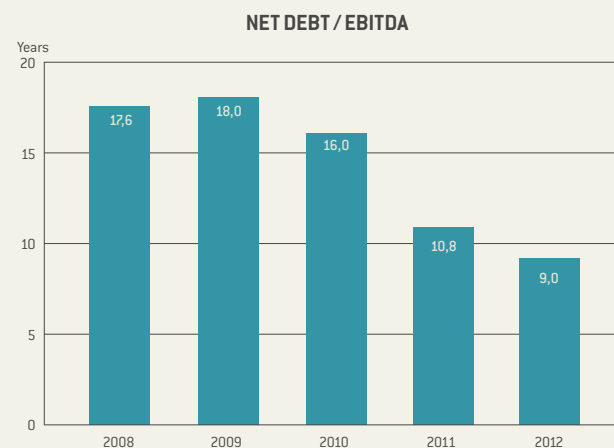
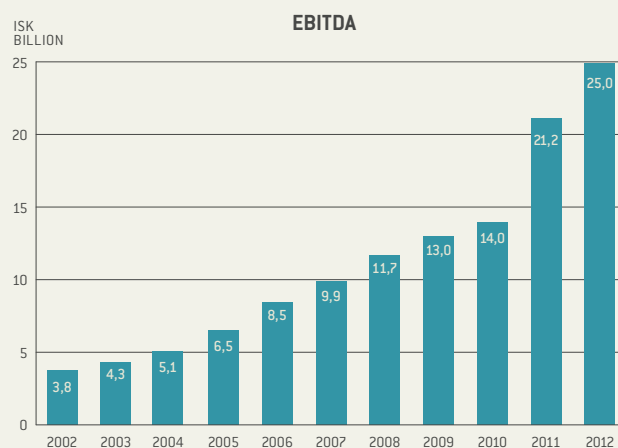


REYKJAVIK ENERGY POWER PLANTS AND THEIR OUTPUT

	ELECTRICITY	HOT WATER
GEOTHERMAL PLANTS		
Nesjavellir	120 MW	300 MW
Hellisheiði	303 MW	133 MW
Total geothermal plants	423 MW	433 MW
HYDROPOWER PLANTS		
Elliðaá	3,2 MW	-
Andakilsá	8,2 MW	-
Total hydropower plants	11,4 MW	-
Low temperature areas	-	600 MW
Total	434,4 MW	1.033 MW

STAFF FIGURES AT YEAR-END 2012

	WOMEN	MEN	ALL
NUMBER OF PERMANENT EMPLOYEES	127	229	426
AVERAGE AGE	45,8	48,6	47,7
AVERAGE LENGTH OF SERVICE	10,7	14,3	13,2
MAN-YEARS	135,7	340,5	476,2
REAL STAFF TURNOVER			2,70%

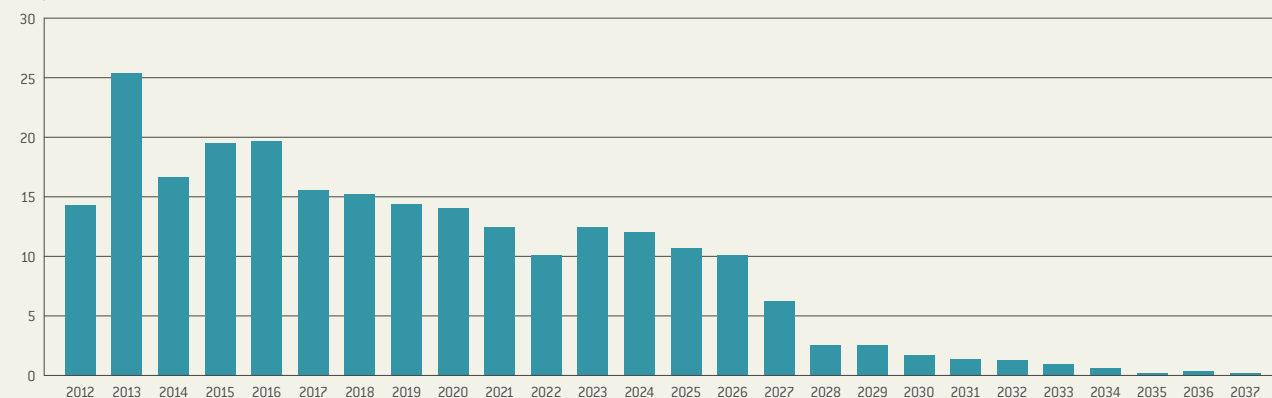


Trends in EBITDA are clear evidence of the turnaround in operation and show the company's significantly improved ability to service its loans. The positive impact of this trend is also revealed

if EBITDA is divided by net debt; the resulting figure shows the number of years it would take to pay up all of Reykjavik Energy's debt if EBITDA were used only to that purpose.

ISK
BILLION

PAYMENTS



Amortisations of Reykjavik Energy's loans will be heavy in 2013, but systematic steps have been taken to enable the company to meet all its obligations. In the absence of any significant turns for the

worse in external factors, such as exchange rates and aluminium prices, it is projected that EBITDA will return sufficient cash to cover payments on debts and necessary investments in the future.

The objective of the thorough reforms of Reykjavik Energy's operation was twofold. First, it was urgent to respond to the pressing financial difficulty facing Reykjavik Energy as a result of the increased debt burden and second, attention had to be focused on the company's core business, i.e. the operation of the utilities to make it more efficient. Every single employee at Reykjavik Energy has been involved in this work in one way or another, which bears witness to the unity of the company's staff.

The results have been immediate. Operating expenses have fallen sharply, and changed attitudes in the decision-making process have resulted in streamlining without any slackening of

requirements, relating to the delivery services of the systems.

The priorities in maintenance projects have been altered, with increasing emphasis on risk analysis in the systems instead of focusing on their age. The result is that maintenance is increasingly focused on areas where there are signs of weakness.

The following table shows the largest financial items in Reykjavik Energy's operation and their trends. Earnings before depreciation and taxes have increased by ISK 13 billion since 2008, which illustrates the turnaround in operations and the improved capacity of the company to deal with its debt load.

KEY FIGURES

OPERATION (ISK million)	2008	2009	2010	2011	2012	CHANGE 11/12
Electricity	11.529	12.540	13.622	16.732	18.414	10,1%
Hot water	5.717	6.003	6.491	8.434	9.650	14,4%
Cold water	1.971	2.510	2.577	2.748	3.040	10,6%
Sewerage	2.010	2.276	2.526	3.251	4.008	23,3%
Fibre-optic	669	797	1.000	1.170	1.386	18,4%
Other income	2.272	1.887	1.700	1.291	1.407	9,0%
Total operating income	24.168	26.013	27.916	33.626	37.905	12,7%
Operating expenses	(12.517)	(13.042)	(13.964)	(12.391)	(12.861)	3,8%
Earnings before interest, taxes and depreciation (EBITDA)	11.652	12.970	13.951	21.235	25.044	17,9%
Depreciation and amortisation	(6.953)	(7.814)	(7.962)	(8.881)	(10.371)	16,8%
Earnings (loss) (EBIT)	4.699	5.157	5.989	12.354	14.673	18,8%
Realised financial income and financial expenses	(3.364)	(4.258)	(3.424)	(3.635)	(5.169)	42,2%
Earnings before unrealised financial items	1.334	898	2.565	8.719	9.504	9,0%
Unrealised financial items	(89.435)	(4.812)	14.201	(16.027)	(13.334)	-16,8%
Income tax	15.064	1.398	(3.037)	6.751	1.535	-77,3%
P/L of the year according to the Financial Statements	(73.037)	(2.516)	13.729	(556)	(2.295)	312,6%
Balance sheet at year-end (ISK million)						
Power plants and utility systems	217.728	230.825	238.274	249.478	244.472	-
Other fixed assets	34.890	42.102	39.996	39.669	34.441	-
Current assets	6.755	8.598	8.270	7.238	18.289	-
Total assets	259.373	281.525	286.540	296.385	297.202	-
Total equity	48.359	40.657	52.847	61.643	60.648	-
Long-term liabilities	196.589	221.780	212.162	214.302	202.129	-
Current liabilities	14.425	19.088	21.531	20.440	34.425	-
Liabilities and Equity						
Net liabilities*	204.537	233.625	222.847	228.571	224.617	-
Cash flow (ISK million)						
Working capital from operations (FFO)	7.983	9.036	10.595	17.231	19.880	15,4%
Net cash provided by operating activities	7.699	8.429	11.588	16.930	18.935	11,8%
Investing activities	(32.373)	(20.470)	(14.542)	(9.539)	(2.747)	-
Financing activities	21.485	13.133	2.220	(8.068)	(11.360)	-
Cash						
Cash and cash equivalents at year-end	1.244	2.943	2.344	1.652	6.886	-
Undrawn credit facilities	14.799	13.800	8.298	5.900	6.800	-
Total liquidity at year-end	16.042	16.743	10.641	7.552	13.686	-
*Net liabilities are interest-bearing debts net of cash						
Financial Indicators						
Profit margin ratio	18,3%	19,8%	21,5%	36,7%	38,6%	-
Return on investments	9,3%	9,2%	9,7%	11,3%	12,8%	-
Outstanding sales ratio	13,6%	12,8%	13,1%	12,6%	12,5%	-
Equity ratio	18,6%	14,4%	18,4%	20,8%	20,4%	-
Current ratio	0,47	0,45	0,38	0,35	0,53	-
Cash from operations as a ratio of operating income	33,0%	34,7%	38,0%	51,2%	52,4%	-
Investment as a proportion of income	133,9%	78,7%	52,1%	28,4%	7,2%	-
Debt servicecover (EBITDA /paid liab. + net paid interest)	1,81	1,23	1,76	1,50	1,24	-
Interest cover	2,10	2,27	3,31	3,52	3,86	-

FINANCING

Last year Reykjavik Energy was granted a loan by Municipality Credit Iceland in the amount of EUR 6.2 million. The loan was taken to re-finance the ongoing sewerage system construction work in Akranes, Borggarbyggð and Kjalarnes, which had been financed on less favourable terms.

An agreement was reached with the French Dexia Bank on a postponement (to the end of 2015) of a large payment which was due in 2013. The payments covered by the agreement amount to ISK 5.4 billion. Heavy payments are due on the company's borrowings in 2013, but this agreement has significantly lightened the burden.

Reykjavik Energy also entered into an agreement with Depfa Bank on modifications of its payments on an EUR 30 million loan, a bullet loan due in 2016. This corresponds to approximately ISK 4.9 billion.

At year-end 2012 Reykjavik Energy held liquid capital in the amount of ISK 13.7 billion, including ISK 6.9 billion in cash.

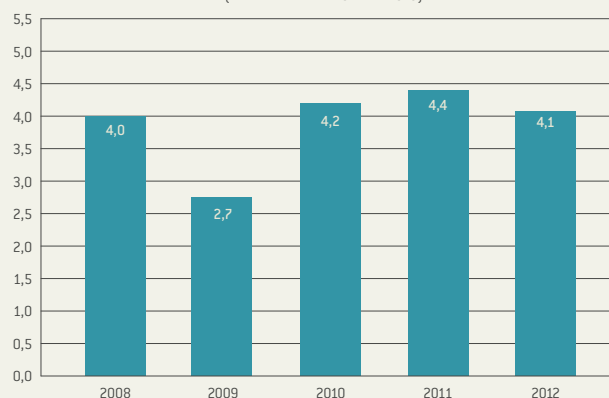
REYKJAVIK ENERGY RISK MANAGEMENT AND CREDIT RATING

Reykjavik Energy's risk strategy was approved by the Board of Directors on the 20th of January, 2012. The Board's policy is that risk should be taken into account in all of the company's business activities, thereby promoting responsible and efficient decision making and governance. A great deal of work has been spent over the year on implementing the risk strategy, and a number of steps have been taken to reduce the risks in the company's operations.

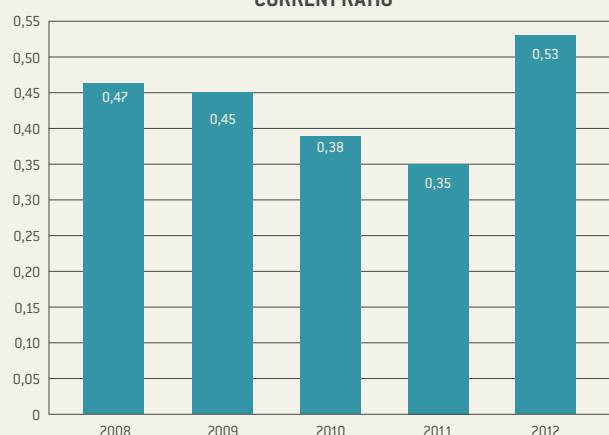
A currency swap contract was concluded with Arion Bank to hedge the company's financial situation against price fluctuations of the Icelandic krona. The agreement ensures access for Reykjavik Energy to foreign currency over the next six years; its value is assessed at approximately ISK 15 billion.

Continued risk-hedging co-operation with the Dutch ING bank has enabled Reykjavik Energy to mitigate risks relating to any unfavourable trends in world aluminium prices, interest and foreign exchange rates. Moody's credit rating for Reykjavik Energy was reviewed in February 2013 and remained unchanged from the preceding year: B1 with negative prospects. The credit rating without the owners' guarantee also remained unchanged at B3. The rating agency Reitun enhanced the company's basic credit rating to B- from C+, but the overall rating including the owners' guarantee remained at B+.

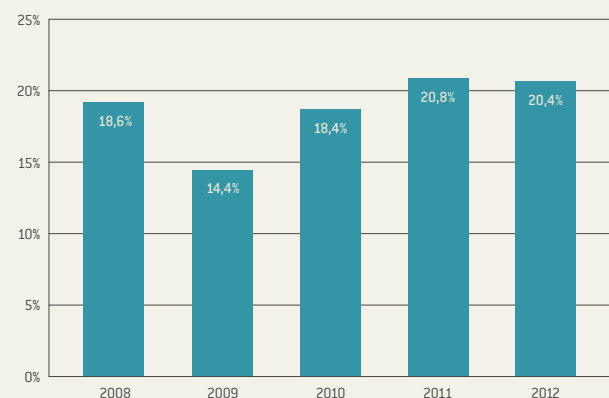
INTEREST COVER
(EBITDA/NET INTEREST EXPENSES)



CURRENT RATIO



EQUITY RATIO



THE PLAN

Reykjavik Energy and its owners' Action Plan – which we refer to simply as “the Plan” – was approved in the spring of 2011; it includes a number of actions designed to improve the company's cash position by ISK 50 billion through 2016. The actions include sales of assets, cost containment measures, postponement of investments, adjustment of the company's tariffs and reductions in operating costs.

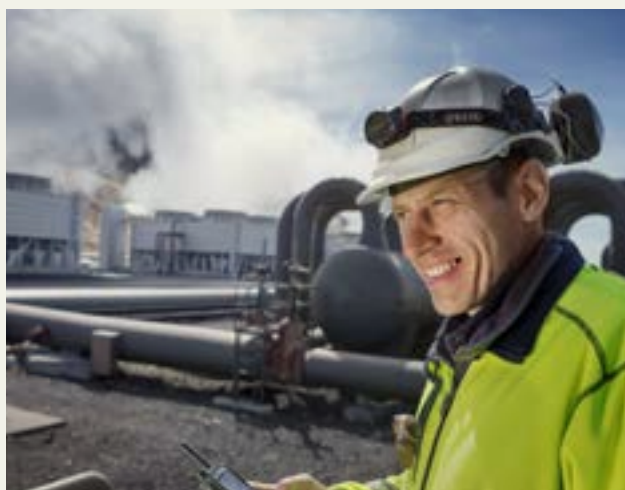
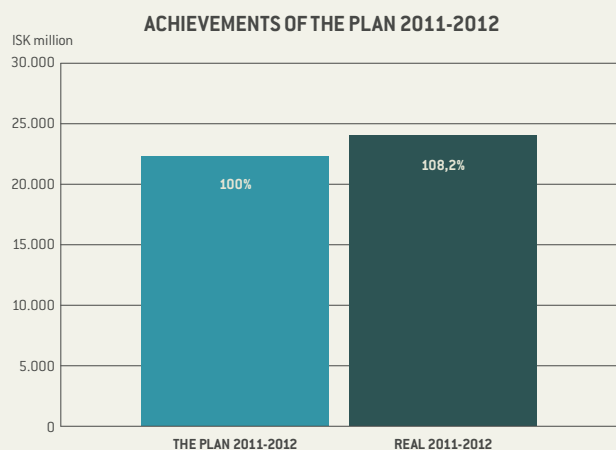
The total outcome of the Plan for 2011-2012 is approximately ISK 1.8 billion in excess of the targets for the year.

The impact of external variables was positive - interest rates, aluminium price and currency exchange - have proved more favorable than set forth in the Plan. All aspects of the Plan are on schedule, though sale of assets has taken somewhat longer than expected.

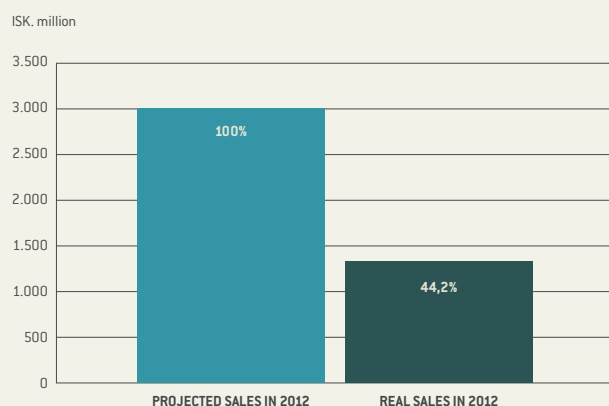
THE PLAN	2011	2012	2013	2014	2015	2016	TOTAL
Action Plan in ISK million	11.877	10.170	15.005	6.813	2.940	4.458	51.263
Principal actions:							
Reduction of investment in utility systems	1.205	3.518	2.690	2.518	2.410	2.659	15.000
Subordinated loan from owners	8.000	-	4.000	-	-	-	12.000
Sale of assets	1.000	2.000	5.100	1.900	-	-	10.000
Increased income from adjusted tariffs	1.122	1.552	1.215	1.295	1.330	1.499	8.013
Reduction in operating expenses	300	900	900	900	1.000	1.000	5.000
Reduction in other investments	250	200	200	200	200	200	1.250
Postponement of investments in sewage system	-	2.000	900	-	-2.000	-900	0

PROGRESS OF THE PLAN	REAL 2011	REAL 2012	REAL 2013	REAL 2014	REAL 2015	REAL 2016	TOTAL
Reduction of investment in utility systems	1.825	4.808	-	-	-	-	6.633
Subordinated loan from owners	7.925	75	-	-	-	-	8.000
Sale of assets	1.115	212	-	-	-	-	1.327
Increased income from adjusted tariffs	1.128	2.200	-	-	-	-	3.328
Reduction in operating expenses	747	887	-	-	-	-	1.634
Reduction in other investments	378	415	-	-	-	-	793
Postponement of investments in sewage system	-	2.150	-	-	-	-	2.150

ACHIEVEMENTS OF THE PLAN	REAL 2011	REAL 2012	REAL 2013	REAL 2014	REAL 2015	REAL 2016	TOTAL
Reduction of investment in supply systems	620	1.290	-	-	-	-	1.910
Subordinated loan from owners	-75	75	-	-	-	-	0
Sale of assets	115	-1.788	-	-	-	-	-1.673
Increased income from adjusted tariffs	6	648	-	-	-	-	654
Reduction in operating expenses	447	-13	-	-	-	-	434
Reduction in other investments	128	215	-	-	-	-	343
Postponement of investments in utility systems	0	150	-	-	-	-	150

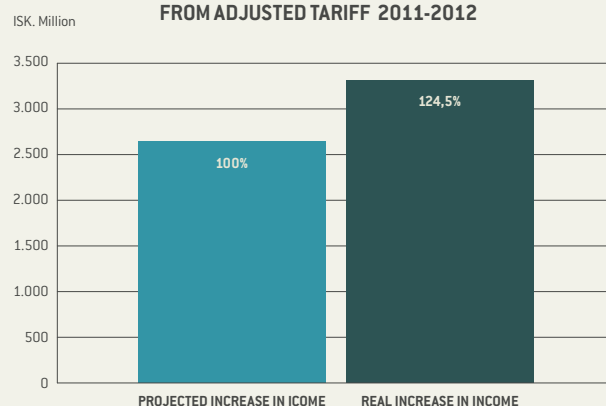


SALE OF ASSETS IN 2011-2012



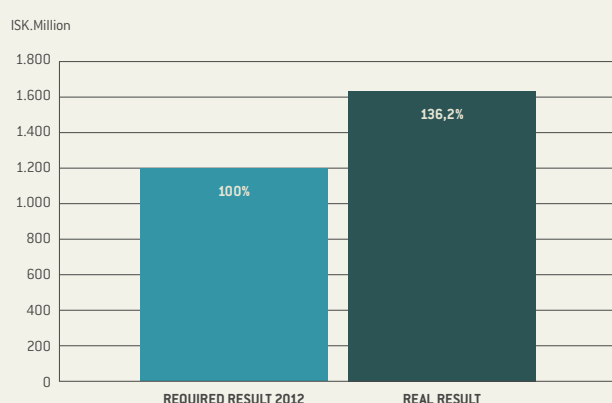
From the beginning of the Plan assets have been sold for ISK 1.327 million. Sold assets that are not a part of the core business of the company amount to ISK 804,5 million. Associated companies have been sold for ISK 398,1 million as well as various other assets and supplies have been sold for ISK 124,4 million. Various properties are undergoing sales procedures and it is expected that targets in the Plan regarding the sale of assets will be reached though the sale process has been more time consuming than expected.

INCREASED INCOME FROM ADJUSTED TARIFF 2011-2012



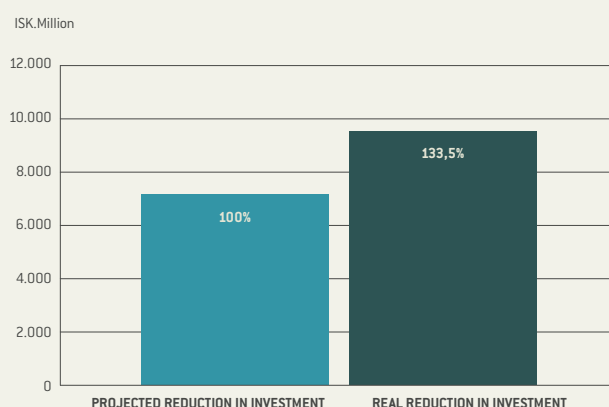
Adjustment of the company's tariff was intended to result in an increase in income of ISK 2.674 million for the period 2011-2012. This target was exceeded by ISK 654,3 million. All proposed tariff adjustments have been approved and implemented.

REDUCTION IN OPERATING EXPENSES 2011-2012



The cost containment target for 2011 - 2016 was ISK 5.000 million but actions to streamline the company's operations have returned results sooner than anticipated. A reduction in operating cost of ISK 1.200 million was projected in 2011-2012. However, the operating cost was lower than that figure by ISK 1.634 million, and the result therefore exceeded the target in the Plan by ISK 434 million for the years 2011-2012.

INVESTMENT 2011-2012



The Management of Utilities prioritises all projects based on importance, with specific attention to risk assessment, and sends its proposals to the Procurement Board for approval. For the year 2012 it was proposed that contributions to investments in utilities should be reduced by ISK 4.723 million, and investments to other projects should be reduced by ISK 450 million. On the one hand, investments are being reduced by means of changed procedures, and on the other hand certain defined sewerage projects are being postponed for two years. The postponement has the effect that ISK 2.9 billion investments are transferred from 2012-2013 to 2015 and 2016. The total investment in sewerage over a five-year period will therefore remain unchanged, but financing costs in the first half of the period will be reduced. This is extremely important in light of the heavy payment burden within the Plan's time frame.



A photograph of an industrial facility, likely a refinery or chemical plant. The scene is dominated by large, polished stainless steel pipes and vessels. In the foreground, a large U-shaped pipe is prominent. To the left, a worker in a yellow safety vest and white hard hat is partially visible. The background shows more industrial structures and a high ceiling with bright lights.

chapter

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THE YEAR IN BRIEF

THE YEAR IN BRIEF

10.01'12

Serious danger of damage when malfunction in Landsnet's system causes chain reaction in RE's plants and utilities

27.04'12

Board of Directors authorises CEO to enter into discussions on transferring the Hverahlid Power Plant to a separate company

15.04'12

Foundation of "Friends of Ellidaá Valley" the cradle of RE's operation

14.03'12

Nordic Investment Bank announces reduced interest on RE loans

25.01'12

Extensive reforms in RE governance announced

17.02'12

Bids for Perlan opened. Highest bid of ISK 1,689 million subsequently withdrawn

28.02'12

Restructuring in RE's operation completed with 20 employees laid off

14.12'12

Board approves
sale of Perlan to
the City of Reykjavik
for ISK 950 million.

22.11'12

First invoices showing
guarantees of origin of electricity
sent out to customers

12.06'12

RE holds open AGM,
where an account is given
of agreements with foreign
banks on changed loan payments

19.10'12

Board approves sale of 49% share
in Gagnaveita Reykjavíkur
subject to RE owner
approval

10.11'12

Repeated storms
cause power disruptions
in Reykjavik area

27.07'12

Call for tenders for
a new water utility in
Reykholtsdalur, where draughts
caused water shortages

10.10'12

Report of Review Committee
on RE's finances presented
- processing of conclusions begins

01.10'12

Report of independent
scientists' group on earthquakes
caused by fluid injection



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MANAGEMENT AND GOVERNANCE



MANAGEMENT AND GOVERNANCE

Reykjavík Energy is a partnership company governed by Act No. 139/2001 on the establishment of the partnership on Reykjavík Energy and Regulation No. 297/2006. Its activities are also subject to various special laws that apply to its respective fields of operation. The owners of Reykjavík Energy are the City of Reykjavík (93.539%), the town of Akranes (5.528%) and the municipality of Borgarbyggð (0.933%). The current partnership agreement between the owners, which provides, among other things for governance, dates from 2004.

OWNERS' STRATEGY

An important step was taken in 2012 to improve governance at Reykjavík Energy with the adoption of an Owners' Strategy. Since the adoption of the Strategy work has been in progress on reviewing other pillars supporting the framework for the company's operation. The owners are now reviewing their partnership agreement and the legislation governing the company in co-operation with the Ministry of Industries and Innovation.

The Owners' Strategy represents an attempt to clarify the role and responsibilities of the owners and ensure their participation in policy decisions on consequential matters; at the same time, the owners are seeking to create an engaging working environment for the company's directors and management to carry out their duties in the company's interests and in line with the strategy approved by the owners.

The Owners' Strategy focuses on respect for the environment, the responsible use of natural resources and a responsible use of funds. Reykjavík Energy shall act with integrity and social responsibility in its operations. The company seeks recognition as a reliable partner and it recognises its important community role.

REYKJAVÍK ENERGY'S CORE VALUES

A part of the policy changes that have been in preparation among Reykjavík Energy's owners, Board of Directors, management and employees has involved a revision of the company's core values. The course of work in 2012 resulted in the selection of three core values: Foresight, Integrity and Efficiency.

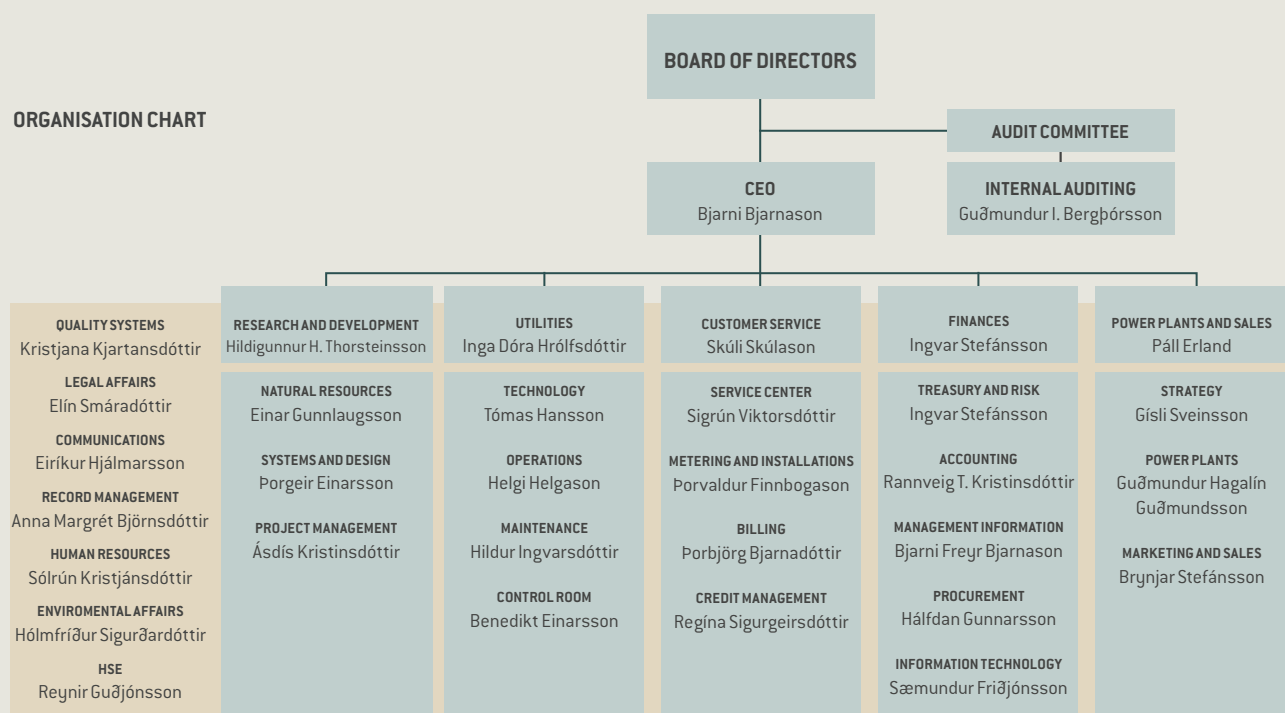
FORESIGHT refers in particular to Reykjavík Energy's role in the community, since utilities by nature require planning for the extreme long term, as the customers' needs for the services is ageless.

INTEGRITY refers to the way in which employees interface customers and each other, how they work and ensure transparency in the company's operations.

EFFICIENCY refers to the requirement of prudent day-to-day operations so customers receive defined services at a reasonable price.

In 2012, RE's employees infused a deeper meaning to these core values as they reflected on the values and incorporated them into the strategy and the day-to-day operation of the company.

ORGANISATION CHART



QUALITY SYSTEM

Reykjavik Energy operates under an integrated quality system that extends to the entire company and is aimed at ensuring reliable delivery and efficient services to customers. The quality system consists of the following documented and certified management systems:

ISO 9001: Quality management

ISO 14001: Environmental management

OHSAS 18001: Occupational health and safety management

ISO 27001: Information security management

HACCP: Food safety management

Electrical safety management system: A mandatory safety system that meets the requirements of the Iceland Construction Authority.

Reykjavik Energy's compliance with these standards is audited annually by independent certification authorities. The audits last year confirmed that the company's operation was as required by the standards.

MANAGEMENT AND ORGANISATION CHART

Bjarni Bjarnason is CEO of Reykjavik Energy. He is a geologist and engineer and was formerly head of Landsvirkjun Power, Kísilidjan (a diatomite plant) at Lake Mývatn and Icelandic Alloys at Grundartangi. Bjarni joined Reykjavik Energy in March 2011.

Ingvar Stefánsson is Chief Financial Officer. Ingvar holds a degree in business administration, specialising in auditing, and a

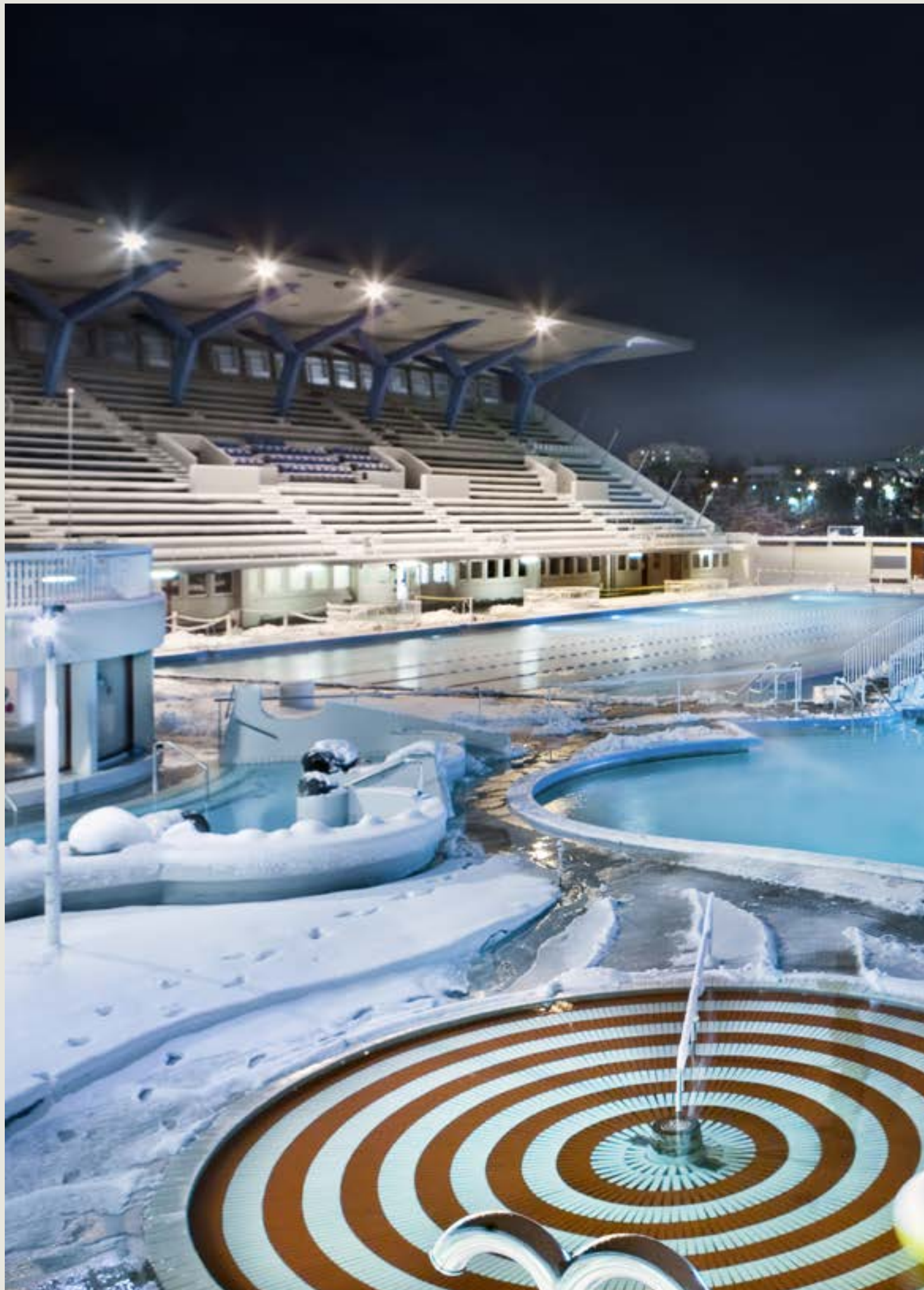
master's degree in financial management. Ingvar joined Reykjavik in 2011, having previously served as a managing director at Íslandsbanki Asset Based Financing. Ingvar is deputy CEO.

Páll Erland is Director of Power Plants and Sales. He studied industrial operations engineering before completing a degree in business administration and an MBA. Páll has been with Reykjavik Energy since 2001. He previously worked as a sales and marketing director and did consultancy work.

Inga Dóra Hrólfsdóttir is Director of Utilities. She holds a master's degree in civil engineering. She has been with Reykjavik Energy since its foundation, and was previously with the Reykjavik District Heating from 1996 and serving as the head of various units at the company.

Skúli Skúlason is Director of Customer Services. He holds a degree in business administration and a master's degree in strategic management. Skúli has been with Reykjavik Energy since 2009. He previously served as the Chief Financial Officer of the Sports and Leisure Council of Reykjavik and engaged in consultancy work.

Hildigunnur Thorsteinsson is Head of Research and Development. She holds a degree in industrial engineering from the University of Iceland and a master's degree from MIT, in the field of geothermal energy. Hildigunnur joined Reykjavik Energy at the end of 2012. She was formerly employed in geothermal projects abroad for an Icelandic company and at the United States Department of Energy, from 2009.



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PUTTING THE CUSTOMER FIRST



PUTTING THE CUSTOMER FIRST

Reykjavik Energy is committed to providing its customers with reliable and secure services and resolving any issues swiftly and proactively. Our employees are dedicated to keeping customers informed about our products and services.

Reykjavik Energy's core values – foresight, efficiency and integrity – are at the forefront all of the company's activities. High importance is placed on respect for customers and providing efficient and friendly service.

Reliable water, heating, electricity and sewage utilities are a fundamental part of the quality of life in Iceland; this is what Reykjavik Energy's service is largely about. At the end of 2012, the service area extended from Grundarfjörður in the north of the Snæfellsnes peninsula in west Iceland to Rangárvellir in south Iceland and included two-thirds of the country's population. To meet customers' needs, Reykjavik Energy operates diverse utility systems and generates electricity at four power plants in Iceland's south-west region.

Providing water and sewage utility service are legal responsibilities of municipalities. Electricity distribution and most heating utilities operate under a concession arrangement, whereas electricity generation, the sale/supply of electricity from power plants and the operation of fibre-optic cable networks are competitive market activities. Reykjavik Energy serves a total of 20 municipalities in south and west Iceland. Services differ in scope between municipalities.

UTILITY SERVICES 2012

Access to clean drinking water is one of the most valuable resources for the inhabitants and businesses of Reykjavik Energy's service area. Most people take clean potable water for granted in their daily lives, seldom considering whether the water's purity could be compromised. But communities where water purity issues have arisen have a clear understanding of the importance of clean potable water and of measures to prevent and remedy such problems.

Various factors pose a risk of pollution of groundwater and water sources in and around the capital region's water protection area, which serves more than half of Iceland's population. Among these risk factors are traffic on the Bláfjallavegur road and the Bláfjallaleið route, operations at the Bláfjöll ski resort, vehicle traffic and rest stops in the Heiðmörk Reserve, outdoor recreation, forestry, birds and vermin. Summer houses and year-round residences in

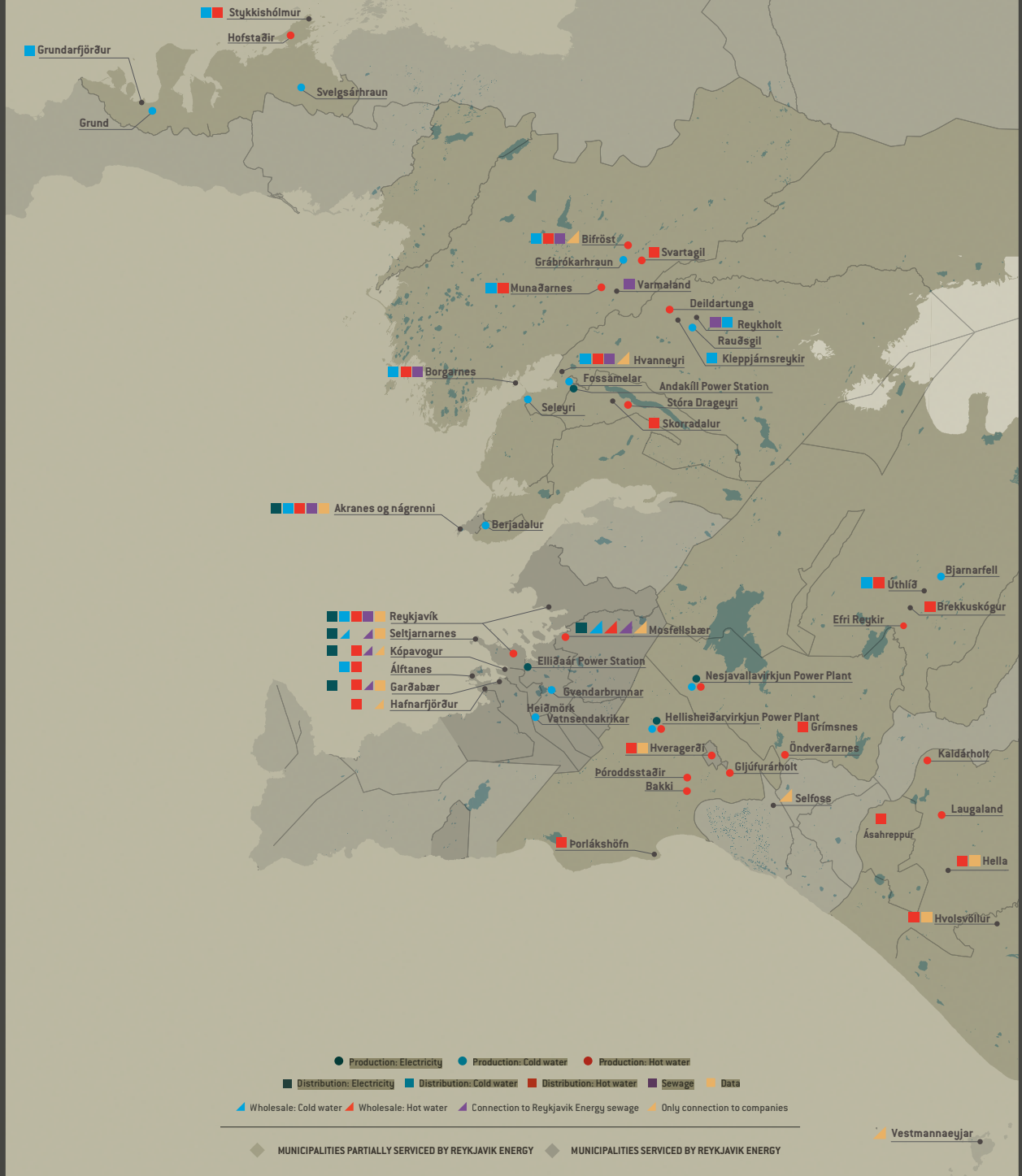
the area are also a source of potential risk. The Greater Reykjavik area's water resources and water protection areas are thus clearly coming under increased pressure.

In 2012, Reykjavik Energy took active steps to promote water protection, which sometimes was met with some resistance. It will nonetheless continue to inform regulators, municipal councillors, non-governmental organisations, the media and the general public about the necessity of protecting water sources to ensure safe drinking water in the future.

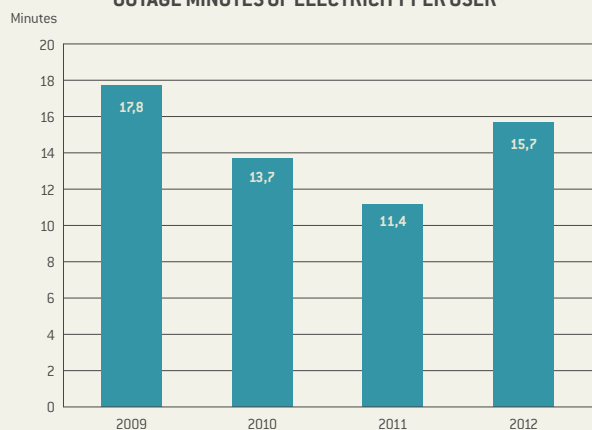
Water distribution network performance was good during the year, with only a few system disturbances. Water sources in the vicinity of populated areas are of vital importance and must be protected by every available means, including monitoring of groundwater levels to prevent contamination. Reykjavik Energy utilises water resources in the Heiðmörk conservation area and operates water utilities in many parts of south-west Iceland. The quality of drinking water is monitored, mostly by bacteriological analysis and chemical measurements, whose frequency is stipulated by a government regulation on drinking water.

Overall, performance of the district heating system was good during the year. No difficulties arose as regards water transmission capacity in times of cold weather and peak loads. Reykjavik Energy operates 13 district heating systems in south-west Iceland, of which the largest (in Reykjavik) is the largest geothermal district heating system in the world. Close monitoring is required of extraction methods and changes in water levels, temperature and chemical composition in each of the geothermal areas utilised. It is important to maintain a balance between utilisation and water levels in the reservoir. Any drop in temperature or change in chemical composition indicates an inflow of cold water. Reykjavik Energy keeps all the areas under close observation to enable their long-term sustainable utilisation. If an imbalance is identified, extraction needs to be decreased. Computer simulations of geothermal energy reservoirs have been used to predict how these areas will react to extraction. Models and simulations are under constant review, in light of the latest data so as to better manage extraction and production, and thereby ensure sustainable utilisation.

SERVICE AREA



OUTAGE MINUTES OF ELECTRICITY PER USER



Wastewater operations were successful during the year, with no major system disturbances or failures in either the collection system or the pumping stations and sewage treatment plants. The largest sewage infrastructure project awaiting completion is a major project in west Iceland, which has been ongoing for the past few years. As part of this project, four biological sewage treatment plants have been brought into service in inland rural areas, but financial difficulties in recent years have delayed completion of the sewage treatment and pumping stations in Akranes town, Borgarnes town and in the Kjalarnes district of Reykjavík.

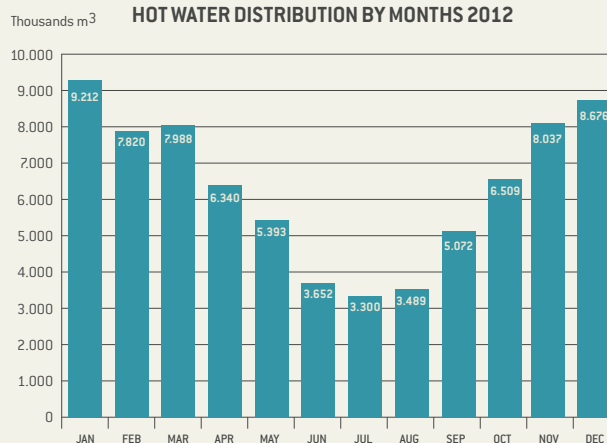
A significant effort was made to ensure the operational security of the electricity distribution system, but icing and salt accumulation caused some disturbances in substations.

MAIN SYSTEM DISTURBANCES IN 2012

In January, a failure occurred in the Brennimelur substation in Hvalfjörður Fjord owned by Landsnet, the transmission system operator. The failure was caused by salt accumulation and icing. This led to extensive power failures around Iceland, including an approximately half-hour outage in the town of Akranes. During the voltage fluctuations, due to the disturbance, many hot water and sewage pumps tripped, causing widespread hot water outages in South Iceland.

In early November, a severe storm broke over the capital area, causing a number of poles on the Kjalarnes power line to break, among other things. This led to a power outage in part of the Kjalarnes district. Because of the weather conditions, power could not be restored until approximately 24 hours later in some areas. A few days later, an extensive power outage occurred in the Grafarholt, Grafarvogur and Kjalarnes districts of Reykjavík and in the nearby town of Mosfellsbær. Salt accumulation on electricity infrastructure from the previous storm triggered a failure in Landsnet's substation at Korpa. Consumers in Mosfellsbær town were the worst affected and went without power for almost four-and-a-half hours.

HOT WATER DISTRIBUTION BY MONTHS 2012



Damage to a large cold water distribution pipe in central Reykjavík caused some service interruptions in August in the form of a water shortage, including the city centre's public swimming pool. One of the most extensive breakdowns occurred on a main line extending from a valve station on the Sæbraut road, by the Elliðavogur bridges in Reykjavík.

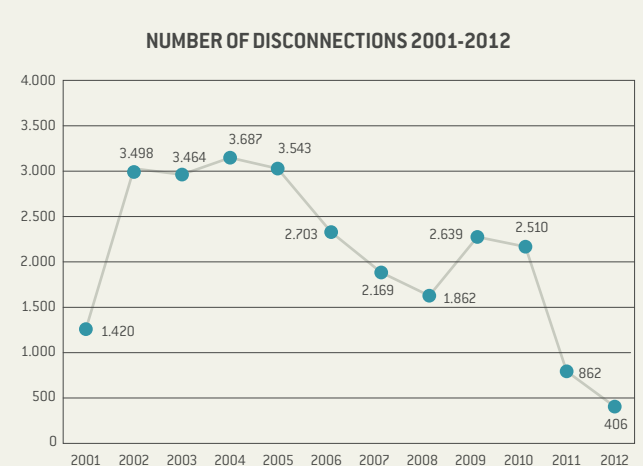
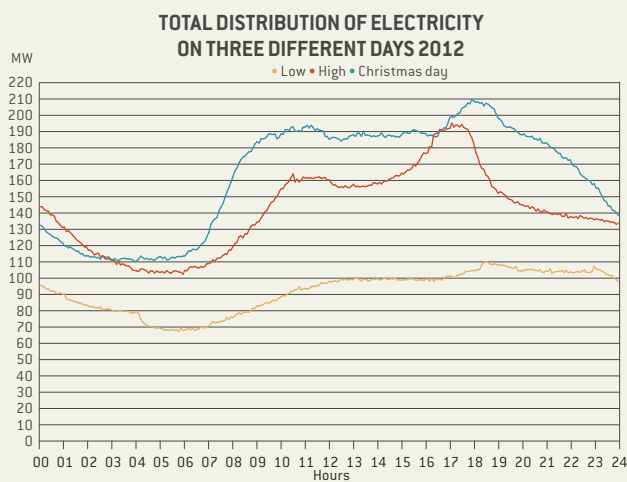
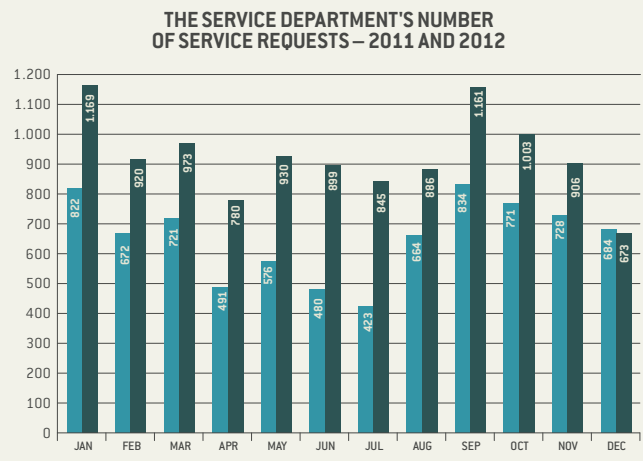
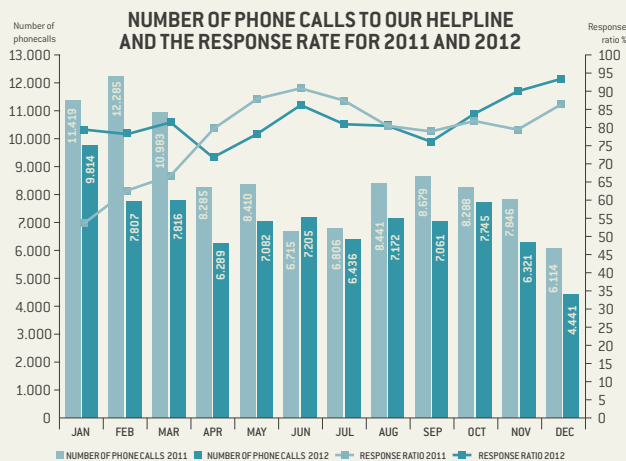
A number of failures occurred in the hot water supply pipeline for the towns of Akranes and Borgarnes in 2012, leading to disruptions for consumers in this service area. The number of failures was similar to that of previous years. Failures also occurred in the water supply pipeline for the Grafarvogur district of Reykjavík in September and October, causing a water outage for a part of the district during the repair time.

KEY MEASURES TO IMPROVE UTILITY SYSTEMS

- Renewal of hot water pipelines in the towns of Borgarfjörður, Hafnarfjörður and Þorlákshöfn and the Breiðholt district of Reykjavík
- Increasing supply for the water utility in Reykholtssalur and improvements to the control systems in Akranes town
- Renewal of fastenings on concrete weights on submarine sewage pipes.
- Comprehensive renewal of pipes under the Klapparstígur street in Reykjavík's city centre

RESEARCH ON UTILITY SYSTEMS AND THEIR DEVELOPMENT

The operation of utility systems requires a long-term approach, sometimes spanning decades, even centuries. Research in 2012 focused in particular on design criteria and consumption forecasts for heating utilities. Reykjavík Energy's forecasting time horizons range from looking at intra-day fluctuations, which can be useful when the distribution system's capacity is limited by failures or maintenance and when the weather outlook is unfavourable, to several years.



Since the pre-2008 period of rapid and extensive development of residential and commercial areas, the growth of Reykjavik Energy's utility systems has been focused mostly on single, large-scale projects. This includes the new National University Hospital, which will require a substantial load increase in our distribution systems. Reykjavik Energy has also been making preparations for utility connections to a new prison, due to be constructed at Hólmsheiði, on the outskirts of Reykjavik.

CUSTOMER SERVICES – KEEPING THE CUSTOMER INFORMED

At the heart of Reykjavik Energy's customer service ethos is the provision of clear and high-quality information, customer-friendly staff and reliability in resolving any issues that arise. During 2012, the company took steps to deepen employees' knowledge of Reykjavik Energy's service and product offering. It is very important for customers to have clear information on what to expect when system disturbances affect utility services, how long the situation will last during repairs and where to turn. A reliable and efficient service delivers real value to customers and success for the company.

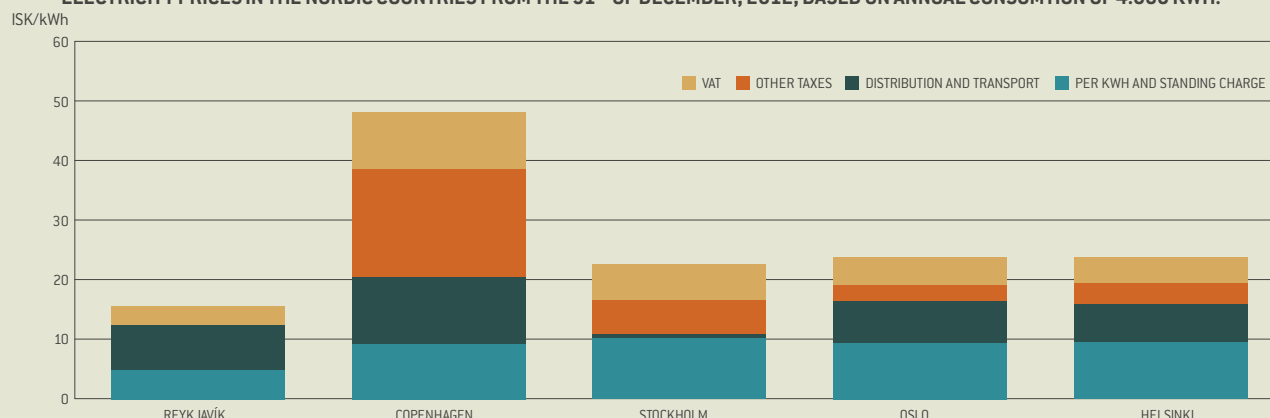
Recently, Reykjavik Energy has placed emphasis on developing e-services to broaden the use of the company's portal website (www.orkanmin.is), where customers can deliver their own

meter readings, view bills and water-and-sewage charges and keep track of their own consumption. The customer portal also provides various guidance and tips on Reykjavik Energy's products and services.

Customer satisfaction surveys in recent years had shown that customers found our bills complex and difficult to understand. In response to this feedback, Reykjavik Energy has improved the layout of invoices and simplified them considerably. Customers will receive invoices in the new and improved layout in the first half of 2013.

Rising numbers of customers have been struggling to pay their bills, as evidenced by a drop in the collection rate from the preceding year. Long-term arrears (over three months) have risen, with customers increasingly requesting payment rescheduling. Reykjavik Energy therefore reviewed its collection processes and gave service representatives wider scope to renegotiate with customers, in order to help them and to avoid having to cut off their power or water. This has delivered a significant drop in the number of disconnections as the number of payment rescheduling agreements has risen.

ELECTRICITY PRICES IN THE NORDIC COUNTRIES FROM THE 31ST OF DECEMBER, 2012, BASED ON ANNUAL CONSUMPTION OF 4.800 KWH.



PRICING OF ENERGY AND UTILITY SERVICES

Customer satisfaction is largely determined by expectations of the service, its quality and price. The bar chart above shows substantial differences in prices for electricity by utility companies in the Nordic capitals. The comparison dates from October 2012 and is based on the tariffs of the largest energy and utility companies in each capital city.

REYKJAVIK ENERGY AND THE COMPETITION

Reykjavik Energy's image has suffered some blows in recent years. This is evident from regular customer satisfaction surveys as well as from public discussion. The company's main focus in rebuilding its brand is to continue to improve services and to make cost and efficiency savings that strengthen the company's financial position. Reykjavik Energy also takes targeted actions to address specific areas of concern, identified in surveys.

The image problem is a hindrance to the company's progress in the face of stiff competition. The most important competitive component of activities is the sale/supply of electricity, which will likely be transferred to a separate company, together with electricity generation.

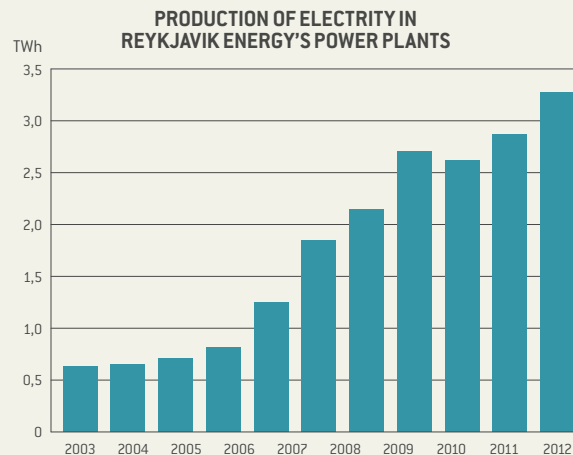
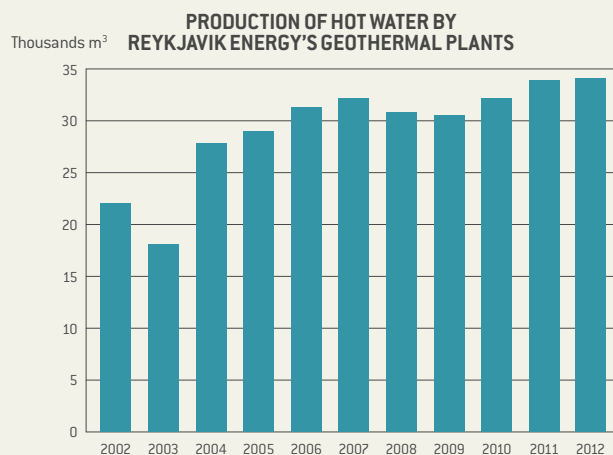
The electricity market has been developing at a rapid pace since being opened up for competition. This has been particularly evident in the past few years, with corporate clients increasingly calling for more services and advice on electricity purchasing. Reykjavik Energy's staff has placed a high priority on service flexibility, precision and professional advice. Competition has grown considerably in recent years and continues to stiffen, as the supply of electricity outweighs the market's demand.

The generation and supply of electricity are competitive activities. Reykjavik Energy is a player in this market and owns and operates four power plants. The jewel in the crown is the Elliðaár Power Plant, a hydropower plant in which the same generating units have been powered by the Elliðaá River since 1921. The second-oldest is the Andakílsá Power Plant, dating from 1947, which was acquired in 2001, when the town of Akranes and the municipality of Borgarfjörður (now Borgarbyggð) became partners in Reykjavik Energy and transferred their energy and utility infrastructure to the company.

The two geothermal power plants in the Hengill area ; at Nesjavellir and Hellisheiði – have long been considered emblems of Iceland's expertise and know-how in geothermal energy. Both plants produce hot water for the Greater Reykjavik area's district heating as well as electricity for power-intensive users and general consumers.

Power plant	Electrical capacity	Thermal capacity	Brought into service
Nesjavellir	120 MW	300 MW	1990-2005
Hellisheiði	303 MW	133 MW (can be increased to 400 MW)	2006-2011

The speed of development of the Hellisheiði plant made it more controversial than the Nesjavellir plant and revealed new challenges in the operation of geothermal plants in Iceland: significant environmental impact over a short period of time, increased hydrogen sulphide emissions and earthquakes induced by the re-injection of geothermal wastewater into the bedrock. Whilst this is a reminder that the natural resource used by the plants is a dynamic and active system, Reykjavik Energy has since attained a satisfactory balance in the plants' operation in this respect.



ENVIRONMENTAL IMPACT

Energy production in the Hengill geothermal area has had some negative impact on the natural environment. The main effects have been in connection with the disruptive nature of construction work, the disposal of run-off water and pollution caused by the emissions of hydrogen sulphide. Reykjavik Energy has been monitoring the impact and will continue to find ways to resolve these issues. The high-temperature area is closely monitored to assess the effects of utilisation and the effects compared with reservoir models and forecasts for the area.

The **Nesjavellir Power Plant** began operations in 1990 as a district heating utility for the capital. In 1998, the production of electricity began at the plant and the discharge of water increased significantly. The effluent water from the plant is separated water, condensed water and heated groundwater that is not utilised for heating. Much of the effluent water is disposed of at the surface by the Nesjavellir Power Plant. The highest level of effluent water tends to be disposed of during the summer months and is mostly heated fresh groundwater, as then is less need for hot water and central heating in the winter. More than a dozen boreholes have been drilled on site to investigate the effects on groundwater. The results show that the water from the springs in the lake has become warmer and action is being taken to resolve the matter.

The **Hellisheiði Power Plant** was opened in 2006. The history of the endeavour is therefore brief and the project was completed within a short timeframe. The effluent water from the plant has been pumped back into the geothermal system to ensure the sustainable status of the project and to protect the groundwater. The groundwater is monitored in over 40 boreholes, to measure the effects of the power plant on the environment. No significant increase in chemicals in the boreholes has been recorded. Procedures for pumping water back into the system have been reviewed and revised following seismicity that occurred when pumping began in a new area by Húsmúli in late 2011.

The regularity of the tremors has gradually been reduced. Construction of the power plant has mostly been completed and the focus has shifted to the restoration of the surroundings and of the local vegetation.

The increased development of geothermal energy production in the Hengill area has resulted in an increase in gas emissions in the immediate vicinity of urban areas. Reykjavik Energy has in recent years worked hard to find a solution to deal with geothermal gases such as carbon dioxide (CO₂), which traps heat and hydrogen sulphide (H₂S), which causes pollution. Work is in progress to reduce emissions of hydrogen sulphide (SulFix project) and carbon dioxide (CarbFix project) by delivering the geothermal gases back deep into the rock layers. This project is an attempt to mimic the natural process that is already taking place in geothermal areas and should therefore prove to be a satisfactory mitigation measure.

In the spring of 2012, Reykjavik Energy, Landsvirkjun and HS Orka formally convened to find environmentally friendly and cost-effective solutions to reduce the concentration of hydrogen sulphide in the air. The companies also support research at the University of Iceland in order to shed light on the possible health-related effects of hydrogen sulphide.

Reykjavik Energy wants to reduce the emission of hydrogen sulphide as much as possible and contributes to research and development in the field, in close cooperation with its stakeholders.



chapter

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HIGHLIGHTS FROM THE ENVIRONMENTAL REPORT



HIGHLIGHTS FROM THE ENVIRONMENTAL REPORT

On the 23rd of November, 2012, the Board of Directors approved a new Environmental and Resource Policy that gives environmental issues more weight than was previously the case. Given the high proportion of new management personnel at the company, changes in RE's business environment and evolving public views on environmental issues, Reykjavik Energy's environmental performance and policies were ripe for review. The Environmental Report's key findings are outlined below, while the full report (in Icelandic) can be viewed on our website: www.or.is.

NEW ENVIRONMENTAL AND RESOURCES POLICY

The Environmental and Resources Policy outlines the environmental principles and values as well as defining important environmental factors to enable a structured approach in RE's environmental management, with clear objectives and lines of responsibility between our employees.

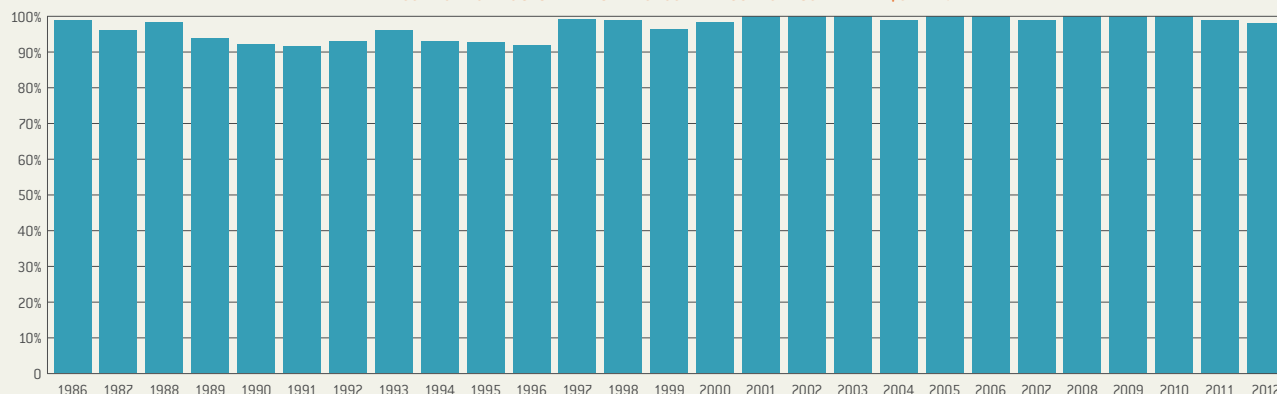
WATER PROTECTION AND THE QUALITY OF DRINKING WATER

Access to clean water for human consumption is among the most valuable resources of the inhabitants and businesses of any area. RE's employees shoulder the responsibility of meeting the water needs of homes and businesses in the service area. Water is obviously a basic necessity for households, in addition to which many businesses, not least in food production, are highly dependent on reliable access to clean water. While most people take clean drinking water for granted in their daily lives, communities where issues have arisen in this respect understand the importance of preventing the pollution of drinking water. Various

land use other than water extraction has in recent years been intensifying around the capital region's water resources, leading to a pressing need to improve the scientific preparation of decisions on future land use in water protection areas and their vicinity. Raising general awareness about the importance of clean drinking water is also essential in safeguarding water resources. The protection of drinking water sources and their responsible management in water protection areas is one of Reykjavik Energy's top priorities in ensuring the company's ability to meet its obligations and securing the long-term protection of potable water.

Each year, samples are taken from all of our water utilities for microbial analysis, the results of which over the past 27 years for Reykjavik are shown in the graph below. Samples are also taken for comprehensive chemical analysis. In 2012, a total of 106 water samples were taken in Reykjavik, of which two samples did not meet quality criteria. These were not taken during thaw conditions or infrastructure projects. The sampling was repeated and this time the samples did meet the quality requirements, meaning that this was not a significant deviation.

PROPORTION [%] OF WATERSAMPLES MEETING QUALITY CRITERIA, 1986-2012.
THE HACCP MONITORING SYSTEM WAS INTRODUCED IN 1997 TO ENSURE WATER QUALITY.



UTILISATION OF RESOURCES

Reykjavik Energy is committed to utilising resources in a sustainable manner. The impact of utilisation on extraction sites, both for cold and hot water, must be closely monitored. Groundwater levels have never fallen below benchmarks in its water protection areas in Heiðmörk. Balance is maintained between utilisation and water levels in low-temperature areas in the capital region. In the high-temperature areas at Hellisheiði and Nesjavellir, the draw-down (pressure drop) due to extraction is compared with the calculated drawdown according to a mathematical model, simulating the effects of the extraction on geothermal heat in the Hengill area. The drawdown at Nesjavellir does not disturb the extraction and is in satisfactory keeping with estimates. Hellisheiði has a short extraction history and development there has been rapid. Its calculated drawdown, according to the mathematical model, is in line with measurements and within the reference limits under the power development licence.

GAS EMISSIONS AND MONITORING OF GEOTHERMAL GAS EMISSIONS

Carbon dioxide (CO₂) and hydrogen sulphide (H₂S) are retracted as a result of power generation at Nesjavellir and Hellisheiði; see graph below. These geothermal gases have an environmental impact – CO₂ because of its greenhouse effects and H₂S because of its smell and toxicity, in high concentrations.

HYDROGEN SULPHIDE

Hydrogen sulphide (H₂S) emissions from RE's power plants in the Hengill geothermal area are currently our largest environmental challenge. H₂S emissions from the Nesjavellir and Hellisheiði plants in 2012 totalled 28,230 tonnes.

Regulatory limit for H₂S emissions is a maximum 24-hour running average of 50 µg/m³. The limit for the maximum annual average is 5 µg/m³.

Whenever the concentration exceeds 150µg/m³ for three consecutive hours, the environmental authorities must be notified. As of the 1st of July, 2014 the notification level will be reduced to 50 µg/m³.

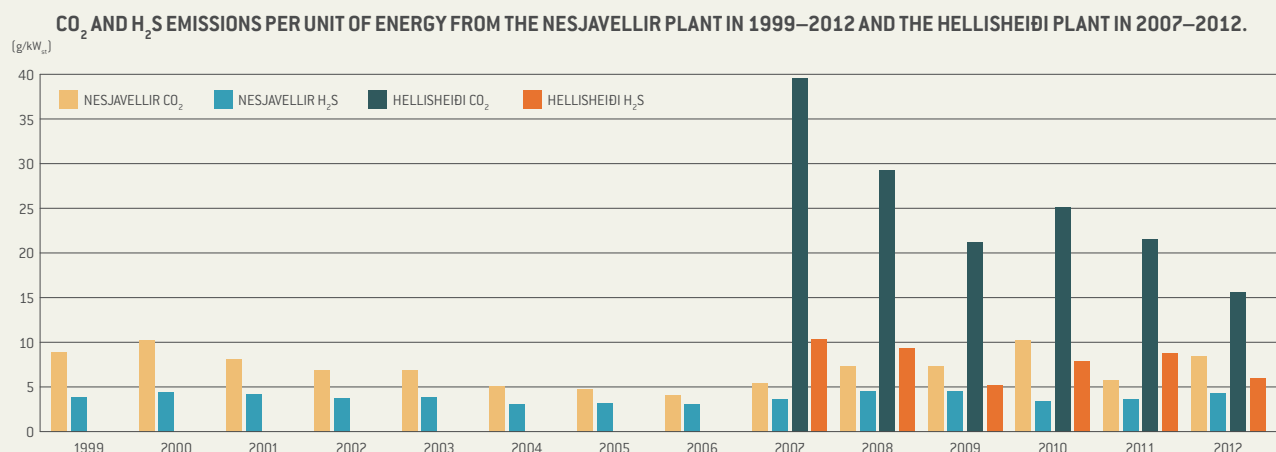
In 2012 an air quality chart recorder was set up in the industrial area at the Nesjavellir plant. This adds to three existing recorders: one in a nearby town, another at a Reykjavik district, and the third in the industrial area at the Hellisheiði plant. The results of the measurements can be accessed on the website of the South Iceland Board of Public Health (SIBPH): www.heilbrigdiseftirlitid.is. Improvements to the recorders were carried out in co-operation with SIBPH. At mid-year, a new service provider took over the recorders' operation and maintenance. A review of the SIBPH website's user interface for the general public was also completed.

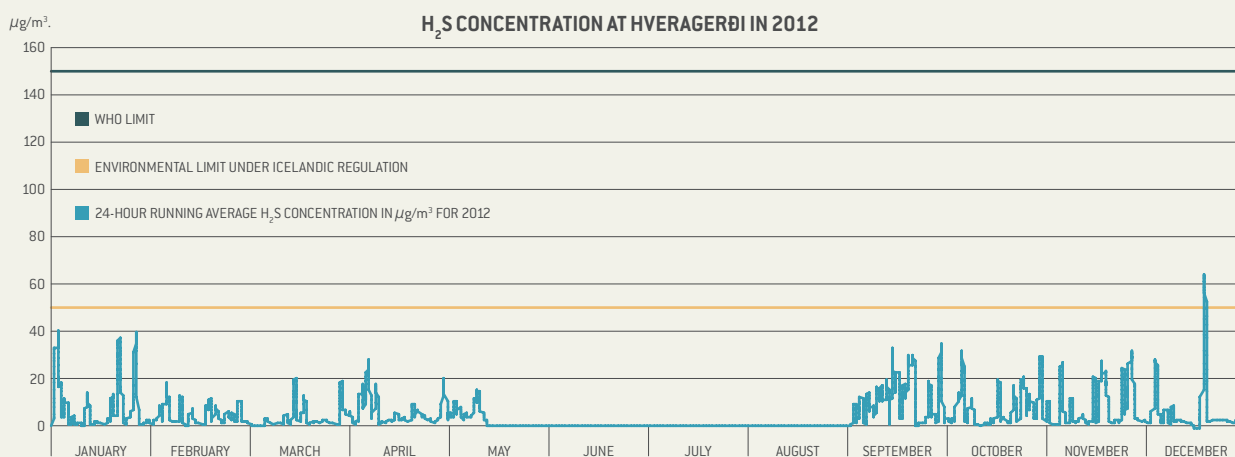
For 2012, the annual average H₂S concentration in the atmosphere could only be estimated, as the measurements during the year were not continuous. Measurements are missing for June and July at Norðlingaholt, when the recorder was out of order, and from June to August for Hveragerði. However, the missing measurements are from a period of the year when H₂S concentrations are expected to be at their lowest due to weather conditions. The estimated H₂S concentration exceeded the annual average at Hveragerði (6.1 µg/m³) but was below the annual average at Norðlingaholt (4.9 µg/m³). At Norðlingaholt the H₂S concentration once exceeded the reference limit for the 24-hour running average;

see the graphs on the next page. H₂S concentrations were below the notification limit during the year.

CARBFIX AND SULFIX INNOVATION PROJECTS

Innovative projects with the goal of reducing H₂S emissions, without producing sulphur or sulphuric acid (the SulFix project) or emitting carbon dioxide (the CarbFix project), from the power plants in the Hengill geothermal area have been in progress for





some years at the Hellisheiði plant. H₂S and CO₂ are injected through boreholes deep into the bedrock, where the compounds are expected to be permanently mineralised. Results indicate that pumping a mixture of H₂S and CO₂ into bedrock is technically feasible. Furthermore, a review of the SulFix method indicates that not only is it less cost-intensive than conventional industrial methods, but also much more eco-friendly, as the gas is returned to the geothermal reservoir and no sulphur or sulphuric acid is produced that needs to be disposed of on the surface.

PARTNERING WITH ENERGY COMPANIES TO CUT ATMOSPHERIC H₂S

In the spring of 2012, RE joined forces with Landsvirkjun and the geothermal power company HS Orka to develop an eco-friendly and efficient solution to reduce H₂S atmospheric emissions. The companies also support research by the University of Iceland into possible health effects of H₂S. The objectives are to cut H₂S emissions to the greatest extent possible and to foster research and development to this end in cooperation with stakeholders.

REINJECTION OF DISPOSAL WATER AND MONITORING OF GROUNDWATER

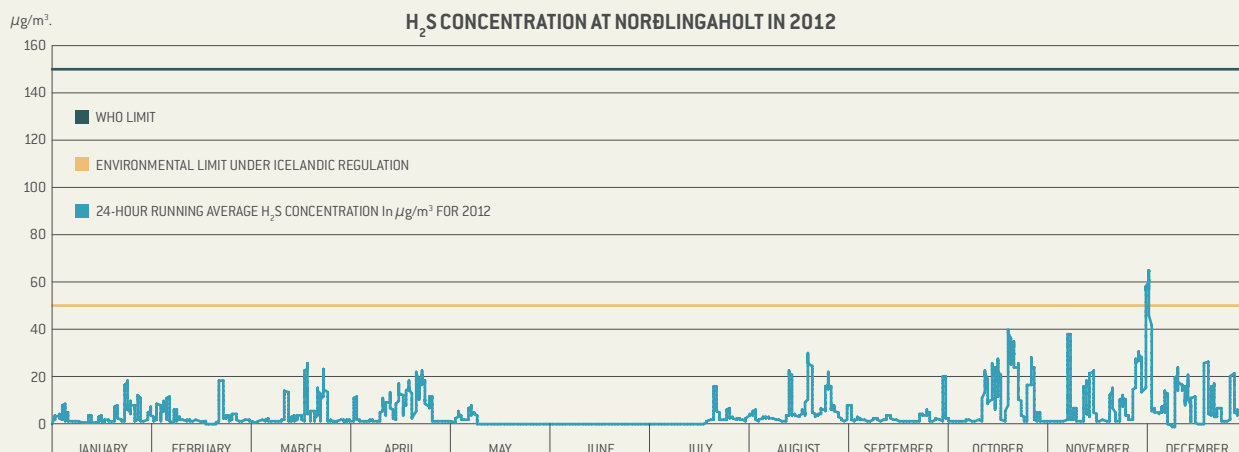
The Nesjavellir Geothermal Plant started operations in 1990 as a heating utility for the Greater Reykjavík area. In 1998, the plant started generating electricity, which increased its geothermal disposal water discharge substantially. This disposal water consists of separated water, condensed water and heated groundwater, not used for heating utility purposes. An average of approximately 400 kg/s of heated (65°C) groundwater from the Grámelur pumping station at Lake Thingvallavatn has been pumped into shallow boreholes and into the Nesjavellir stream. This disposal takes place mostly in summer, while there is little demand for hot water for heating purposes. Measurement results show that, largely as a result of this, the water temperature in springs at Lake Thingvallavatn has risen; see graph on next page. RE is looking at ways in

which to stem the rise in temperature in the springs at Lake Thingvallavatn, the idea being to deliver more hot water from Nesjavellir to districts in the capital region. We are also considering installing an additional cooling tower at the plant.

Separated water is rich in dissolved minerals that have been separated from the bedrock, as a result of the high temperature in the geothermal reservoir. Nearly half of the separated water and two-thirds of the condensed water at the Nesjavellir plant is diverted into re-injection wells extending into the lower groundwater strata (400-800m). However, approximately half of the separated water is disposed of into a shallow borehole at the plant. Efforts are underway to improve this situation.

At the Hellisheiði plant, separated water has been pumped into the geothermal reservoir through boreholes at Gráuhnúkar, Húsmúli and, for emergency disposal at the surface, near Húsmúli, as shown in the figure on next page. Reykjavik Energy is permitted to dispose of separated water at the surface in emergency cases, i.e. in the event of major breakdowns in the plant. Groundwater levels and the plant's impact on groundwater are monitored at more than 30 monitoring wells. No significant chemical increases have been detected in the wells.

As of the autumn of 2011, overflow water (a mixture of fresh groundwater from a water utility in Engidalur valley and condensed water from the plant's condensers) from cooling towers 5 and 6 at the Sleggja station building was discharged into a stream that runs from a ravine at the top of the Sleggjubeinsdalur valley and into a pond that was growing at a rapid rate. In 2012, remedial action was taken by drilling two 200m boreholes to receive the overflow water. To reduce the pond's size, cuts were made in the lava to open up a way for the water to seep into the lava's crevices.



SEISMICITY

Considerable seismic activity occurred in the Húsmúli area near Hellisheiði Power Plant when reinjection of disposal water into the geothermal reservoir began in September 2011. This induced seismicity has since subsided to a low level. In September 2012, a team of experts delivered a report setting out procedures for the development and operation of re-injection areas, as well as dealing with training, consultation and co-operation with residents in the vicinity.

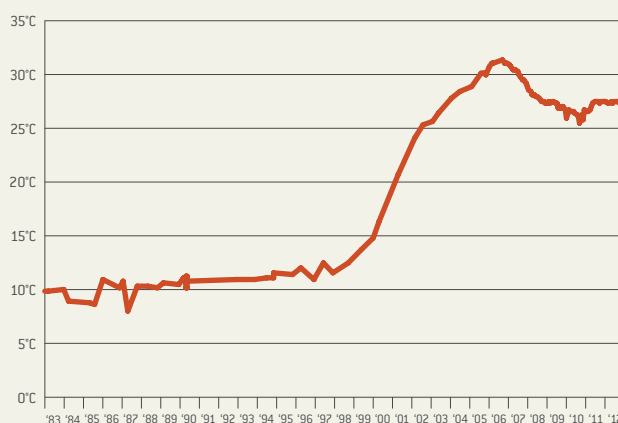
SEWAGE

The disposal of wastewater discharge from sewage treatment stations and disposal through overflows are important environmental considerations for our sewage systems. These factors are closely monitored and remedial measures are taken where needed.

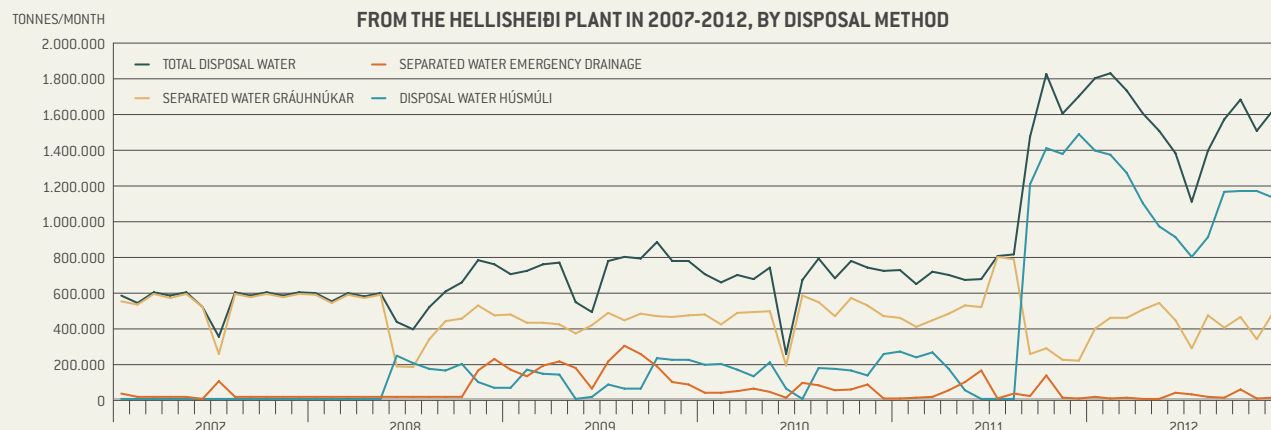
SITE RESTORATION AND REVEGETATION

Infrastructure development at the Hellisheiði plant is mostly complete, so the current focus is on site restoration and revegetation. The methods used are mostly based on the results of experiments carried out in the power plant's surrounding area in co-operation with the Agricultural University of Iceland.

WATER TEMPERATURE (°C) AT VARMAGJÁ 1983-2012



QUANTITY OF DISPOSAL WATER (TONNES/MONTH) FROM THE HELLISHEIÐI PLANT IN 2007-2012, BY DISPOSAL METHOD







chapter

8

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HUMAN RESOURCES

HUMAN RESOURCES

Reykjavik Energy's development and progress depends on the efforts of employees possessing appropriate education and knowledge and dedicated to working toward the company's objectives.

Reykjavik Energy's permanent employees were 426 at year-end 2012, 299 men and 127 women. The average age of permanent employees was 48 years and the average length of service was 13.2 years. Work was continued on the Action Plan, which is designed to reduce operating costs and streamline operations and the number of permanent employees was reduced by 27 throughout the course of 2012. Staff turnover was 13.7% and was mostly due to the offer of early retirement for employees over 63 years old. The voluntary turnover; or the percentage of staff who resigned, was in fact 2.7%. The continuous redesigning of the company also gave a number of staff the opportunity to take on new challenges and to transfer between departments within Reykjavik Energy.

During the year, systematic efforts were made to improve morale and job satisfaction. Workplace surveys, assessing human resources and management at the company were conducted in December. The results showed positive developments and an increase in grading since the previous year. About 80% of all the topics measured had increased in grading since the previous year; including important issues such as job satisfaction, morale and effective management.

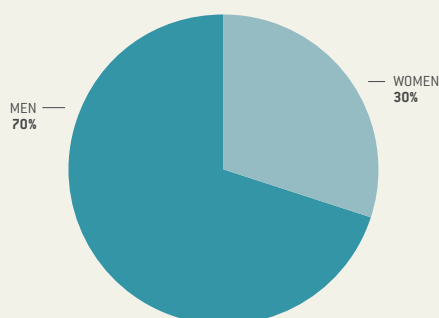
At Reykjavik Energy we attach great importance to the qualifications of our staff and we therefore invest in education and training. In 2012, about 90 training events were held of various kinds. On average, each employee attended about four events. One of the key tasks of the year was to strengthen the management team. Some significant changes were made in the company's organisation chart. It was important to create unity within the team and to strengthen its development through training, dissemination of information and assignments. All managers were subjected to management evaluation and individual training schedules, and in addition, the team underwent a programme of management training in order to create a joint understanding and comprehensive overview.

EQUALITY

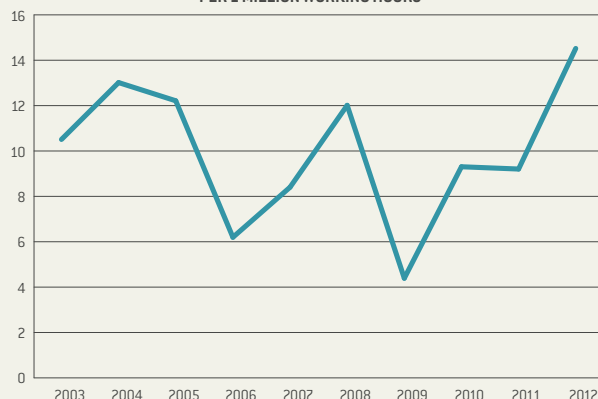
Reykjavik Energy has a special committee for equal opportunities, whose role is to enforce equal rights, to monitor issues on equality and to ensure that the company complies with the Act of 2008 / No. 10, on the Equal Status and Equal Rights of Women and Men.

Decisive steps have been taken in recent years to ensure that equality is at the forefront of all our employment decisions. Our policy is to encourage an environment that is free from discrimi-

DIVISION OF STAFF BY GENDER



TREND IN THE NUMBER OF LOST TIME INJURIES PER 1 MILLION WORKING HOURS*



nation, where all men and women can reach their full potential and are assessed upon individual merit. We also take great care in assuring gender equality and in 2011 women comprised 32% of our management, the highest ratio to date. This year their number grew by 30% and they are now 42% of our management team.

Last year, the Ministry of Welfare and the Icelandic Standards Institute introduced the blueprint for a new equal wage standard. Reykjavik Energy has been an active participant in the development of the standard and has a representative on the technical committee developing the standard. The standard was approved in December, 2012 and Reykjavik Energy is in the process of assessing how or if the implementation of the standard would support RE's efforts to reach its goal, with regard to equal opportunity issues.

HEALTH AND SAFETY

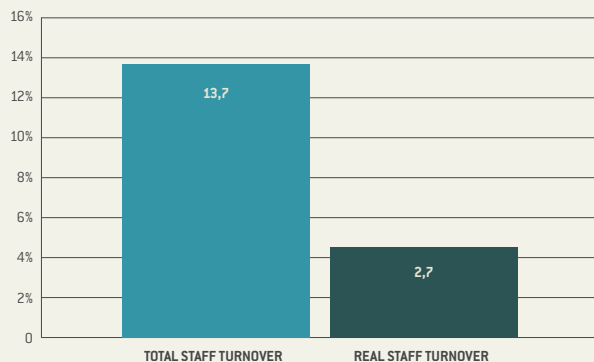
At Reykjavik Energy, matters of health and safety are a priority. We expect all our employees to return home after work, safe and sound, and the company's goal is for no one to get injured at work or suffer health problems as a result of their work. Reykjavik Energy is certified under Safety Standard OHSAS 18001 and operates in compliance with the standard.

There were 11 lost time incidents at Reykjavik Energy in 2011. A Lost Time Incident is an accident resulting in personnel not being able to work the following day as a result of their injury. In none of the incidents was the result a prolonged absence or an irreversible damage or impairment.

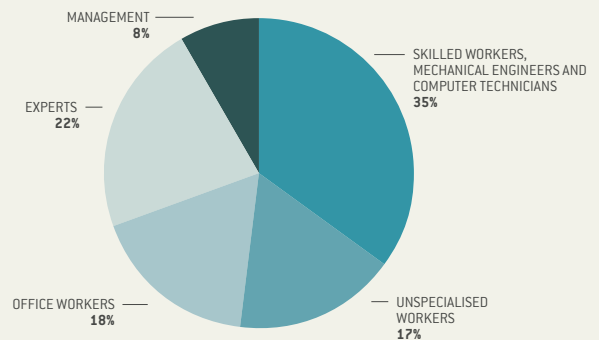
A great deal of effort was put into education and collaboration with local response units. The Metropolitan Fire Department was introduced to the operation of the utilities and the Árnæssýsla Fire Authority to the operation of the power plants, as it is to everyone's benefit that all response units are familiar with potential venues for any response action.

An extensive exercise for the Reykjavik Energy Emergency Management was organised. Participants included various organisations and associations, such as the Neyðarlínan the 112 National Emergency dispatchers, the police, fire department, Road Administration, as well as the Health Authority and the Reykjavik Emergency Shift, in addition to our own staff. Participants agreed that the exercise had been useful and that its many lessons could be used for improvements. The deficiencies that were revealed related to communication and work processes. A procedure has been established to deal with proposals for improvement.

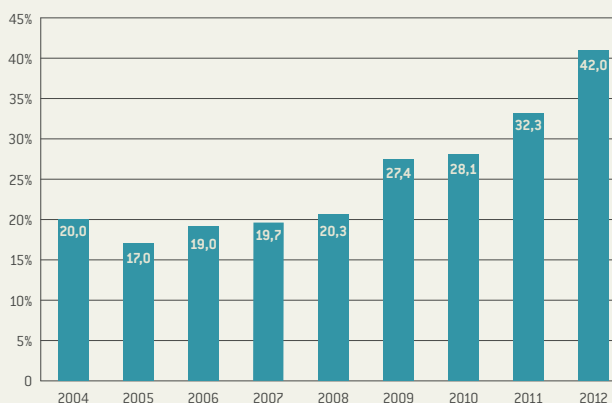
TOTAL STAFF TURNOVER 2012



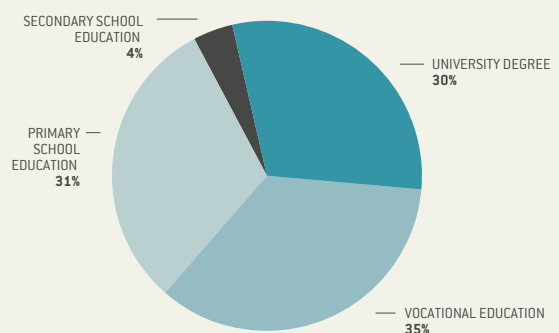
JOB TYPE DISTRIBUTION



PROPORTION OF WOMEN IN MANAGEMENT IN PARENT COMPANY



EMPLOYEE EDUCATION





chapter

9

**GAGNAVEITA
REYKJAVÍKUR**



GAGNAVEITA REYKJAVÍKUR

Gagnaveita Reykjavíkur ehf (GR) is a telecommunications company owned by Reykjavik Energy.

GR's role is to develop and operate a high-speed data transmission network using fibre optic and IP network technology.

In 2012 GR continued its development of the fibre optic network, which is mostly concentrated in the metropolitan area of Reykjavik but also extends to western and southern Iceland.

GR's operation was successful last year. The number of homes connected to the fibre optic network grew by 7,600, to over 52,000 at year-end. GR has completed connecting Akranes, Seltjarnarnes, Hella and Hvolsvöllur, in addition to approximately 85% of Reykjavik. The next step for GR was to begin installing fibre optic cables in selected areas in Hafnarfjörður, Kópavogur and Gardabaer.

GR launched a public marketing campaign for the first time late last year and promoted the fibre optic network under the heading of "One of the fastest streets in the world". The advertisements appeared on television, in newspapers and online media. The objective was to encourage people to check whether they were living in streets connected to the fibre optic network; clicking on GR's banner allowed users to check whether their home was connected.

The number of customers using the fibre optic network grew by 4,600 during the year. 20,000 customers are currently using the fibre-optic network for their telecommunications needs. 2012 was the first year in the history of GR when the majority of the company's income was generated in the household market.

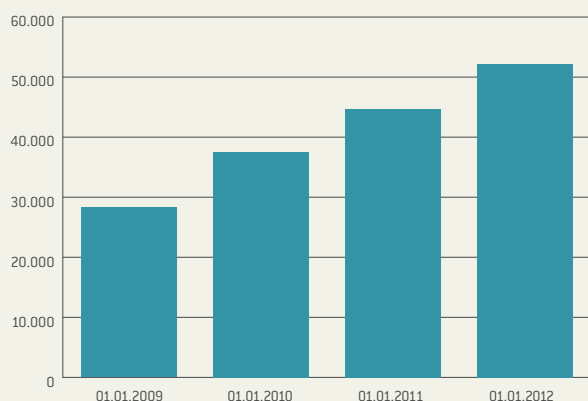
Households connected to the fibre-optic network can now choose from the service of five telecommunications companies offering Internet, telephone and television services: Hringdu, Hringidan, Tal, Vodafone and Símafélagid.

For some time GR has been installing network equipment in private homes, capable of transmitting 1 GB/s. Preparations began by offering a 400 Mb/s telecommunication service to households over the fibre optic network in selected areas of Reykjavik. This service will be an addition to the current 100/Mb/s service currently offered to all households connected to the fibre optic network. The fibre optic cable is the only telecommunication connection in Iceland that can offer this data transmission capability to households.

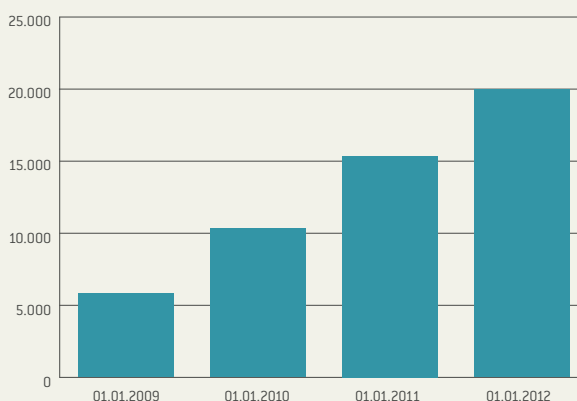
Businesses and other corporate customers continued to be large-scale users of the fibre-optic network. The demand for high-speed connection has increased rapidly, and the number of such connections grew significantly over the year. GR continued its development of core and backhaul networks in co-operation with telecommunications companies, which included Metrónet Vodafone and Nova's 3G mobile phone network.

GR has 26 permanent employees, but in addition to those employees a number of experts and contractors work on the development and operation of the company.

TREND IN NUMBER OF FIBRE OPTIC HOUSEHOLD CONNECTIONS



TREND IN NUMBER OF FIBRE OPTIC CUSTOMERS



HERE ARE SOME EXAMPLES OF THE LOOK AND PRESENTATION OF THE MARKETING MATERIAL

NEWSPAPER ADVERTISEMENTS:

HOFTEIGUR, REYKJAVÍK

EIN HRAÐASTA GATA Í HEIMI

LJÓSLEIÐARI	HEFÐBUNDIN SÍMALÍNA (t.d. ADSL og Ljósnet)
- 100 Mb/s. í báðar áttir - á sama tímal	- Miklu hægtari tenging frá húsi en að.
- Ekkert „allt að“. Bara alltaf hámarkshraði.	- Ennþá hægtari tenging ef langt er í símastöð.
- Öflugasta fjarskiptatenging sem býst.	- Byggir á gamalli tækni og kopartengingu.

ÞÚ FINNUR MUNINN ÞEGAR ÞÚ FÆRÐ ÞÉR LJÓSLEIÐARA

Hvers vegna ættir þú að setta þig við gamla og hægvirka símalínu ef hægt er að fá síma, net og sjónvarp gegnum ljósleiðara á hámarkshraða á sama verði?

Byrð þú við eina hröðustu götu í heimi?
Kynntu þér málið á www.ljosleidarinn.is

LJÓSLEIÐARINN

HÁTEIGSVegur, REYKJAVÍK

EIN HRAÐASTA GATA Í HEIMI

LJÓSLEIÐARI	HEFÐBUNDIN SÍMALÍNA (t.d. ADSL og Ljósnet)
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Kynntu þér málið á www.ljosleidarinn.is

LJÓSLEIÐARINN

BANNERS

BYRÐ ÞÚ VIÐ EINA HRÖÐUSTU GÖTU Í HEIMI?

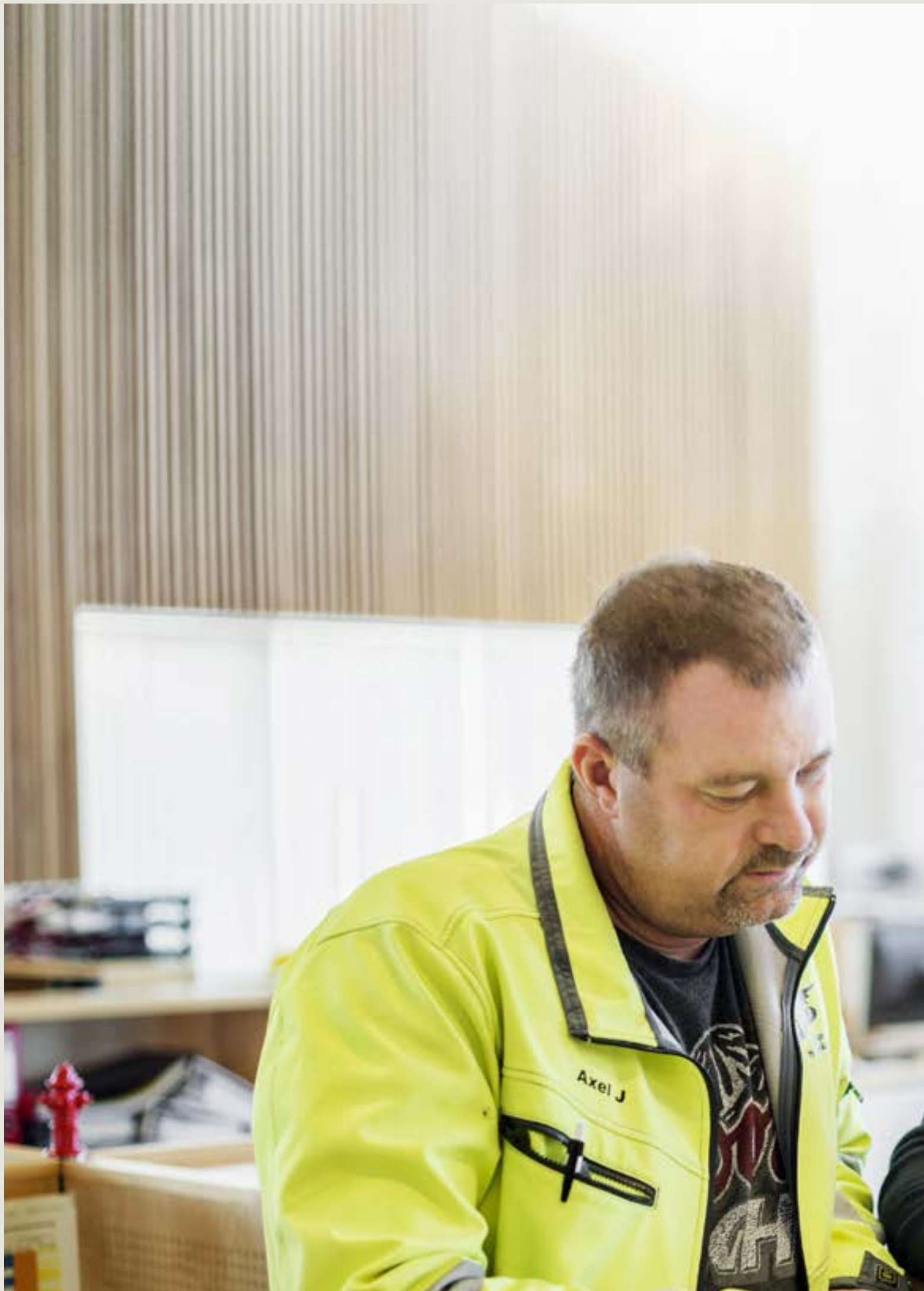
Smelltu hér og fáðu sjónvarp, síma og net á hraða ljóssins. 100 Mb/s tenging og sami hraði í báðar áttir.

LJÓSLEIÐARINN

BYRÐ ÞÚ VIÐ EINA HRÖÐUSTU GÖTU Í HEIMI?

Smelltu hér og fáðu sjónvarp, síma og net á hraða ljóssins. 100 Mb/s tenging og sami hraði í báðar áttir.

LJÓSLEIÐARINN



chapter

10

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CONSOLIDATED FINANCIAL STATEMENTS



ORKUVEITA REYKJAVÍKUR
CONSOLIDATED / FINANCIAL STATEMENTS 2012

Orkuveita Reykjavíkur
Bæjarhálsi 1
110 Reykjavík
reg no. 551298-3029

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Endorsement by the Board of Directors and the Managing Director

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 operating its own power plants, producing and selling electricity and hot water. It provides local distribution of electricity, hot water and cold water, operates the sewage systems in its service area as well as a telecom network based on IP and fiber optic technology.

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

Loss of operations of Orkuveita Reykjavíkur for the year 2012 was ISK 2.295 million. According to the statement of financial position the Company's assets were ISK 297.202 million at year-end, book value of equity at the end of the year was ISK 60.648 million, resulting in equity ratio of 20.4%

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

	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 2013 due to the operating year 2012.

The Icelandic Parliament passed changes to several Acts affecting the energy sector in the year 2008. These changes involve among others things that the Company must be split so that exclusive licence operations and competitive operations will be operated by separate entities. This act will come into effect 1 January 2014. Preparations for these changes are well underway.

Corporate governance

The Board of Directors of Orkuveita Reykjavíkur has implemented a code of procedures, last confirmed 17 February 2012. In them the scope of the Board's work is defined as well as work of the Managing Director. The Company takes into account the owners policy that was approved in the summer of 2012. The Board maintains and seeks to improve good corporate governance. At the beginning of the year the Board appointed an audit committee. In an appendix with the Financial Statements further information regarding corporate governance can be found and further information on corporate governance, owners' policy and the Board's procedures will be discussed in the Company's Annual Statements. The Annual Statement will be published in April 2013 and can then be found on the Company's website, www.or.is

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 IFRS's 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 31 December 2012 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 and the Managing Director of Orkuveita Reykjavíkur hereby confirm the Company's consolidated financial statements for the year 2012.

Reykjavík, 22 March 2013.

The Board of Directors:

Haraldur Flosi Tryggvason

Gylfi Magnússon

Hrönn Ríkharðsdóttir

Sóley Tómasdóttir

Kjartan Magnússon

Managing Director:

Bjarni Bjarnason

Áritun óháðs endurskoðanda

Til stjórnar og eigenda Orkuveitu Reykjavíkur.

Við höfum endurskoðað meðfylgjandi ársreikning Orkuveitu Reykjavíkur fyrir árið 2012. Ársreikningurinn hefur að geyma rekstrarreikning og yfirlit um afkomu auk tekna og gjalda sem eru færðar beint á eigið fé, efnahagsreikning, eiginfjáryfirlit, sjóðstreymisyfirlit, upplýsingar um helstu reikningsskilaaðferðir og aðrar skýringar.

Ábyrgð stjórnenda á ársreikningnum

Stjórnendur eru ábyrgir fyrir gerð og glöggri framsetningu ársreikningsins í samræmi við alþjóðlega reikningsskilastaðla, eins og þeir hafa verið staðfestir af Evrópusambandinu. Stjórnendur eru einnig ábyrgir fyrir því innra eftirliti sem þeir telja nauðsynlegt til að gera þeim kleift að setja fram ársreikning sem er án verulegra annmarka, hvort sem er vegna sviksemi eða mistaka.

Ábyrgð endurskoðanda

Ábyrgð okkar felst í því álit sem við látum í ljós á ársreikningnum á grundvelli endurskoðunarinnar. Endurskoðað var í samræmi við alþjóðlega endurskoðunarstaðla. Samkvæmt þeim ber okkur að fara eftir settum siðareglum og skipuleggja og haga endurskoðuninni þannig að nægjanleg víska fái um hvort ársreikningurinn sé án verulegra annmarka.

Endurskoðun felur í sér aðgerðir til staðfestingar á fjárhæðum og öðrum upplýsingum í ársreikningnum. Val endurskoðunaraðgerða byggist á faglegu mati endurskoðandans, þar með talið á þeirri hættu að verulegir annmarkar séu á ársreikningnum, hvort sem er vegna sviksemi eða mistaka. Við áhættumatið er tekið tillit til þess innra eftirlits sem varðar gerð og glögga framsetningu ársreiknings, til þess að skipuleggja viðeigandi endurskoðunaraðgerðir, en ekki til þess að gefa álit á virkni innra eftirlits félagsins. Endurskoðun felur einnig í sér mat á því hvort reikningsskilaaðferðir og matsaðferðir sem stjórnendur nota við gerð ársreikningsins séu viðeigandi sem og mat á framsetningu hans í heild.

Við teljum að við endurskoðunina höfum við aflað nægilegra og viðeigandi gagna til að byggja álit okkar á.

Álit

Það er álit okkar að ársreikningurinn gefi glögga mynd af afkomu samstæðunnar á árinu 2012, fjárhagsstöðu hennar 31. desember 2012 og breytingu á handbæru fé á árinu 2012, í samræmi við alþjóðlega reikningsskilastaðla eins og þeir hafa verið staðfestir af Evrópusambandinu.

Staðfesting vegna skýrslu stjórnar

Í samræmi við ákvæði 5. tl. 1. mgr. 106 gr. laga nr. 3/2006 um ársreikninga staðfestum við samkvæmt okkar bestu vitund að í skýrslu stjórnar sem fylgir ársreikningi þessum eru veittar þær upplýsingar sem þar ber að veita í samræmi við lög um ársreikninga og koma ekki fram í skýringum.

Reykjavík, 22. mars 2013.

KPMG ehf.

Auðunn Guðjónsson

Guðný Helga Guðmundsdóttir

Income Statement 2012

	Notes	2012	2011
Operating revenue	5	37.904.545	33.626.215
Energy purchase		(4.865.858)	(5.016.487)
Salaries and salary related expenses	7	(3.701.222)	(3.836.419)
Other operating expenses	8	(4.293.531)	(3.538.078)
Operating expenses, total		(12.860.611)	(12.390.983)
EBITDA		25.043.934	21.235.231
Depreciation and amortisation	9	(10.371.085)	(8.880.736)
Results from operating activities, EBIT		14.672.849	12.354.496
Interest income		146.916	126.924
Interest expenses		(7.092.787)	(5.689.628)
Other (expenses) income on financial assets and liabilities		(11.547.680)	(14.093.609)
Total financial income and expenses	10	(18.493.550)	(19.656.314)
Share in loss of associated companies	15	(9.754)	(5.400)
Loss before income tax		(3.830.455)	(7.307.218)
Income tax	11	1.535.261	6.750.946
Loss for the year		(2.295.194)	(556.272)
Attributable to:			
Equity holders of the Company		(2.294.823)	(556.291)
Minority interest in subsidiaries		(371)	20
Loss for the year		(2.295.194)	(556.272)

The notes on pages 11 to 52 are an integral part of these Consolidated Financial Statements.

Statement of Comprehensive Income for the year ended 31 December 2012

	Notes	2012	2011
Loss for the year .....	(	2.295.194)	(556.272)
Other comprehensive income			
Revaluation reserve, increase	12	0	15.137.813
Revaluation reserve, decrease	12	0	(5.000.000)
Income tax effect of revaluation		0	(1.245.295)
Changes in fair value of assets available for sale	16	1.300.000	460.000
Total comprehensive (loss) profit for the year		<u>(995.194)</u>	<u>8.796.246</u>
Total comprehensive income attributable to:			
Equity holders of the Company .....	(	994.823)	8.796.227
Minority interest in subsidiaries .....	(	371)	20
Total comprehensive (loss) profit for the year		<u>(995.194)</u>	<u>8.796.246</u>

The notes on pages 11 to 52 are an integral part of these Consolidated Financial Statements.

Consolidated Statement of Financial Position

31 December 2012

	Notes	2012	2011
Assets			
Property, plant and equipment	12	246.111.462	258.802.010
Intangible assets	14	1.218.980	1.256.937
Investments in associated companies	15	59.826	118.148
Investments in other companies	16	3.265.182	1.983.269
Embedded derivatives in electricity sales contracts	17	14.150.678	17.168.462
Hedge contracts	18	893.934	0
Other financial assets	18	9.745.440	7.886.188
Deferred tax assets	19	3.467.268	1.932.007
Total non-current assets		<u>278.912.770</u>	<u>289.147.020</u>
Inventories	20	402.872	431.560
Trade receivables	21	4.721.350	4.227.536
Embedded derivatives in electricity sales contracts	17	587.982	514.508
Hedge contracts	18	38.956	0
Other financial assets	18	5.986	569
Properties held for sale	13	5.347.856	0
Other receivables	21	298.181	411.196
Cash and cash equivalents	22	6.885.693	1.652.484
Total current assets		<u>18.288.875</u>	<u>7.237.853</u>
Total assets		<u><u>297.201.645</u></u>	<u><u>296.384.873</u></u>

The notes on pages 11 to 52 are an integral part of these Consolidated Financial Statements.

Consolidated Statement of Financial Position

31 December 2012

	Notes	2012	2011
Equity			
Revaluation reserve		51.791.161	53.923.091
Fair value reserve		1.760.000	460.000
Retained earnings		7.092.309	7.255.202
Equity attributable to equity holders of the Company		60.643.470	61.638.293
Minority interest		4.353	4.724
Total equity	23	60.647.822	61.643.016
Liabilities			
Loans and borrowings	24	201.546.363	213.838.494
Retirement benefit obligation	25	483.377	460.874
Hedge contracts	18	98.974	2.390
Total non-current liabilities		202.128.714	214.301.758
Accounts payable		1.366.254	1.627.619
Loans and borrowings	24	29.956.923	16.384.762
Hedge contracts	18	150.300	17.389
Other current liabilities	26	2.951.632	2.410.329
Total current liabilities		34.425.109	20.440.099
Total liabilities		236.553.823	234.741.857
Total equity and liabilities		297.201.645	296.384.873

The notes on pages 11 to 52 are an integral part of these Consolidated Financial Statements.

Interim Statement of Changes in Equity for the year 2012

	Revaluation reserve	Fair value reserve	Retained earnings	Attributable to equity holders of the Company	Minority interest	Total equity
The year 2012						
Equity at 1 January 2012	53.923.090	460.000	7.255.201	61.638.291	4.725	61.643.016
Depreciation transferred to retained earnings	(2.131.929)		2.131.929	0		0
Changes in fair value of assets available for sale		1.300.000		1.300.000		1.300.000
Loss for the year			(2.294.823)	(2.294.823)	(371)	(2.295.194)
Total comprehensive income	(2.131.929)	1.300.000	(162.894)	(994.823)	(371)	(995.194)
Equity at 31 December 2012	51.791.161	1.760.000	7.092.307	60.643.468	4.354	60.647.822
The year 2011						
Equity at 1 January 2011	46.882.894	0	5.959.170	52.842.064	4.705	52.846.769
Revaluation, increase	15.137.813			15.137.813		15.137.813
Revaluation, decrease	(5.000.000)			(5.000.000)		(5.000.000)
Income tax on revaluation	(1.245.295)			(1.245.295)		(1.245.295)
Depreciation transferred to retained earnings	(1.852.322)		1.852.322	0		0
Changes in fair value of assets available for sale		460.000		460.000		460.000
Loss for the year			(556.291)	(556.291)	20	(556.271)
Total comprehensive income	7.040.196	460.000	1.296.031	8.796.227	20	8.796.247
Equity at 31 December 2011	53.923.090	460.000	7.255.201	61.638.291	4.725	61.643.016

The notes on pages 11 to 52 are an integral part of these Consolidated Financial Statements.

Interim Statement of Cash Flows for the year 2012

	Notes	2012	2011
Cash flows from operating activities			
Cash generated from operations before interest and taxes	33	24.335.571	20.574.518
Received interest income		137.916	127.147
Paid interest expenses .....	(	5.411.118)	(3.777.307)
Dividend received		54.475	43.840
Paid due to other financial income and expenses .....	(	182.318)	(38.063)
Net cash from operating activities		<u>18.934.526</u>	<u>16.930.135</u>
Cash flows from investing activities			
Acquisition of property, plant and equipment .....	(	3.122.147)	(10.203.833)
Acquisition of intangible assets .....	(	50.383)	(80.258)
Proceeds from sale of property, plant and equipment		226.200	582.268
Proceeds from sale of other companies		197.693	179.000
Acquisition of other financial assets .....	(	28.000)	(16.887)
Proceeds and repayment of other financial assets		29.858	1.036
Net cash used in investing activities	(	<u>2.746.779)</u>	<u>(9.538.674)</u>
Cash flows from financing activities			
Proceeds from new borrowings		1.007.996	0
Repayment of borrowings .....	(	12.317.428)	(10.449.874)
Proceeds from new borrowings from the owners		74.640	7.925.360
Credit facility, change .....	(	2.482.638)	(6.771.507)
Current liabilities, change		2.357.358	1.227.863
Net cash from financing activities	(	<u>11.360.072)</u>	<u>(8.068.157)</u>
Increase (decrease) in cash and cash equivalents		<u>4.827.676</u>	<u>(676.696)</u>
Cash and cash equivalents at year beginning		1.652.484	2.343.648
Effect of currency fluctuations on cash and cash equivalents		<u>405.534</u>	<u>(14.468)</u>
Cash and cash equivalents at end of the year		<u><u>6.885.693</u></u>	<u><u>1.652.484</u></u>
Investments and financing without payment effects:			
Acquisition of property, plant and equipment .....	(	195.704)	(302.915)
Proceeds from sale of property, plant and equipment		0	135.000
Proceeds from sale of other companies		0	149.541
Receivables, change		0	(284.541)
Current liabilities, change		195.704	302.915
Other information:			
Working capital from operation		19.880.141	17.231.251

The notes on pages 11 to 52 are an integral part of these Consolidated Financial Statements.

Notes to the Financial Statements

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Notes

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 Reykjavík. 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 consolidated financial statements of Orkuveita Reykjavíkur is a part of the interim financial statements of Reykjavík city.

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 financial statements were approved by the Board of Directors on 22 March 2013.

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 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 12 - Property, plant and equipment
- note 16 - Investments in other companies
- note 17 - Embedded derivatives in electricity sales contracts
- note 18 - Other financial assets and other financial liabilities
- note 19 - Deferred tax assets and liabilities
- note 25 - Retirement benefit obligations
- note 28 - Market risk

Notes

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.

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 the Central Bank of Iceland (2011: 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

3. Significant accounting policies, contd.

c. Financial instruments

i) Non-derivative financial assets

Loans, receivables and cash in bank are recognised when received. All other 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. Any interest in transferred financial assets that is created or retained by the group is recognized as a separate asset or liability.

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.

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.

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 in accordance with the Company's risk policy or investment plan. 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.

Loans and receivables

Loans and receivables are financial assets with certain or determinable payments and are not listed in active markets. Such assets 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 loans and receivables are measured at amortised cost using the effective interest method, less any impairment losses.

Loans and receivables comprise of receivables and other current assets.

Cash and cash equivalents comprise cash balances and call deposits.

Notes

3. Significant accounting policies, contd.

c. Financial instruments, contd.

ii) Non-derivative financial liabilities

Loans and subordinated loans are recognised when they are incurred. All other financial liabilities, including loans at fair value through profit and loss are initially accounted for on the business day the Company becomes part of the contractual agreement of the financial instrument.

Financial liabilities are eliminated from the financial statements when the contractual agreements of the instrument are no longer valid.

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.

The Company classifies non-derivative financial liabilities as other financial liabilities. Such liabilities 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 financial liabilities are measured at amortised cost using the effective interest method.

Other non-derivative financial liabilities comprise of borrowings, accounts payable and other current liabilities.

iii) Derivative financial instruments

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.

iv) Economic hedges

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.

Fair value changes in such derivatives are recognised in the income statement.

v) Other embedded derivatives

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

Notes

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.

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.

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.

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 earnings unless the relevant asset is sold or discontinued.

The fair value of these 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 revaluated in accordance with those changes. The calculation is based on official information and actual statistics from the Company'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. The impairment test of assets is also taken into consideration and revaluation is not recognised beyond the expected future cash flow of the assets. Distribution systems for hot water, cold water, sewage and electricity are licensed operations and subject to official revenue targets that are based mostly on changes in the construction cost index. This is taken into consideration when revaluating these systems.

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.

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.

Notes

3. Significant accounting policies, contd.

d. Property, plant and equipment, contd.

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.

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 Company 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.

Notes

3. Significant accounting policies, contd.

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.

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

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

i) Revenues from sale and distribution of electricity and hot water

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 year plus a fixed fee.

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.

ii) Revenues from sale of cold water and sewage

Revenue from the sale of cold water and sewer are based on the size of properties plus a fixed fee and are set forth linearly in the income statement. In addition revenue is stated for cold water according to measurement from specific industries.

iii) Connection revenues

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.

iv) Other revenues

Other revenue is recognised when generated or upon delivery of goods or services.

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

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 for the parent company is 36.0% and the tax ratio for the subsidiaries is 20.0%. Cold water supply and sewer is exempt from tax.

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 the current tax rate, which is 36.0% for the parent company that is a partnership and 20.0% for the subsidiaries that are 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

3. Significant accounting policies, contd.

o. Segment reporting

A segment is a distinguishable component of the Company that is engaged in business and is capable to earn revenues and accept cost, both within and outside of the Company. The return of all segments is overviewed by management to value their performance.

Segment results and their assets include items directly attributable to a segment as well as those that can be allocated on a reasonable basis.

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

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

p. New standards and interpretations

The Company has implemented all international accounting standards, their interpretation and changes on existing standards that were effective at year end 2012 and are related to the Company's operation. The Group has not beforehand implemented international accounting standards, their interpretation and changes which are effective after 31 December 2012. 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 Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

a. 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 re-measured in accordance with those changes. The results of the impairment tests are also taken into consideration and revaluation is not recognised beyond the expected future cash flow of those assets.

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 exclusive 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.

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.

Notes

4. Determination of fair values, contd.

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 Company 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 Company recognises profit or loss at the initial registration date of the instruments.

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

Sector	Official obligations
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.

Customers that have significant effect on the Company's revenues

One customer has significant effect on the Company's revenues in the year 2012, i.e. Norðurál Grundartangi ehf.

Revenues from Norðurál Grundartangi ehf., a customer of the Company's Production and Sale's division, represents approximately ISK 6.943 million or 18.3% of total revenues. (2011: ISK 5.652 million, or 16.8% of total revenue.)

Notes

3. 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*.

Business segments - divisions

The year 2012	Utilities	Production and sale	Other Operation	Adjustments	Total
External revenue	24.536.839	12.928.173	439.533	0	37.904.545
Inter-segment revenue	239.150	11.249.187	382.497	(11.870.834)	0
Total segment revenue	24.775.989	24.177.360	822.030	(11.870.834)	37.904.545
Segment result	11.352.117	4.586.527	(7.002)	0	15.931.642
Unallocated expenses				(1.258.793)	
Results from operating activities					14.672.849
Financial income and expenses				(18.493.550)	
Share of loss of associated companies				(9.754)	
Income tax				1.535.261	
Loss for the year				(2.295.194)	
The year 2011					
External revenue	21.439.485	11.956.289	230.441	0	33.626.215
Inter-segment revenue	317.170	4.061.665	482.184	(4.861.019)	0
Total segment revenue	21.756.655	16.017.954	712.625	(4.861.019)	33.626.215
Segment result	8.829.471	5.122.206	(131.009)	0	13.820.668
Unallocated expenses				(1.466.172)	
Results from operating activities					12.354.496
Financial income and expenses				(19.656.314)	
Share of loss of associated companies				(5.400)	
Income tax				6.750.946	
Loss for the year				(556.272)	

Notes

3. Segment reporting, contd.

Business segments - divisions, contd.

The year 2012	Utilities	Production and sale	Other Operation	Adjustments	Total
Balance sheet (31.12. 2012)					
Property, plant and equipment and properties held for sale	134.028.592	110.594.420	9.286	6.827.021	251.459.319
Intangible assets	0	0	0	1.218.980	1.218.980
Shares in associates					59.826
Other unallocated assets					44.463.520
Total assets					297.201.645

Unallocated liabilities					236.553.823
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Investments:

Property, plant and equipment	2.170.195	697.863	0	146.877	3.014.935
Intangible assets	0	0	0	50.383	50.383

Depreciation, amortization:

Property, plant and equipment	5.024.089	4.443.127	0	815.529	10.282.745
Intangible assets	0	0	0	88.340	88.340

The year 2011

Balance sheet (31.12. 2011)

Property, plant and equipment	133.688.631	117.555.164	36.109	7.522.107	258.802.011
Intangible assets				1.256.937	1.256.937
Shares in associates					118.148
Other unallocated assets					36.207.778
Total assets					296.384.874

Unallocated liabilities					234.741.857
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Investments:

Property, plant and equipment	2.208.279	7.382.796	0	154.095	9.745.170
Intangible assets	0	0	0	80.258	80.258

Depreciation, amortization:

Property, plant and equipment	4.781.813	3.401.467	20.544	379.853	8.583.677
Intangible assets	0	0	171.862	125.198	297.060

3. Segment reporting, contd.

Business segments - sectors

The year 2012

Income

	Electricity	Hot water	Cold water	Sewer	Fibre-optic cable system	Adjustments	Total
External revenue	19,252,841	9,904,780	3,176,966	4,184,368	1,385,590	0	37,904,545
Inter-segment revenue	824,308	137,839	33,275	43,827	0	(1,039,249)	0
Total segment revenue	20,077,149	10,042,619	3,210,241	4,228,195	1,385,590	(1,039,249)	37,904,545

Balance sheet (31.12. 2012)

Properties, current and non-current	112,712,357	70,343,547	18,699,324	38,864,090	10,840,001	0	251,459,319
Intangible assets	570,483	355,942	96,299	196,256	0	0	1,218,980
Unallocated assets	0	0	0	0	0	0	44,523,346
Total assets	113,282,840	70,699,489	18,795,623	39,060,346	10,840,001	0	297,201,645

Investments

Property, plant and equipments	984,378	573,471	216,723	302,763	937,599	0	3,014,934
Intangible assets	23,579	14,813	3,930	8,061	0	0	50,383

Depreciation, amortization

Property, plant and equipments	4,563,001	3,379,335	536,353	1,281,570	522,485	0	10,282,744
Intangible assets	33,750	27,525	8,479	18,586	0	0	88,340

Notes

3. Segment reporting, contd.

Business segments - sectors, contd.

The year 2011

Income

	Electricity	Hot water	Cold water	Sewer	Fibre-optic cable system	Adjustments	Total
External revenue	17.515.064	8.732.030	2.818.304	3.390.673	1.170.144	0	33.626.215
Inter-segment revenue	1.171.938	155.271	41.870	50.374	0	(1.419.453)	0
Total segment revenue	18.687.002	8.887.301	2.860.174	3.441.047	1.170.144	(1.419.453)	33.626.215

Balance sheet (31.12. 2011)

Properties	119.559.252	70.123.187	18.696.299	39.998.384	10.424.888	0	258.802.010
Intangible assets	664.920	291.609	95.527	204.881	0	0	1.256.937
Unallocated assets	0	0	0	0	0	0	36.325.925
Total assets	120.224.172	70.414.796	18.791.826	40.203.265	10.424.888	0	296.384.872

Investments

Property, plant and equipments	7.231.993	901.350	186.932	247.147	1.177.749	0	9.745.171
Intangible assets	42.457	19.101	5.939	12.761	0	0	80.258

Depreciation, amortization

Property, plant and equipments	3.829.908	2.386.919	494.645	1.416.898	455.306	0	8.583.676
Intangible assets	47.833	210.871	12.015	26.340	0	0	297.059

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 2012	Hot water 2012	Electricity 2011	Hot water 2011
Power plant at Nesjavellir				
Revenue	8.663.959	1.915.000	8.575.389	1.520.000
Operating expenses	(1.419.692)	(525.679)	(984.606)	(500.517)
Depreciation	(3.504.326)	(449.152)	(2.794.359)	(406.192)
Profit before financial expenses	3.739.941	940.170	4.796.424	613.291
Return on investment	3.8%	8.0%	4.8%	5.4%

The power plants at Hellisheiði and Nesjavellir are mixed production plants, where both hot water and energy are produced.

7. Salaries and salary related expenses

	2012	2011
Salaries and salary related expenses are specified as follows:		
Salaries	2.988.203	3.278.044
Defined contribution pension expenses	395.860	463.847
Defined benefit pension expenses	55.547	37.721
Other salary related expenses	313.216	406.071
Expensed salaries and salary related expenses due to early retirement plan and laid-off employees 1)	314.271	192.965
Total salaries and salary related expenses	4.067.097	4.378.648

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

Expensed in the income statement	3.701.222	3.836.419
Capitalised on projects	365.875	542.228
Total salaries and salary related expenses	4.067.097	4.378.648

Number of employees:

Number of annual working units	476	532
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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	16.695	15.439
Salaries to the Director and five/four Managing Directors of the Parent Company ...	94.037	79.187
Salaries to the Board of Directors and Managing Directors of subsidiaries	21.931	20.771
Defined contribution pension expenses	17.075	14.598
Termination expenses, pension expenses included 2)	9.071	20.034
	158.808	150.029

Included in salaries are car benefits and vehicle subsidy.

1) A part of curtailing in the operations is to decrease the number of employees. This is achieved partly by offering employees that have reached the age of 63, early retirement. Those who accept this offer are not expected to work for the Company during the termination. When employees leave the Company, either due to early retirement or due to lay-offs the termination cost is recognised immediately.

2) In September the manager of Sales and Production left the company. Expenses due to the termination of his employment, salary related expenses included, were all expensed upon his departure from the company. In the year 2011 similar payments were made upon the departure of the former CFO of the company.

Notes

8. Other operating expenses

	2012	2011
Other operating expenses is specified as follows:		
Operational cost of utilities and power plants	1.570.857	1.145.147
Collection cost and other office cost	625.924	603.256
Operation cost of properties	566.098	516.809
Public levies and insurance cost	447.369	206.193
Various cost	1.083.283	1.066.672
Other operating expenses, total	<u>4.293.531</u>	<u>3.538.078</u>

9. Depreciation and amortisation

	2012	2011
Depreciation and amortisation is specified as follows:		
Depreciation of property, plant and equipment	9.052.618	8.583.676
Amortisation of assets in construction	743.431	0
Amortisation of properties held for sale	486.696	0
Depreciation and amortisation, total, cf. note 12	<u>10.282.745</u>	<u>8.583.676</u>
Amortisation of intangible assets, cf. note 14	<u>88.340</u>	<u>297.059</u>
Depreciation and amortisation recognised in the income statement	<u>10.371.085</u>	<u>8.880.736</u>

10. Financial income and expenses

	2012	2011
Financial income and expenses are specified as follows:		
Interest income	146.916	126.924
Interest expense	(6.232.254)	(4.899.197)
Guarantee fee to owners 1)	(860.534)	(790.431)
Total interest expenses	<u>(7.092.787)</u>	<u>(5.689.628)</u>
Fair value changes of embedded derivatives in electricity sales contracts	(2.944.310)	(2.728.135)
Fair value changes of assets available for sale	0	(611.169)
Fair value changes of financial assets and financial liabilities through P/L	1.847.840	679.855
Change in valuation of derivatives in default, cf. note 33	(558.759)	0
Hedge contracts	417.832	62
Foreign exchange difference	(10.364.758)	(11.479.368)
Dividends	54.475	45.145
Total of other income (expenses) on financial assets and liabilities	<u>(11.547.680)</u>	<u>(14.093.609)</u>
Total financial income and expenses	<u>(18.493.550)</u>	<u>(19.656.313)</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 Orkuveita Reykjavíkur in 2005. The fee on yearly basis for its licenced operations is 0.375% and 0.48% regarding loans due for operations in the open market. (2011: The fee was 0.375% on all loans) The calculation of the fee is done at the end of each quarter. The guarantee fee amounted to ISK 861 million in the year 2012 (2011: ISK 790 million) and is accounted for among interest expenses.

Notes

10. Financial income and expenses

Capitalised financing cost

No financing cost due to construction of a power plant was capitalised in the year 2012. Capitalised financing cost for the year 2011 amounted to ISK 1.287 million and was deducted from financial expense. Interest ratio that was used in the calculation of capitalised financing cost for the year 2011 was 7.46%.

	2012	2011
Interest expense is specified as follows:		
Interest expenses, charged in the income statement	(7.092.787)	(5.689.628)
Capitalised finance cost	0	(1.287.642)
Interest expenses	(7.092.787)	(6.977.270)

Fair value changes through P/L

Generally accepted valuation methods are used to determine the fair value of certain financial assets and financial liabilities, further discussed in note 4. Change in fair value that is expensed in the income statement amounts ISK 1.096 million. (2011: expense ISK 2.659 million).

11. 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.

Income tax recognised in the income statement is specified as follows:	2012	2011
Change in deferred income tax	(1.535.261)	6.750.946
Income tax recognised in the income statement	(1.535.261)	6.750.946

Reconciliation of effective tax rate:	2012	2011
Loss before income tax	(3.830.455)	(7.307.218)
Income tax according to current tax ratio	36.0% (1.378.964)	36.0% (2.630.598)
Effect of various tax rates in the Group	(0.9%) 33.817	(0.7%) 54.575
Effect of valuation of exploitation of deferred tax losses	2.6% (100.000)	63.7% (4.655.873)
Non-taxable operation of water supply and sewer	2.4% (93.706)	(2.9%) 208.881
Other items	0.1% 3.592	(3.7%) 272.069
Effective income tax	40.1% (1.535.261)	92.4% (6.750.946)

Notes

12. Property, plant and equipment

Property, plant and equipment is specified as follows:

The year 2012	Production system	Utility system	Other real estates	Other equipment	Total
Cost or deemed cost					
Balance at year beginning	195.996.921	222.894.519	8.140.245	5.596.352	432.628.037
Reclassification of assets	1.301.287	(884.548)	1.383.128	(3.528.887)	(1.729.019)
Additions during the year	993.880	1.856.200	19.769	145.086	3.014.935
Transferred to properties held for sale	(60.701)	0	(7.390.556)	(869.043)	(8.320.300)
Sold or disposed of	0	(91.361)	(69.054)	(99.219)	(259.634)
Balance at year-end	198.231.387	223.774.810	2.083.533	1.244.289	425.334.019
Depreciation					
Balance at year beginning	58.379.184	111.034.725	1.825.401	2.586.718	173.826.027
Reclassification of assets	491.232	(1.693.391)	580.320	(1.107.180)	(1.729.019)
Depreciated during the year	5.611.392	3.858.468	644.176	168.709	10.282.745
Transferred to properties held for sale	(57.224)	0	(2.156.978)	(758.241)	(2.972.444)
Sold or disposed of	0	(89.570)	(11.624)	(83.559)	(184.752)
Balance at year-end	64.424.583	113.110.231	881.295	806.447	179.222.557
Carrying amounts					
At 1.1. 2012.....	137.617.737	111.859.794	6.314.845	3.009.634	258.802.010
At 31.12. 2012.....	133.806.804	110.664.579	1.202.237	437.842	246.111.462
Thereof assets in construction at year end.....	7.209.960	1.555.018	0	0	8.764.979
The year 2011					
Cost or deemed cost					
Balance at year beginning	191.999.364	193.739.637	8.367.940	5.520.843	399.627.784
Additions during the year	7.571.665	2.043.869	33.191	96.445	9.745.170
Sold or disposed of	(541.385)	0	(260.886)	(20.936)	(823.207)
Revaluation, increase	3.015.875	27.111.013	0	0	30.126.888
Revaluation, decrease	(6.048.598)	0	0	0	(6.048.598)
Balance at year end	195.996.921	222.894.519	8.140.245	5.596.352	432.628.037
Depreciation					
Balance at year beginning	53.917.500	93.547.119	1.691.261	2.440.910	151.596.790
Reclassification of assets	0	0	0	0	0
Depreciated during the year	4.534.610	3.735.613	161.163	152.291	8.583.676
Sold or disposed of	(261.409)	0	(27.023)	(6.482)	(294.915)
Revaluation, increase	1.237.081	13.751.993	0	0	14.989.074
Revaluation, decrease	(1.048.598)	0	0	0	(1.048.598)
Balance at year end	58.379.184	111.034.725	1.825.401	2.586.718	173.826.027
Carrying amounts					
At 1.1. 2011.....	138.081.864	100.192.518	6.676.679	3.079.933	248.030.994
At 31.12. 2011.....	137.617.737	111.859.794	6.314.845	3.009.634	258.802.010
Thereof assets in construction at year end.....	8.225.347	1.529.241	0	0	9.754.588

Notes

12. Property, plant and equipment, contd.

Assets in construction

At year-end 2012 parliament approved a draft on protection and utilisation of natural resources, which is based on a Framework Program on protection and utilisation of hydropower and geothermal power. The area of Bitra is categorised in a protected area and therefore the book value of OR's assets and research in the area, ISK 743 million is amortised in the year 2012.

Revaluation

Revaluation was last executed as specified in the following table:

Date of Revaluation

Production systems

Hot water	31.12.2011
Cold water	31.12.2011
Electricity	31.12.2011

Distribution systems

Hot water	31.12.2011
Cold water	30.9.2011
Sewage	30.9.2011
Electricity	31.12.2011
Fibre-optic cable system	30.9.2010

When revaluating, the relevant asset groups are measured at fair value. The aforementioned revaluation is recognised in a revaluation reserve among equity taken into account effects of deferred income tax as further explained in note 3. d.

Impairment tests

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 3.64% to 6.31%,
- 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.

Uncertainty is about when construction projects will be commenced due to unsettled energy sale contracts and financing of the projects.

All sectors of the distribution systems and the production system stood the impairment test.

Information on revalued assets at year end

	Production system	Distribution system	Total
The year 2012			
Revalued carrying amount	133.806.804	110.664.579	244.471.382
Thereof effect of revaluation	(27.206.629)	(40.048.340)	(67.254.969)
carrying amount before effect of revaluation	106.600.175	70.616.238	177.216.413
The year 2011			
Revalued carrying amount	137.617.737	111.859.794	249.477.531
Thereof effect of revaluation	(28.117.996)	(42.097.167)	(70.215.163)
carrying amount before effect of revaluation	109.499.741	69.762.627	179.262.369

Rateable value and insurance value

The rateable value of the Company's assets measured in the rateable value assessment amounted to ISK 31.390 million at year end 2012 (2011: ISK 24.879 million). The fire insurance value of the company's assets amounted to ISK 38.499 million at the same time (2011: ISK 37.046 million). Among those assets are real estates capitalised among production and distribution systems as well as properties held for sale.

Notes

12. Property, plant and equipment, contd.

Obligations

In May 2008 the Company entered into a contract concerning purchase of equipment for power plants. The equipment will be delivered in the year 2016. The contract and other contracts regarding developments at Hellisheiði amount to ISK 12.3 billion as per exchange rate at end of the year (2011: ISK 12.4 billion). More information regarding these contracts can be found in note 36. 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 the end of the year is estimated at ISK 1.2 billion (2011: ISK 1.2 billion).

13. Properties held for sale

Properties held for sale are specified as follows:

	2012	2011
Orkuveita Reykjavíkur, headquarters at Bæjar- and Réttarhóls, 110 Reykjavík	4.397.856	0
Perlan, Öskjuhlíð, 105 Reykjavík	950.000	0
Properties held for sale, total	5.347.856	0

At year-end 2012 Reykjavík City purchased Perlan from the Company, negotiated price amounting to ISK 950 million. The sale was finalised at the beginning of the year 2013. In the beginning of 2013 the Company sold its headquarters at Bæjar- and Réttarhóls for ISK 5.100 million. Because of these transactions these assets are reclassified among current assets in the financial statements for the year 2012.

14. Intangible assets

Intangible assets are specified as follows:

	Heating rights	Preparation cost	Software	Total
The year 2012				
Cost				
Balance at year beginning	1.427.031	0	3.045.194	4.472.225
Reclassification of assets	0	0 (	1.723.761)	(1.723.761)
Additions during the year	0	0	50.383	50.383
Balance at end of the year	1.427.031	0	1.371.816	2.798.847
Amortisation				
Balance at year beginning	491.550	0	2.723.738	3.215.288
Reclassification of assets	0	0 (	1.723.761)	(1.723.761)
Amortisation during the year	11.974	0	76.366	88.340
Balance at end of the year	503.524	0	1.076.343	1.579.867
Carrying amounts				
At 1.1. 2012.....	935.481	0	321.456	1.256.937
At 31.12. 2012.....	923.507	0	295.473	1.218.980
The year 2011				
Cost				
Balance at year beginning	1.427.031	261.864	2.964.934	4.653.829
Additions during the year	0	0	80.258	80.258
Sold or disposed of	0 (	261.864)	2	(261.862)
Balance at year end	1.427.031	0	3.045.194	4.472.225
Amortisation				
Balance at year beginning	438.570	90.000	2.611.134	3.139.704
Amortisation during the year	12.594	171.862	112.604	297.060
Sold or disposed of	40.386 (	261.862)	0	(221.476)
Balance at year end	491.550	0	2.723.738	3.215.288
Carrying amounts				
At 1.1. 2011.....	988.461	171.864	353.800	1.514.125
At 31.12. 2011.....	935.481	0	321.456	1.256.936

Notes

15. Investments in associated companies

Investments in associated companies are specified as follows:

	2012		2011	
	Share	Carrying amount	Share	Carrying amount
Envent Holdings ehf.	0.0%	0	24.5%	45.000
Iceland American Energy Inc.	83.7%	0	83.7%	0
Vistorka ehf.	0.0%	0	29.0%	42.591
Íslensk Nýorka ehf.	27.6%	29.339	0.0%	0
Metan hf.	0.0%	0	35.4%	3.568
Netorka hf.	23.5%	29.207	21.9%	25.708
Reykjavik Energy Grad. School hf.	45.0%	1.281	50.0%	1.281
Total		59.827		118.148

The Company's share in the loss of its associated companies amounted to ISK 10 million in the year 2012 (2011: loss of ISK 5 million).

Vistorka ehf. and Íslensk Nýorka ehf. were merged in the year 2012 under the name of Íslensk Nýorka ehf. Recompense in the merger were shares in Íslensk Nýorka ehf.

16. Investments in other companies

Investments in other companies are specified as follows:

	Share	2012	2011
HS Veitur hf.	16.6%	957.000	957.000
Landsnet hf. 1)	6.8%	2.160.000	860.000
Other shares in companies		148.182	166.269
Other shares in companies, total		3.265.182	1.983.269

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.

1) According to provisions in the Energy laws no. 65/2003 only current owners of shares in Landsnet are allowed to assign their shares to other owners of Landsnet and are not allowed to sell their shares to other parties.

17. Embedded derivatives in electricity sales contracts

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

	2012	2011
Fair value of embedded derivatives at the beginning of the year	17.682.970	20.411.105
Fair value changes during the year	(2.944.310)	(2.728.135)
Fair value of embedded derivatives at year-end	14.738.660	17.682.970

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

Non-current embedded derivatives	14.150.678	17.168.462
Current embedded derivatives	587.982	514.508
Total embedded derivatives at year-end	14.738.660	17.682.970

Further discussion regarding embedded derivatives can be found in note 28 c.

Notes

18. Other financial assets and financial liabilities

	2012	2011
Non-current assets		
Financial assets at fair value through profit or loss:		
Bonds	9.744.861	7.868.334
Hedge contracts	893.934	0
	<u>10.638.795</u>	<u>7.868.334</u>
Bonds and other receivables:		
Bonds	579	17.853
	<u>579</u>	<u>17.853</u>
Total among non-current assets	<u>10.639.373</u>	<u>7.868.334</u>
Current assets		
Financial assets at fair value through profit or loss:		
Hedge contracts	38.956	0
	<u>38.956</u>	<u>0</u>
Bonds and other receivables:		
Bonds	5.986	569
	<u>5.986</u>	<u>569</u>
Total among current assets	<u>44.942</u>	<u>569</u>
Non current liabilities		
Financial liabilities at fair value through profit or loss:		
Hedge contracts	(98.974)	(2.390)
	<u>(98.974)</u>	<u>(2.390)</u>
Current liabilities		
Financial liabilities at fair value through profit or loss:		
Hedge contracts	(150.300)	(17.389)
	<u>(150.300)</u>	<u>(17.389)</u>

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 31.

19. Deferred tax assets and liabilities

Deferred tax assets and liabilities is specified as follows:

	2012	Tax assets	Tax liabilities	Net amount
Deferred tax assets/liabilities at the beginning of the year		1.932.006	0	1.932.006
Calculated income tax for the year		1.535.261	0	1.535.261
Deferred tax assets/liabilities at end of the year		<u>3.467.267</u>	<u>0</u>	<u>3.467.267</u>
2011				
Deferred tax assets/liabilities at the beginning of the year		206.741	3.780.403	(3.573.662)
Calculated income tax for the year		2.970.543	(3.780.403)	6.750.946
Income tax, due		17	0	17
Effect of change in income tax rate on revaluation account		(1.245.295)	0	(1.245.295)
Deferred tax assets/liabilities at year end		<u>1.932.006</u>	<u>0</u>	<u>1.932.007</u>

Notes

19. Deferred tax assets and liabilities, contd.,

Deferred tax assets and liabilities are attributable to the following:

	31.12. 2012		31.12. 2011	
	Tax assets	Tax liabilities	Tax assets	Tax liabilities
Property, plant and equipment	(15.063.674)	0	(17.056.401)	0
Embedded derivatives	(5.305.918)	0	(6.365.869)	0
Other items	2.599.893	0	888.700	0
Effect of carry forward taxable loss	21.236.966	0	24.465.576	0
Deferred tax assets/liabilities at year end	3.467.268	0	1.932.006	0

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. Carryforwards taxable loss at year end can be used as follows:

	2012	2011
Unadjusted taxable loss for the year 2008, usable until year 2018	56.383.614	65.631.854
Unadjusted taxable loss for the year 2009, usable until year 2019	4.953.017	4.953.017
Carry forwards taxable loss at year end 2012	61.336.631	70.584.871

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

20. Inventories

Inventories are specified as follows at year end:

	2012	2011
Inventory of materials	402.872	431.560

The Company's material inventories consist of material for maintenance, renewal and construction of the Company's production and distribution systems. Inventories for renewal and new constructions are accounted for among property, plant and equipment as part of building cost of assets under construction.

21. Receivables

Trade receivables is specified as follows at year end:

	2012	2011
Trade receivables, industrial consumers	917.120	537.146
Trade receivables, retail	4.122.730	3.969.640
Trade receivables, total	5.039.850	4.506.786
Allowance for doubtful accounts	(318.500)	(279.250)
	4.721.350	4.227.536

Other current receivables are specified as follows at year end:

Value added tax	0	23.617
Pre-paid expenses	199.480	185.715
Capital income tax	34.832	35.382
Accrued interest income	32.035	23.035
Receivables from employees	6.529	8.275
Other receivables	25.305	135.172
	298.181	411.196

Notes

22. Cash and cash equivalents

Cash and cash equivalents at year end are specified as follows:	2012	2011
Bank balances	6.885.693	1.652.484

23. Equity

Equity ratio of the Company at year end 2012 is 20.4% (2011: 20.8%). Return on equity was negative by 3.7% in the year (2011: negative by 1.0%).

Revaluation reserve

Revaluation reserve comprises of increase in the value of properties, plant and equipment after taking tax effects into account. Depreciation of the revaluated price are expensed in the income statement and transferred at the same time from the revaluation reserve account to retained earnings.

Fair value reserve

Fair value reserve comprises increase of the value of assets categorised as available for sale after taking tax effects into account.

Retained earnings

Dividend was not paid to the owners of the parent Company in the year 2012. (2011: No payment of dividend).

The Company's Board of Directors do not propose dividend to be paid to the owners of the parent company in the year 2013 due to the operating year 2012. The owners of the parent company decide on dividend payments.

24. 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 28.

Non-current liabilities	2012	2011
Bank loans	195.721.276	195.380.948
Subordinated loan from owners of the Company	8.849.752	8.211.459
Credit facilities	0	2.381.700
Bond issuance	22.515.068	22.191.286
	227.086.096	228.165.393
Current portion on non-current liabilities	(25.539.733)	(14.326.899)
	201.546.363	213.838.494
Current liabilities		
Current portion on non-current liabilities	25.539.733	14.326.899
Short-term bank loans	4.417.190	2.057.863
	29.956.923	16.384.762
Total interest bearing loans and borrowings	231.503.286	230.223.256

Notes

24. Loans and borrowings, contd.,

Terms of interest-bearing loans and borrowings

Liabilities in foreign currencies:

	Date of maturity	2012		2011	
		Average interest rate	Carrying amount	Average interest rate	Carrying amount
Liabilities in CHF	5.10.2027	0.56%	33.989.877	0.47%	43.999.890
Liabilities in EUR	6.12.2032	0.98%	84.800.019	2.04%	67.075.409
Liabilities in USD	8.11.2030	1.81%	41.956.344	1.61%	39.089.748
Liabilities in JPY	5.10.2027	0.47%	16.304.551	0.50%	23.450.772
Liabilities in GBP	26.2.2024	1.85%	5.084.266	1.86%	7.372.326
Liabilities in SEK	5.10.2027	2.06%	8.891.712	2.75%	11.923.887
			191.026.769		192.912.031
Liabilities in Icelandic kronas:					
Indexed	10.1.2037	4.67%	36.059.327	4.76%	35.253.362
Non-indexed	31.1.2013	7.53%	4.417.190	7.5%	2.057.863
			40.476.517		37.311.225
Total interest-bearing loans and borrowings			231.503.286		230.223.256

Repayment on non-current liabilities are specified as follows on the next years:	2012	2011
The year 2012.....	-	14.326.899
The year 2013.....	25.539.733	29.277.537
The year 2014.....	16.747.099	15.883.347
The year 2015.....	19.625.714	13.141.900
The year 2016.....	19.697.595	22.652.881
The year 2017.....	15.625.559	13.976.357
Later	129.850.396	118.906.472
Total non-current liabilities, including next year's repayment	227.086.096	228.165.393

Next years repayment

In the year 2012 repayments of certain loans were re-negotiated that explains the change in the distribution between years. If non-current loans are refinanced in order to prolonge the loan terms, it can be assumed that the distribution of the repayments will be different from the above.

Guarantees and pledges

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

Covenants

Loans for the amount of ISK 16.856 million have certain covenants that regard repayment time as a proportion of EBITDA and as interests as a proportion of EBITDA as well as reviewing that budgets are within set limits. (2011: ISK 14.933 million). Management regularly evaluate the covenants and in their view there is not danger of them being breached.

Notes

25. 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 508 million at year end 2012, discounted based on 2% interests and taken into account the share in the net asset of the pension fund (2011: ISK 477 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 2013 is recognised among current liabilities.

Retirement benefit obligation is specified as follows:	2012	2011
Retirement benefit obligation at the beginning of the year	476.694	457.307
Contribution due to pension payments during the year ..... (	23.864) (	18.334)
Increase in the pension fund obligation during the year	55.547	37.721
Retirement benefit obligation at year end	<u>508.377</u>	<u>476.694</u>
Non-current component of retirement benefit obligation	483.377	460.874
Current component of retirement benefit obligation	25.000	15.820
Retirement benefit obligation at year end	<u>508.377</u>	<u>476.694</u>

26. Current liabilities

Other current liabilities is specified as follows:	2012	2011
Unpaid taxes	860.745	560.809
Unpaid salaries and salary related items	463.324	681.513
Accrued interest expenses	799.631	909.373
Current component of retirement benefit obligation	25.000	15.820
Derivative contracts in default, cf. note 36	740.000	181.241
Other liabilities	62.933	61.573
	<u>2.951.632</u>	<u>2.410.329</u>

27. Risk management and financial instruments

Overview

On the 20th. of January 2012 a risk policy was approved by the Board of Directors of Orkuveita Reykjavík. The Board's policy is that in all of the Company's operations, risks are to be considered and thereby the policy implements a mindset of responsible and efficient decisions as well as good corporate governance. The risk policy explains the overview and main targets of the Board in this matter. The risk policy also defines the main risk factors, measurement indicators, objectives and risk limits in the daily risk management. One of the main foundations in the risk policy is to define the risk factors which are of relevance, measure their impact and define acceptable limits when controlling them.

Decision making and control on the execution of the risk management is in the hands of a risk council. The risk council consists of the Managing Director, Managing Director of finance, Head of treasury and risk and Head of the financial department. It overviews for instance:

- that suitable methods are used to recognise and measure risk
- that risk monitoring systems are in place and efficient
- that the risk policy of the Board is complied with in the operations of the Company

Notes

27. Risk management and financial instruments, contd.,

The department of treasury and risk oversees and controls risk. The objective of the department is to monitor, analyse and control the financial risks of the Company.

Financial risk is divided into:

- Market risk, further discussed in note 28
- Liquidity risk, further discussed in note 29
- Credit risk, further discussed in note 30

28. Market risk

Market risk is the risk that changes in the market price of foreign currencies, aluminium price and interests will affect the Company's income or the value of its financial instruments. In regard of the current Balance Sheet the market risk is mainly due to changes in interest, currency, index and aluminium price but risk regarding portfolio assets such as shares in companies and bonds is minimum. This is the risk that weighs the most in the Company is divided into:

- a. Currency risk due to liabilities in the balance sheet and cash flow in foreign currencies.
- b. Interest rate risk due to loans and contracts made by the Company.
- c. Risk due to changes in the world market price of aluminium.

a. Currency risk

Currency risk is the risk of changes in currency prices having a negative effect on the Company's income. Currency risk is measured in the difference between assets and liabilities in each currency where taken into consideration all assets, liabilities and derivatives. The department of treasury and risk is permitted to use forward contracts and currency swaps to mitigate risk due to currency fluctuations.

The Company 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).

Approx. 84.1% of the Company's non-current loans are in foreign currencies. The Company has entered into long term electricity sales contracts in foreign currency (USD). The expected future revenues from these contracts on the accounting date amount to approx. ISK 160.383 million. 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:

	2012	2011	31.12. 2012	31.12. 2011
	Average exchange rate		Exchange rate at year end	
CHF	133,352	131,188	140,640	130,795
EUR	160,733	161,416	169,800	158,780
USD	125,052	116,067	128,740	122,320
JPY	1,570	1,458	1,495	1,590
GBP	198,155	186,005	208,150	190,140
SEK	18,4684	17,876	19,758	17,843
CAD	125,110	117,309	129,360	120,095
TWI	221,796	216,843	232,686	217,195

Notes

28. Market risk, contd.

a. Currency risk, contd.

Exposure to currency risk

The Company's exposure to currency risk based on the nominal amounts is specified as follows:

2012	CHF	EUR	USD	JPY	GBP	CAD	SEK	DKK	Total
Loans and borrowings	(33.989.877)	(84.800.019)	(41.956.344)	(16.304.551)	(5.084.266)		(8.891.712)	(191.026.769)	
Accounts payables	(37.253)	(299.766)						(337.019)	
Trade receivables		658.285			47			658.332	
Bank deposits	1.709	6.226.479	492.598	135	131	2.530	1.263	90	6.724.936
Embedded derivatives		14.738.660							14.738.660
Hedge contracts	(217.681)	14.874.347	2.754	156.497	(10.985)	(18.706)			14.786.226
Other financial assets		9.744.861							9.744.861
Balance sheet risk	(34.205.849)	(63.736.446)	(16.618.951)	(16.147.919)	(5.095.073)	2.530	(8.909.154)	90	(144.710.772)
Estimated sale in 2013			8.116.661						8.116.661
Estimated purchase in 2013	(155.915)	(25.849)	(290.034)	(154)				(471.952)	
Balance sheet risk	0	(155.915)	8.090.812	(290.034)	(154)	0	0	0	7.644.709
Net risk	(34.205.849)	(63.892.361)	(8.528.139)	(16.437.953)	(5.095.227)	2.530	(8.909.154)	90	(137.066.063)

28. Market risk, contd.**a. Currency risk, contd.****Exposure to currency risk, contd.**

2011	CHF	EUR	USD	JPY	GBP	CAD	SEK	DKK	Total
Loans and borrowings	(43.999.890)	(67.075.409)	(39.089.748)	(23.450.772)	(7.372.326)	(11.923.887)	(192.912.031)	(5.515)	(299.416)
Accounts payables		(293.119)			(782)				626.769
Trade receivables		27.324	588.749	10.696					1.357.207
Bank deposits	470	711.445	638.435	212	183	3.338	3.039	85	17.682.970
Embedded derivatives			17.682.970						(19.779)
Hedge contracts	(377.996)	(12.372)		370.589					7.868.334
Other financial assets			7.868.334						
Balance sheet risk	(44.377.416)	(66.336.640)	(12.616.752)	(23.069.275)	(7.372.924)	3.338	(11.920.847)	(5.430)	(165.695.947)
Estimated sale in 2011 ...			7.539.896						7.539.896
Estim. Purch. in 2011	(1.210.284)		0	(1.254)				(1.211.538)	
Balance sheet risk	0	(1.210.284)	7.539.896	(1.254)	0	0	0	0	6.328.358
Net risk	(44.377.416)	(67.546.924)	(5.076.856)	(23.070.529)	(7.372.924)	3.338	(11.920.847)	(5.430)	(159.367.589)

Sensitivity analysis

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

	CHF	EUR	USD	JPY	GBP	CAD	SEK	DKK	Total
The year 2012	2.189.174	4.079.133	1.063.613	1.033.467	326.085	(162)	570.186	(6)	9.261.489
The year 2011	2.840.155	4.245.545	807.472	1.476.434	471.867	(214)	762.934	348	10.604.541

This analysis assumes that all other variables, in particular interest rates, remain constant. The analysis was performed on the same basis for the year 2011. 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

28. Market risk, contd.

b. Interest rate risk

Interest rate risk is the risk of changes in interest rates having a negative effect on the Company's income. The Company is exposed to interest rate risk due to interest bearing assets, liabilities and financial instruments measured at fair value. The Company's liabilities both have fixed and variable interest rates, majority being subject to variable interest rates. The department of treasury and risk monitors that interest rate risk is within preset limits and has permission to control interest rate risk with derivatives.

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

	2012	2011
Fixed rate instruments		
Financial assets	6.564	18.423
Financial liabilities	42.553.480	41.570.434
	42.560.044	41.588.857
Variable rate instruments		
Financial liabilities	188.949.806	188.672.600
	188.949.806	188.672.600
Financial instruments at fair value		
Other financial assets	9.744.861	7.868.334
Hedge contracts	683.616 (	19.779)
	10.428.477	7.848.555

In the following table, effect of changes on financial instruments at fair value is set forth, taken into account the effect of taxes. The analysis was done in the same way for the previous year.

	Cash flow sensitivity analysis		Fair value sensitivity analysis	
	100 p increase	100 p decrease	100 p increase	100 p decrease
31.12. 2012				
Embedded derivatives	0	0 (	725.573)	811.329
Other financial assets	0	0 (	226.081)	237.008
Hedge contracts	284.502 (	284.502)	699.815 (	717.916)
Interest bearing loans	(633.244)	633.244	0	0
	(348.742)	348.742 (	251.839)	330.420
31.12. 2011				
Embedded derivatives	0	0 (	976.334)	1.102.158
Other financial assets	0	0 (	222.413)	235.021
Hedge contracts	0	0	70 (	71)
Interest bearing loans	(661.878)	661.878		
	(661.878)	661.878 (	1.198.677)	1.337.108

Notes

28. Market risk, contd.

c. Aluminium risk

Aluminium risk is the risk that changes in the price of aluminium has a negative effect on the income of the Company.

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 contracts have been done 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 has begun, but the contract is for the next 25 years. These electricity sales contracts are denominated in USD and the price of the electricity is connected to the world market price of aluminium. Income of electricity contracts that are effected by price of aluminium is 20.0% of total revenue for the year 2012 (2011: 19.1%)

To reduce risk due to aluminium prices the Company has entered into derivative contracts to reduce the fluctuation of income effected by aluminium prices. The department of treasury and risk has permission to hedge 100% of the aluminium risk of next year and proportionally less in the next two years. At the accounting date hedges amounted to 22.16% of expected income effected by aluminium in the years 2013 to 2014 (2011: 7.5%).

Embedded derivatives in electricity sales contracts

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 embedded derivatives for Grundartangi has been measured and recognised in the financial statements and partly for the contracts with Helguvík.

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 a 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 25 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.

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 year are recognised in the income statement among income on financial assets.

Among embedded electricity sales contracts is a contract with Norðurál Helguvík ehf. (NH), stated at the book value of ISK 1.9 billion. The constructions of the aluminium plant at Helguvík have been delayed and there is uncertainty regarding continuance of the project. It was scheduled to begin delivery of power to the aluminium plant 1 September 2011 and NH was obliged to begin payments from that date. NH has used a option in the contract that allows NH to use the power at the aluminium plant at Grundartangi.

Counter party risk is valued by the management as considerable and the risk is reflected in the stated book value of the derivative.

If the contract will be terminated or renegotiated on other terms, the book value of the embedded derivative would be fully expensed through the income statement.

Notes

28. Market risk, contd.

c. Aluminium risk, contd.

Sensitivity analysis on the price of aluminium

	Sensitivity of Fair value	
	10% decrease	10% increase
31.12. 2012		
Embedded derivatives	(6.483.469)	6.471.310
Aluminium hedges	275.762 (	197.940)
Financial assets at fair value through P/L	(353.902)	353.902
Total	(6.561.608)	6.627.271

31.12. 2011

	Sensitivity of Fair value	
	10% decrease	10% increase
Embedded derivatives	(6.698.980)	6.673.253
Aluminium hedges	36.796 (	36.796)
Financial assets at fair value through P/L	(276.459)	276.459
Total	(6.938.643)	6.912.916

d. Other market risk

Other market risk such as interest spread and risk in shares in other companies is limited, as investments in such securities is an insubstantial part of the Company's operation.

29. Liquidity risk

Liquidity risk is the risk that the Company 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.

The Company's cash and cash equivalents at the end of the period amounted to ISK 6.9 billion. Furthermore, the Company had unused loan authorisations and a open credit line to the total amount of approx. ISK 6.8 billion. The Company had thus in total ensured capital at the end of the period to the amount of approx. ISK 13.7 billion. The corresponding amount at year end 2011 amounted to ISK 7.8 billion.

In an agreement made between the Company and its owners in March 2011, the owners obliged themselves to grant a loan to the Company, amounting to ISK 12 billion. ISK 8 billion were granted at the time of the agreement and ISK 4 billion were granted in March 2013.

Notes

29. Liquidity risk, contd.

c. Liquidity risk, contd.

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

31.12. 2012

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	231.503.285	(260.057.715)	(33.352.320)	(19.281.902)	(62.068.130)	(145.355.362)
Accounts payable	1.366.254	(1.366.254)	(1.366.254)	0	0	0
Other liabilities ...	2.951.632	(2.951.632)	(2.951.632)	0	0	0

Derivative financial instruments

Hedge contracts	(249.274)	(1.233.289)	(631.390)	(553.736)	(103.455)	55.292
	235.571.897	(265.608.890)	(38.301.596)	(19.835.638)	(62.171.585)	(145.300.070)

31.12. 2011

Non-derivative financial instruments

Interest-bearing liabilities	230.223.256	(266.244.117)	(20.623.894)	(32.346.083)	(61.363.182)	(151.910.958)
Accounts payable	1.627.619	(1.627.619)	(1.627.619)	0	0	0
Other liabilities ...	2.410.329	(2.410.329)	(2.410.329)	0	0	0

Derivative financial instruments

Hedge contracts	19.779	(19.216)	(17.261)	(1.955)	0	0
	234.280.983	(270.301.281)	(24.679.103)	(32.348.038)	(61.363.182)	(151.910.958)

If non-current loans are refinanced in order to prolonge the loan terms, it can be assumed that the distribution of the repayments will be different from the above.

Notes

30. Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's receivables from customers. Credit risk is mainly due to whole sale electricity contracts and derivatives that the Company has entered into for hedging purposes. Losses due to unpaid receivables are insubstantial and have limited effect on the Company's return.

When entering into contracts it shall be insured, as possible, that the counterparty is trustworthy and settlement with large counterparties shall be looked into regularly as well as their credit rating.

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

	2012	2011
Trade receivable	4.721.350	4.227.536
Other current receivables	298.181	411.196
Other financial assets	9.751.425	7.886.757
Hedge contracts	932.890	0
Cash and cash equivalents	6.885.693	1.652.484
Total	22.589.539	14.177.972

Financial assets as stated above are categorised as *loans and receivables* except for a part of *other financial assets* and *hedge contracts*. Their categorisation can be seen in note 32.

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

Trade receivable, industrial consumers	917.120	537.146
Trade receivable, retail	3.804.230	3.690.390
	4.721.350	4.227.536

Impairment

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

	2012		2011	
	Gross balance	Allowance	Gross balance	Allowance
Not past due receivables	4.081.898	102.884	3.167.551	73.317
Past due, 1 to 30 days	316.652	12.263	870.132	30.514
Past due, 31 to 90 days	108.612	24.581	67.067	2.721
Past due, 91 days and older	532.688	178.772	402.036	172.698
Total	5.039.850	318.500	4.506.786	279.250

Allowance due to receivables is valued at each reporting date by management. Collectability is valued both in general using historic evidence and also specifically for receivables that are in default.

Receivables due to sewage and cold water have statutory lien in properties and therefore allowance is not considered for those claims.

The Customer Services department governs the collection of receivables and supplies customers with information regarding claims. Collection is done in a well defined process where among other things, consistency in procedures is maintained as much as possible.

Notes

31. 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 interest bearing liabilities, together with the carrying amounts are specified as follows:

	2012		2011	
	Carrying amount	Fair value	Carrying amount	Fair value
Interest-bearing liabilities	(231.503.285)	(223.412.705)	(230.223.256)	(224.628.071)

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.

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:

	2012	2011
Embedded derivatives in electr. sales contr.	2.37% to 11.56%	1.94% to 10.12%
Other financial assets	3.99% to 4.39%	6.63% to 7.11%
Interest bearing loans	1.05% to 4.76%	1.87% to 4.99%

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).

2012	Level 2	Level 3	Total
Shares in companies	0	3.265.182	3.265.182
Embedded derivatives in sales contracts	0	14.738.660	14.738.660
Other financial assets	0	10.684.315	10.684.315
Other financial liabilities	(249.274)	0	(249.274)
	(249.274)	28.688.157	28.438.883
2011			
Shares in companies	0	1.983.269	1.983.269
Embedded derivatives in sales contracts	0	17.682.970	17.682.970
Other financial assets	0	7.868.334	7.868.334
Other financial liabilities	(19.779)	0	(19.779)
	(19.779)	27.534.573	27.514.794

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

Notes

32. Overview of financial instruments

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

	31.12. 2012			31.12. 2011		
	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			3.265.182			1.983.269
Embedd. electr. sales contracts ..		14.738.660			17.682.970	
Other financial assets	939.454	9.744.861		18.423	7.868.334	
Trade receivabl. .	4.721.350			4.227.536		
Other receivabl. ..	298.181			411.196		
Cash	6.885.693			1.652.484		
Interest-bearing .. liabilities	(231.503.285)		(230.223.256)			
Other financial liabilities		(249.274)			(19.779)	
Account payabl. . (	1.366.254)		(1.627.619)			
Other current liabilities	(2.951.632)		(2.410.329)			
	(222.976.493)	24.234.247	3.265.182	(227.951.565)	25.531.525	1.983.269

33. Statement of cash flows, details

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

	2012	2011
Loss for the year	(2.295.194)	(556.272)
Adjusted for:		
Financial income and expenses	18.493.550	19.656.314
Share of loss of associated companies	9.754	5.400
Income tax	(1.535.261)	(6.750.946)
Depreciation and amortisation	10.371.085	8.880.736
Profit from sale of assets and other changes	(41.318)	(143.338)
Retirement benefit obligation, change	31.683	19.387
Working capital from operation before interest and taxes	25.034.299	21.111.281
Inventories, decrease	28.688	135.236
Trade and other receivables, change	(702.520)	(899.899)
Payables and other current liabilities, change	(24.897)	227.900
Cash generated from operations before interests and taxes	24.335.571	20.574.518

Notes

34. 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. Transactions and positions with subsidiaries are eliminated in the financial statements but that information is provided here. This information does not include sale of conventional household supplies to the related parties.

Sale to related parties:	2012	2011
Reykjavik City	1.235.886	898.467
Institutions and companies controlled by Reykjavik City	431.868	256.930
Subsidiaries	367.253	470.432
Associates	0	12.534
	2.035.007	1.638.363
Purchases from related parties:		
Reykjavik City	5.246	22.050
Institutions and companies controlled by Reykjavik City	6.841	5.797
Subsidiaries	15.028	14.808
Associates	42.949	54.038
	70.064	96.694
Receivables for related parties:		
Reykjavik City	284.843	316.143
Institutions and companies controlled by Reykjavik City	39.505	34.094
Subsidiaries	90.636	76.930
Subsidiaries, interest bearing loans	6.988.862	6.623.659
	7.403.846	7.050.825
Payables for related parties:		
Reykjavik City	77.141	2.650
Institutions and companies controlled by Reykjavik City	305	120
Subsidiaries	0	339.156
Subsidiaries, interest bearing	0	0
	485.758	341.927
Interest bearing loans from owners of the parent Company:		
Reykjavik City	8.277.970	7.753.254
Akranes town	489.214	458.204
Borgarbyggð, municipality	82.568	0
	8.849.752	8.211.459
Interest expense on loans from owners of the parent Company:		
Reykjavik City	429.649	234.042
Akranes town	25.392	13.831
Borgarbyggð, municipality	2.824	0
	457.864	247.873

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 10.

Notes

35. Group entities

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

Subsidiaries	Main operation	Share	
		31.12. 2012	31.12. 2011
Gagnaveita Reykjavíkur ehf.	Data transfer	100.0%	100.0%
Reykjavík Energy Invest ehf.	Investments	100.0%	100.0%
Úlfjótssvatn frítímabyggð ehf.	Preperation company	100.0%	100.0%
Hrafnabjargavirkjun hf.	Preperation company	60.0%	60.0%

Main changes in the Group during the year

At year-end 2012 shares in were decreased by approx. ISK 225 million or from ISK 225 million to ISK 500 thousand. The decrease was was on one hand to level out Úlfjótssvatn frítímabyggð ehf. deficit that amounted to ISK 41 million and on the other hand to repay a claim the Company had on the mother company.

36. Other issues

Reducted payments from Norðurál

From 1 October 2011 Norðurál has reduced contractual payments of electricity from Orkuveita Reykjavíkur and HS Orka. Orkuveita Reykjavíkur does not accept Norðurál's interpretation regarding this matter and a claim due to this, amounts to ISK 691 million. A conclusion from the Tribunal is expected during the next months in an Arbitration, where HS Orka is the claimant and has made its claims against Norðurál on the grounds of the reduction af contractual payments. As OR is also a party to the trilateral contract the company is also a respondant to the arbitration. If the Tribunal accepts HS Orkas arguments, OR will claim Norðurál for the total amount. The claim is among trade receivables, taken into account an allowance due to uncertainty in the matter.

Possible sale of financial assets

Among other financial assets in the balance sheet is a bond issued by Magma Energy Sweden A.B. Orkuveita Reykjavíkur has mandated Straumur Investment Bank Inc. to act as an advisor in relations to a potential sale of the bond, but a final decision regarding the sale of the bond has not been taken.

The bond is classified as a financial asset for sale through P/L and its book value at year end 2012 is ISK 9.7 billion.

If a decision is made to sell the bond it can effect the presentation of the bond in the financial statements.

Delays of power plant constructions

The continuation of energy production projects has been called into question due to delays in meeting contractual conditions of energy sales contracts between Orkuveita Reykjavíkur and Norðurál Helgúvík ehf. (NH). A review of energy sales contracts is ongoing with NH. It is OR's opinion that some of the contractual conditions have been breached and OR is in dispute with NH on this matter. As a result, there have also been delays in the fulfilling of contracts with other parties such as machine producers and contractors. Negotiations have been conducted concerning compensation due to these delays. The largest contracts are with Mitsubishi Heavy Industries (MHI) and Balcke Dürr (BD) regarding the delivery of machinery, Orkuveita Reykjavíkur's obligation regarding those contracts is discussed in note 12. Settlement has been reached with MHI and BD regarding delay of delivery of this machinery. Uncertainty still remains regarding investments of Hverahlíðarvirkjun, the amount of compensation to MHI and BD is unknown, but could be considerable if realised. 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. The management is confident that solutions which should lower these costs considerably will be realised.

Notes

36. Other issues, contd.

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

22 March 2013, the day Orkuveita Reykjavíkur's financial statements for the year 2012 were authorised for issue, the TWI is 221,1783 but was 232,6864 at the reporting date 31 December 2012. If interest bearing loans and borrowings would be accounted for according to the foreign exchange rates on the reporting date they would have amounted to ISK 217.6 billion or ISK 9.5 billion lower 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 8.7 billion on the reporting date or 6.0 billion lower than on the accounting date. Further information about the effect of changes in the exchange rates and aluminium prices can be found in note 28.

Derivative contracts in default

After the collapse of the Icelandic banks in 2008 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.

Among other current liabilities are derivative contracts accounted for that are in default. The contracts have not been settled due to uncertainties, both with Orkuveita Reykjavíkur and the Receivership Committees of the fallen banks concerning how to settle them. As a measure of precaution it has been decided to expense ISK 559 million in the year 2012 in addition to the ISK 181 million expensed in earlier accounting periods. In total ISK 740 million have been expensed due to these defaulted contracts. This action is in no way an admittance of the debt on Orkuveita Reykjavíkur's behalf and the amount can either increase or decrease when the contracts are settled. The contracts are accounted for among other current liabilities.

Corporate governance statement (unaudited)

Corporate governance

Orkuveita Reykjavíkur's (OR) main operations are governed by the provisions of Act No.139/2001 (as amended). The owners of OR have outlined an 'Ownership Policy', whereby the Board of OR is expected to set out the 'Board Operation Procedures', with regard to further fulfilling legal requirements. The Ownership Policy can be accessed via the OR website: www.or.is.

Orkuveita Reykjavíkur values

Our values are integrity, foresight and efficiency. These are the principles that guide us in all our business endeavours.

Board of Directors

The Board of Directors at OR is appointed by six individuals; five are appointed by the Reykjavík City Council and one is appointed by the Akranes Council. The Borgarbyggð Council appoints a special representative and Reykjavík appoints the Chairman and the Vice Chairman, from the representatives in the Reykjavík City Council. The Board is responsible for the financial and operational matters of OR. The Board of Directors include, Haraldur Flosi Tryggvson, Chairman of the Board, District Court Attorney and a lawyer at LMB, Brynhildur Davíðsdóttir, Vice Chairman and Docent at the Department of Environment and Natural Sources, at the University of Iceland, Gylfi Magnússon, Docent at the Institute for Economic Studies, at the University of Iceland, Kjartan Magnússon, City Council Representative, Sóley Tómasdóttir, City Council Representative and Hrönn Ríkharðsdóttir Akranes Town Council Representative. Thirteen Board meetings were held in 2012 and the majority of the Members of the Board were present.

Audit Committee

The OR Audit Committee is governed by Chapter IX. Act No. 3/2006 on annual financial statements Act no. 80/2008. The Committee's rules of procedure are devised by the Board of Directors, in accordance with the law.

The Auditing Committee acts as a consultant to the Board of Directors and acts on its behalf. The Committee does not have executive powers. There are three members of the Audit Committee. Gylfi Magnússon is the only Board Member and he works in cooperation with Sigríður Ármannsdóttir, Chairman of the Committee and Ingvar Garðarsson; both State Authorized Public Accountants. Thirty five meetings were held in the year 2012.

The Internal Auditor for OR is Guðmundur I. Bergþórsson and he works under the auspices of the Audit Committee.

The CEO and Executive Directors

The Board of Directors appoints the CEO; Bjarni Bjarnason is OR's CEO. The Board and the CEO are responsible for the operations of OR. The five Executive Directors at OR and the CEO, form the Executive Board and they convene on a weekly basis.

The Chief Financial Officer is Ingvar Stefánsson. He is responsible for the Treasury and Risk, Accounting, Management Information, Procurement and Information technology.

The Director of Utilities is Inga Dóra Hrólfsdóttir. The Utilities is divided into Technology, Operations, Maintenance and Control Room.

The Director of Power Plants and Sales is Páll Erland. He is responsible for the power plants, Sales and Marketing Division and the policy making decisions for the power plants and Sales Division.

The Director of Customer Services is Skúli Skúlason. The Customer Services is divided into the Service Centre, Metering and Installations, Billing and Credit Management.

The Director of Research and Development is Hildigunnur H. Thorsteinsson. Research and Development is divided into Natural resources, Systems and Design and Project Management.

Corporate governance statement (unaudited)

Corporate governance statement, contd.,

Orkuveita Reykjavíkur - Risk management

A new OR risk management policy was approved by the Board of Directors 20 January 2012. It is the policy of the Company board that all of the Company's operations are low risk by promoting responsible and effective decision making and management. The risk management policy provides an overview of the Board's strategy in this regard. It also defines the main types of risk, a risk measurement scale, basic strategies, objectives and goals regarding daily risk management within the Company.

Internal monitoring and risk management

OR prepares its financial statements in accordance with the International Financial Reporting Standards (IFRS's) and focuses on well-defined areas of responsibility, including job descriptions, alongside regular reporting and transparency in all activities. Monthly operational meetings are an important part of the internal monitoring of profits, operating costs and investments, as well as regular meetings of the 'Risk Committee' of the Company. The Board monitors the financial risk of the company and receives regular reports on the issue. For more information on risk management, please see the explanatory notes on the Financial Statements.

Further discussion of corporate governance can be found in the Annual Report, released in April, 2013 and available on the website: www.or.is.

