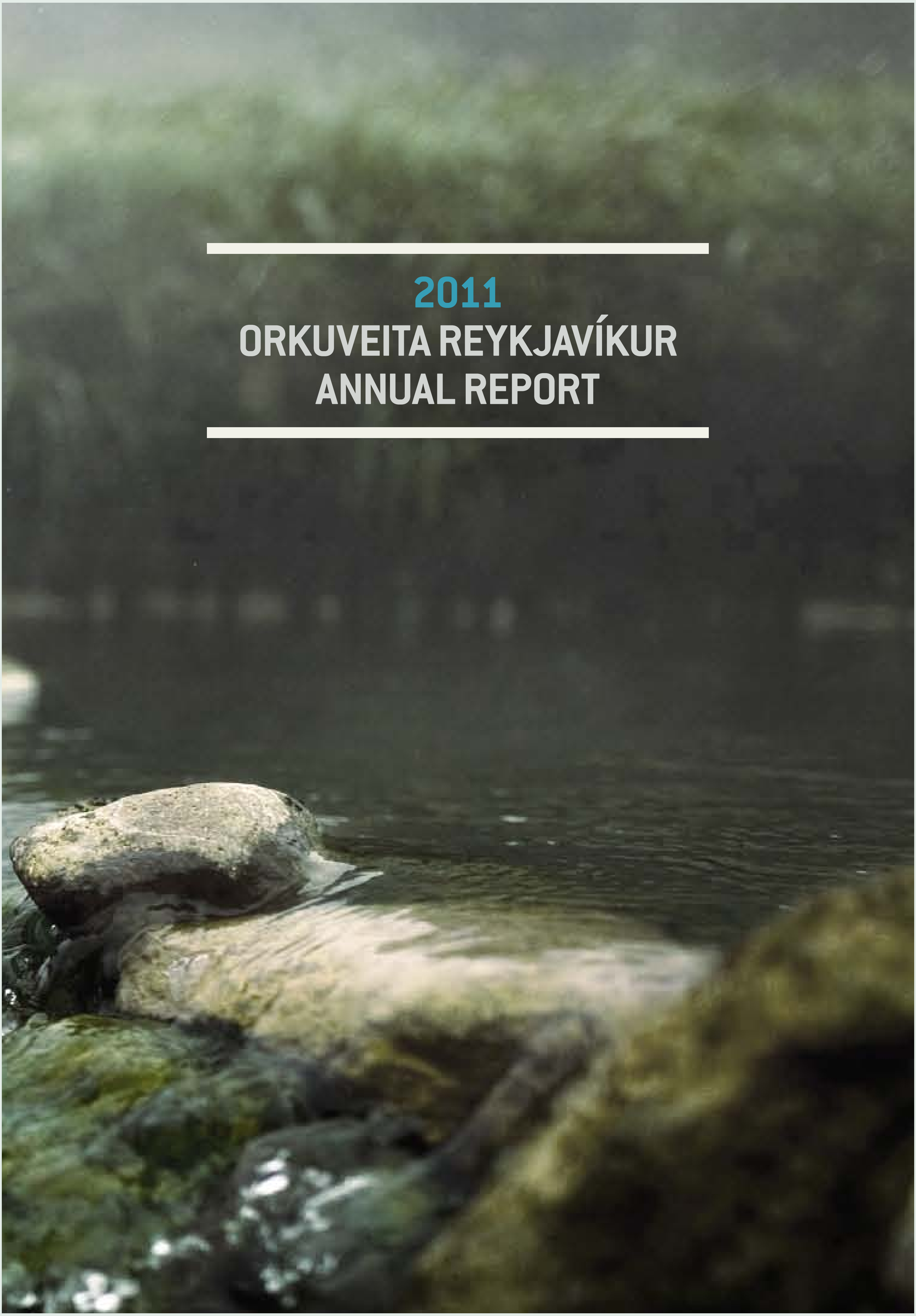

2011
ORKUVEITA REYKJAVÍKUR ANNUAL REPORT

PHOTOS

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PAGE 6 AND 12: **KRISTINN H. ÞORSTEINSSON**

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PAGE 20: **GUÐMUNDUR SIGURVINSSON**

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01 //
ADDRESS FROM THE CHAIRMAN AND THE CEO

CHAIRMAN´S ADDRESS

Orkuveita Reykjavíkur is a large and dynamic company owned by several municipalities which provides important basic services to households and businesses. The municipalities have to some extent delegated the provision of statutory public services to Orkuveita Reykjavíkur, but the company is also engaged in energy production and sales in a competitive environment. It is undisputed that both functions are fundamental in a modern society, although there may be disagreement regarding ways and means. It is therefore a serious matter when problems arise in the operations of Orkuveita Reykjavíkur. Reports of such difficulties can have an impact that reaches far beyond the financial position of the company itself, with potentially adverse effects on the functioning of the municipalities that own Orkuveita Reykjavíkur as well as the businesses and households that rely on its services.

In recent months the board of Orkuveita Reykjavíkur has had to bear news of this nature to its owners. The company is in a difficult position, due mainly to a heavy debt burden and a corresponding shortage of liquidity. This news has not been taken lightly, nor has it been ignored; far from it. Public officials and politicians representing the owner municipalities have combined their efforts to support Orkuveita Reykjavíkur in these difficult times. The staff and management of Orkuveita Reykjavíkur have also done their part. Together, these parties have developed an action plan, commonly referred to simply as "the Plan", that calls for a number of steps designed to guide Orkuveita Reykjavíkur through the worst of the difficulties and restore it to its former stability.

It is safe to say that the plan and its offshoots took up most of the time of the company's board of directors in 2011 while also serving as a guideline for management in the turmoil surrounding the implementation of its actions. It is therefore extremely satisfying to see the results of this labour in last year's operating figures. All the targets have either been met or exceeded. The first steps envisaged under the plan have been completed with a promise of a brighter future.

These accomplishments were not achieved without sacrifice. It has proven necessary to reduce the scope of operations substantially. A number of employees of Orkuveita Reykjavíkur have departed, many after serving the company for years. I am grateful to those fine people for their service and wish them well in their future endeavours.

The infrastructure of Orkuveita Reykjavíkur has also undergone significant changes. Employees have had to endure stress and uncertainty resulting from the upheaval that accompanies extensive restructuring. Their perseverance is admirable. The management team has also seen changes, with new people coming in and others transferring to new posts. There was also a change of Chief Executive Officer in the course of the year: Dr. Helgi Thór Ingason, who had been appointed interim CEO, left the position at the end of March 2011. He was responsible for implementing the first phase of the changes, in addition to participating in the development and implementation of the process of hiring a new CEO. Bjarni Bjarnason took over as CEO in early 2011 and, together with his management team, has done outstanding work in a short time. All of these people deserve our gratitude.

Of the other major issues confronting the board of Orkuveita Reykjavíkur it should be mentioned that the company's obligations relating to energy sales to power-intensive industries required considerable attention in 2011. While this is a delicate issue there is every reason to be optimistic that a satisfactory outcome will be achieved.

The highlight of 2011 in the operations of Orkuveita Reykjavíkur was the concerted effort outlined above. The boldness and restraint of politicians, the steadfastness of public officials and the resourcefulness of management have combined to produce real results. The opportunity to participate in that work has been a true privilege.

Haraldur Flosi Tryggvason

CEO´S ADDRESS

The distribution systems operated by Orkuveita Reykjavíkur may be equated to society's vascular and nervous system and it must be managed in a sound and prudent manner. The operation should ideally be based on a strong equity position while ensuring stable prices and services to customers and generating reasonable profits for the owners. This was not the case at the beginning of 2011, at which point it became clear that the company was in a precarious position and might be unable to meet payroll expenses as early as the coming summer.

Every crisis is an opportunity, however, and operational reforms have been undertaken in an organised and professional manner. A detailed analysis of every aspect of the operation of Orkuveita Reykjavíkur, carried out throughout most of last year, has served as the basis for decisions and every effort has been made to gather support for the reforms among the staff, management, board of directors and owners. These efforts have been successful for the most part.

A precise analysis of Orkuveita Reykjavíkur's financial position led to the approval of an ambitious six-year action plan in March. Its goal is to improve the company's cash flow by ISK 50 billion in the period from 2011 to 2016, requiring measures to be taken in every area of the company's operations as well as contributions from owners and customers. All efforts are now being made to put this plan into practice; this is essential if Orkuveita Reykjavíkur is to fulfil the role intended by its owners. The action plan of Orkuveita Reykjavíkur and its owners, referred to simply as "the Plan", sets out a clear strategy for the company's operations. No dividend will be paid to owners while the operating difficulties remain unresolved, the owners will lend the company funds to meet the worst of the debt problems and the tariffs will be raised to generate additional revenues. In addition, the plan calls for Orkuveita Reykjavíkur to abandon any investments beyond those which are strictly necessary for its operations and to sell assets, with a view to focusing exclusively on utilities while withdrawing from other sectors. Last but not least, the plan requires Orkuveita Reykjavíkur to reduce its day-to-day operating costs by ISK five billion in the period 2011–2016. Achieving the targets required in the past year has not been without suffering and unfortunately some staff cuts have been necessary.

In the autumn, an analysis of working procedures and human resource needs prompted changes in Orkuveita Reykjavíkur's organisational chart for the purpose of simplifying processes and improving efficiency. Among the changes made was an increased emphasis on servicing customers in line with Orkuveita Reykjavíkur's role as a service company, engaging in the operation of utilities. The day-to-day operation of supply systems was separated from long-term projects and development, and the organisational chart is now based on the assumption that the production and sale of electricity will be transferred to a separate entity, as required by law. The positions of Environmental Manager, HSE Manager and File Manager have been created directly under the CEO for the purpose of providing support and incentive to the management and staff of the company in these important areas of operations.

Many of the managers required under the new organisational chart were hired from among Orkuveita Reykjavíkur's excellent staff, although outside talent has also been recruited to strengthen the management team. A re-organisation of the kind that Orkuveita Reykjavíkur went through last year provides an opportunity to work simultaneously on a number of changes. To give an example, the company was able to increase the proportion of women in its management team to 32% at years end. At the same time, efforts are being made to eliminate the gender pay gap at the company.

There is more work to be done at Orkuveita Reykjavíkur in the area of human resources. The restructuring of the company's operations has been very hard for the staff and adversely affected morale. While employees have shown perseverance and ability to adapt during these tumultuous times, it has not been easy. The staff of Orkuveita Reykjavíkur has decreased by 200 in recent months after peaking at 600 in 2008. However, the tasks of the company remain fundamentally the same, which gives an indication of the scope of the changes made to its organisation and day-to-day operations. At the same time employees have had to endure a harsh public discussion about the company. The restructuring of Orkuveita Reykjavíkur's day-to-day operations is now completed and positive development is ahead. It is important to build up a culture of trust and sound morale in the company on a lasting basis.

The 2011 annual financial statements of Orkuveita Reykjavíkur, published here, bear witness to a turnaround in its operations. Day-to-day operating costs are substantially lower and operating profit more than doubled, from slightly less than ISK 6 billion to over ISK 12 billion. Orkuveita Reykjavíkur is highly leveraged and its debt problems are urgent. Sound day-to-day operations are one of the main prerequisites for overcoming the debt burden.

To conclude, I would like to express my gratitude to the entire staff of Orkuveita Reykjavíkur for their outstanding service during difficult times, and the board of directors and owners for their excellent collaboration and steadfast support with regard to the important tasks that needed to be carried out last year.

Bjarni Bjarnason

02 //

KEY FIGURES FROM OPERATIONS

KEY FIGURES FROM OPERATIONS

Orkuveita Reykjavíkur's annual financial statements for 2011 comprise the consolidated accounts of Orkuveita Reykjavíkur and its subsidiaries. The company's operating profit (EBIT) was ISK 6.4 billion higher in 2011 than in 2010, more than doubling year-on-year. Payroll and other operating costs decreased while revenues increased. All the targets in the action plan of Orkuveita Reykjavíkur and its owners, approved in March 2011, have been met and some have been surpassed. *The annual financial statements are available on the company's website at http://www.or.is/English/About/Annualreports/.*

INCOME STATEMENT

Consolidated operating revenues amounted to ISK 33,626 million in 2011, increasing by 20.5% from the preceding year. Consolidated operating costs before depreciation amounted to ISK 12,391 in 2011, decreasing by 11.3% from the year before. Earnings before depreciation (EBITDA) amounted to ISK 21,235 million, increasing by 52.2% from the previous year.

Realised financial income and expenses were negative by ISK 3,635 in 2011 after being negative by ISK 3,424 million in 2010. Unrealised financial income and expenses were negative by ISK 16,027 million after being positive by ISK 14,201 million in 2010; this one-year change of over ISK 30 billion did not affect cash flow.

BALANCE SHEET AND CASH FLOW

At year-end 2011, total consolidated assets were ISK 296,385 million, as compared to ISK 286,540 million in 2010. Total liabilities were ISK 234,742 million at year-end 2011, as compared to ISK 233,694 million at year-end 2010. Interest-bearing liabilities amounted to ISK 230,223 million at year-end 2011, compared to ISK 225,191 million at year-end 2010. Orkuveita Reykjavíkur has a heavy debt load, and changes in external conditions can have a significant impact on financial instruments. Among the external factors that can affect Orkuveita Reykjavíkur's financial position are aluminium prices, interest rates and currency exchange rates. Orkuveita Reykjavíkur received a loan from its owners amounting to ISK 8 billion in 2011, but has otherwise used cash provided by operations for investments and repayments of loans.

Orkuveita Reykjavíkur's equity totalled ISK 61,643 million at year-end 2011. The equity ratio was 20.8%, as compared to 18.4% in 2010. In 2011 a revaluation of fixed assets was carried out, resulting in equity increase of ISK 8.9 billion. Net cash from operating activities amounted to ISK 16,9 billion in 2011, increasing by 46.1% from the year before. The increase is largely due to tariff increases and curtailing in operations.

FINANCING

According to the action plan of Orkuveita Reykjavíkur and its owners covering the period 2011 to 2016, the company will receive a loan from its owners in the total amount of ISK 12 billion. Each owner will participate in the loan in proportion to their shareholding in the company. The first part of the loan, amounted to ISK 8 billion, was disbursed in April 2011, with a further ISK 4 billion scheduled for disbursement in 2013. The loan is provided for a term of 15 years on the terms offered by Municipality Credit Iceland; no payments are required for the first five years. This loan, in conjunction with various cost-cutting measures and postponement of investments for the next few years, has the objective of ensuring that Orkuveita Reykjavíkur's funding requirements are met in the period 2011 to 2016. At year-end Orkuveita Reykjavíkur had ISK 1.7 billion in cash and cash equivalent, in addition to undrawn credit facilities totalling ISK 5.9 billion. Thus, the company's cash and available credit lines amounted to ISK 7.6 billion at the end of the year. An agreement for an additional line of credit in the amount of ISK 2 billion was signed at the beginning of 2012.

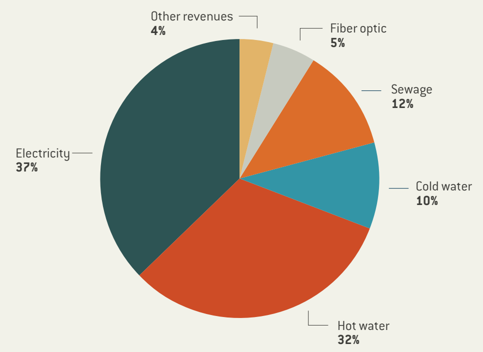
RISK MANAGEMENT

The board of directors of Orkuveita Reykjavíkur approved a risk strategy for the company on the 20th of January 2012. It is the policy of the board of directors that risks should be given due consideration in all activities of the company, thereby promoting responsible and efficient decisions and management practices. The risk policy sets out the board of directors' overall vision and chief goals in this area. It also defines the main types of risks, benchmarks for measuring those risks and the principal methods, targets and limits to be observed in the company's day-to-day risk management. The main risks in the company's operations are divided into core risks, financial risks and operational risks.

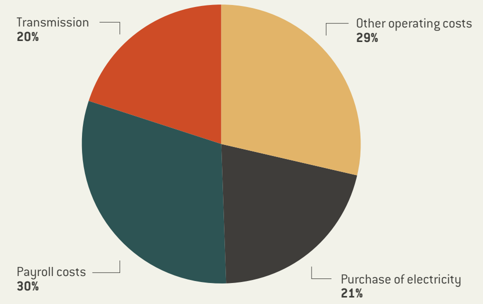
An agreement was concluded with the Dutch bank ING to hedge against aluminium price and interest rate fluctuations. The purpose of the agreement is to minimize Orkuveita Reykjavíkur's exposure to any potentially unfavourable effects from these factors, which could have a significant impact on the company's financial position. The agreement reduces the company's need for cash to meet unfavourable fluctuations. Orkuveita Reykjavíkur believes that this agreement is a sign of the confidence that financial institutions in Iceland and abroad have in the action plan being followed and the company's ability to carry it through. While the agreement does not directly affect the action plan of Orkuveita Reykjavíkur and its owners, announced in spring 2011, it does strengthen its progress.

Moody's issued a new credit rating for Orkuveita Reykjavíkur in July 2011. The credit rating was downgraded by one notch, from Ba1 to B1, with a negative outlook. Moody's rationale for the downgrade was that Orkuveita Reykjavíkur's owners were now less likely to be able to provide extraordinary support to the company in the event of need for such support. The baseline credit assessment remained unchanged at B3. After reviewing the company's credit rating in April 2011, the Icelandic rating agency Reitun confirmed its previous rating of B+ with a stable outlook, taking account of owner guarantees.

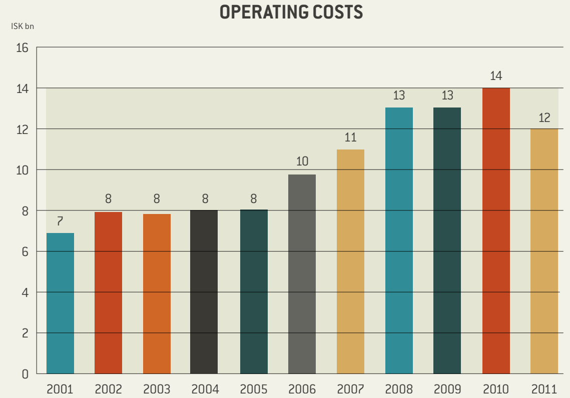
DISTRIBUTION OF REVENUES 2011



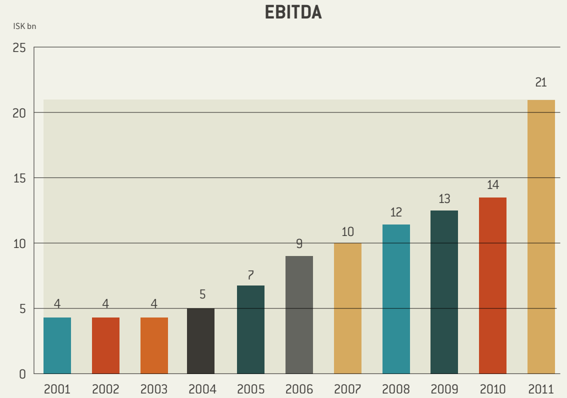
DISTRIBUTION OF OPERATING COSTS 2011



OPERATING COSTS



EBITDA



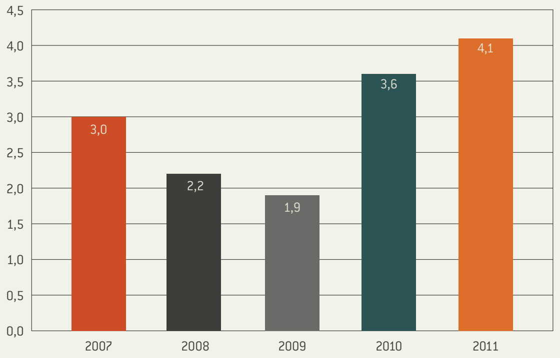
INSTALLED CAPACITY

	ELECTRICITY	THERMAL ENERGY
GEOTHERMAL POWER PLANTS		
Nesjavellir	120 MW	300 MW
Hellisheiði	303 MW	133 MW
Total geothermal power plants	**423 MW**	**433 MW**
HYDROPOWER PLANTS		
Elliðaá	3,2 MW	-
Andakílsá	8,2 MW	-
Total hydropower plants	**11,4 MW**	-
Low-temperture areas		600 MW
Total	434,4 MW	1.033 MW

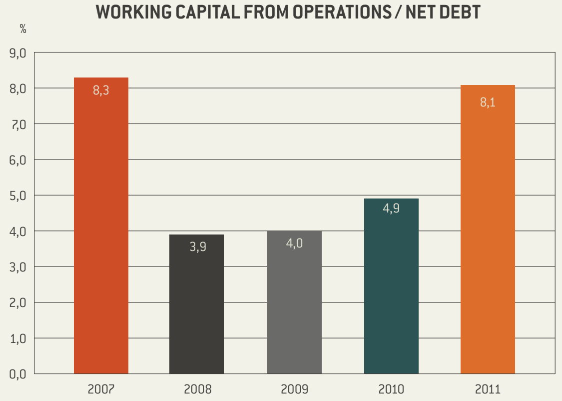
EMPLOYEES 2011

	WOMEN	MEN	TOTAL
NUMBER OF PERMANENT EMPLOYEES ON PAYROLL AT YEAR-END	127	326	453
AVERAGE AGE AT YEAR-END	46,0	48,6	47,9
AVERAGE LENGTH OF SERVICE AT YEAR-END	10,3	13,8	12,9
MAN-YEARS	150,1	382,1	532,2
STAFF TURNOVER			4,30%

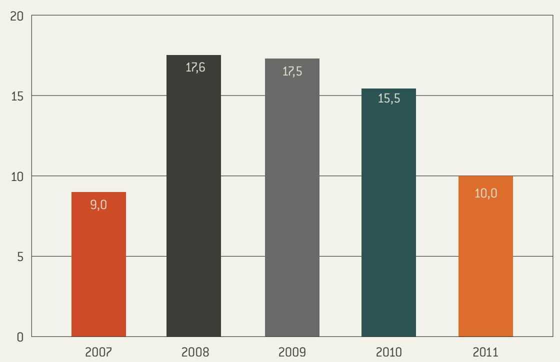
FFO INTEREST COVERAGE



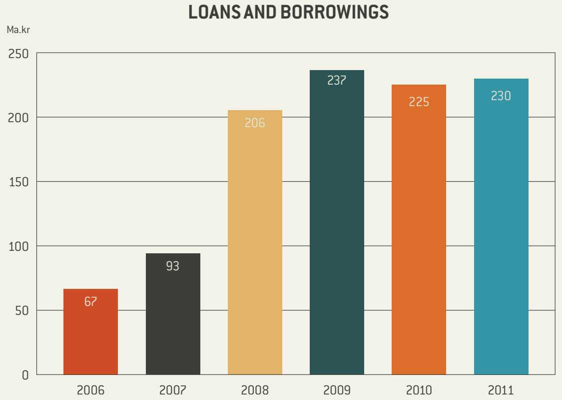
WORKING CAPITAL FROM OPERATIONS / NET DEBT



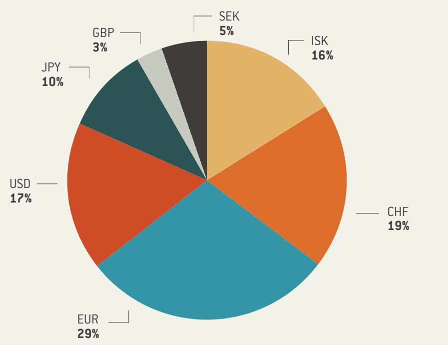
NET DEBT / EBITDA



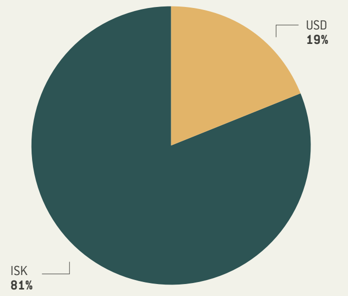
LOANS AND BORROWINGS



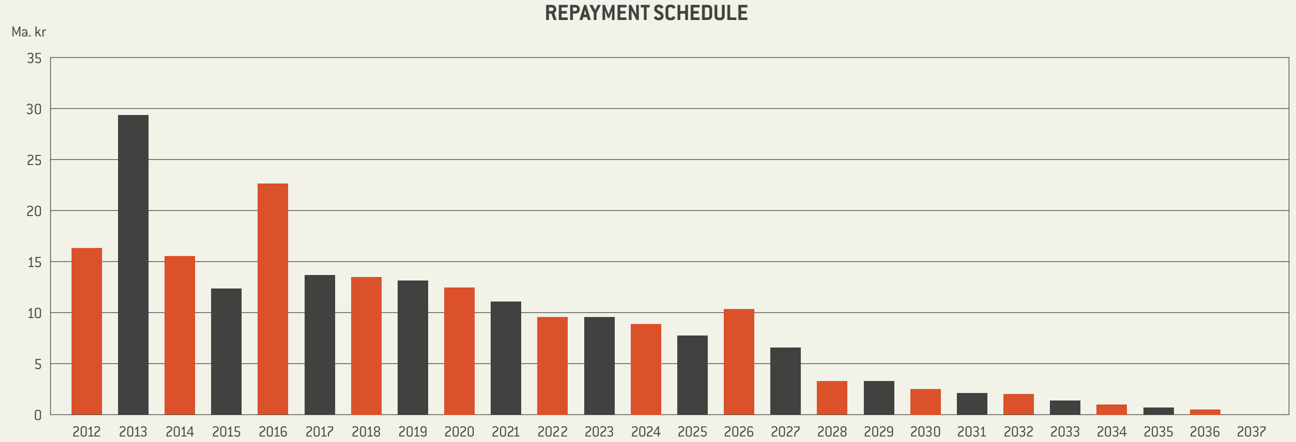
CURRENCY COMPOSITION OF LOANS AND BORROWINGS



CURRENCY COMPOSITION OF REVENUES



REPAYMENT SCHEDULE



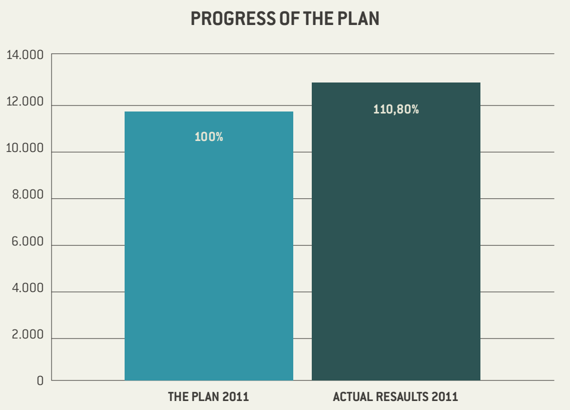
KEY FIGURES

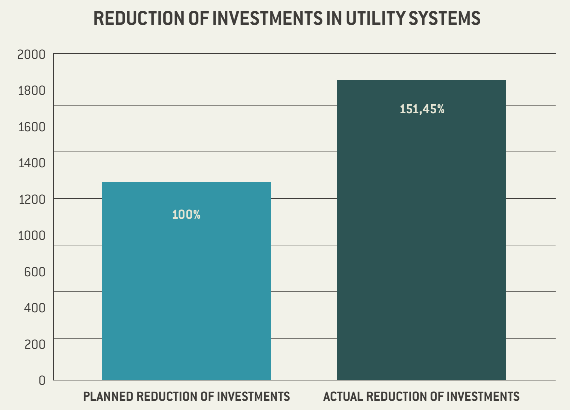
Operations (ISK MILLION)	2007	2008	2009	2010	2011	Change 10/11
Income						
Electricity	9.649	11.529	12.540	13.622	16.732	22,8%
Hot water	5.400	5.717	6.003	6.491	8.434	29,9%
Cold water	1.899	1.971	2.510	2.577	2.748	6,6%
Sewage	1.710	2.010	2.276	2.526	3.251	28,7%
Fibre-optic	555	669	797	1.000	1.170	17,0%
Other income	2.150	2.272	1.887	1.700	1.291	(24,1%)
Total income		**24.168**	**26.013**	**27.916**	**33.626**	**20,5%**
Operational costs	(11.449)	(12.517)	(13.042)	(13.964)	(12.391)	(11,3%)
EBITDA	9.914	11.652	12.970	13.951	21.235	52,2%
Depreciation	(5.538)	(6.953)	(7.814)	(7.962)	(8.881)	11,5%
Operational profit (EBIT)	**4.376**	**4.699**	**5.157**	**5.989**	**12.354**	**106,3%**
Realised financial gains / financial loss	(2.431)	(3.364)	(4.258)	(3.424)	(3.635)	6,2%
Profit before unrealised financial gains / financial loss	**1.945**	**1.334**	**898**	**2.565**	**8.719**	**239,9%**
Unrealised financial gains / financial loss	6.365	(89.435)	(4.812)	14.201	(16.027)	-
Income tax	(1.794)	15.064	1.398	(3.037)	6.751	-
Profit /(loss) of the year according to the Financial Statements	6.516	(73.037)	(2.516)	13.729	(556)	-
Balance Sheet year-end (ISK million)						
Power plants and utility systems	153.790	217.728	230.825	238.274	249.478	-
Other fixed assets	29.307	34.890	42.102	39.996	39.669	-
Current assets	8.394	6.755	8.598	8.270	7.238	-
Total assets	**191.491**	**259.373**	**281.525**	**286.540**	**296.385**	
Total Equity	**88.988**	**48.359**	**40.657**	**52.847**	**61.643**	**-**
Long-term liabilities	93.205	196.589	221.780	212.162	214.302	-
Current liabilities	9.298	14.425	19.088	21.531	20.440	-
Total liabilities and equity	**191.491**	**259.373**	**281.525**	**286.540**	**296.385**	
Net liabilities*	88.890	204.537	233.625	222.847	228.571	
Cash Flow Statement (ISK million)						
Funds from operations (FFO)	7.386	7.983	9.036	10.595	17.231	62,6&
Cash generated from operations	7.395	7.699	8.429	11.588	16.930	46,1%
Investing activities	(29.947)	(32.373)	(20.470)	(14.542)	(9.539)	-
Financing activities	26.050	21.485	13.133	2.220	(8.068)	-
Liquidity						
Cash and cash equivalents at year-end	3.751	1.244	2.943	2.344	1.652	-
Undrawn credit facilities	19.000	14.799	13.800	8.298	5.900	-
Total liquidity at year-end	**22.751**	**16.042**	**16.743**	**10.641**	**7.552**	**-**
Key ratios						
Profit margin ratio	18,5%	18,3%	19,8%	21,5%	36,7%	
Return on investments	11,2%	9,3%	9,2%	9,7%	11,3%	
Outstanding sales ratio	12,9%	13,6%	12,8%	13,1%	12,6%	
Equity ratio	46,5%	18,6%	14,4%	18,4%	20,8%	
Current asset ratio	0,90	0,47	0,45	0,38	0,35	
Change in current assets as a proportion of operating income	34,6%	33,0%	34,7%	38,0%	51,2%	
Investments as a proportion of income	140,2%	133,9%	78,7%	52,1%	28,4%	
Debt service cover (EBITDA /paid liab. + net paid interest)	1,54	1,81	1,23	1,76	1,51	
Interest coverage	2,99	2,22	1,85	3,63	4,07	

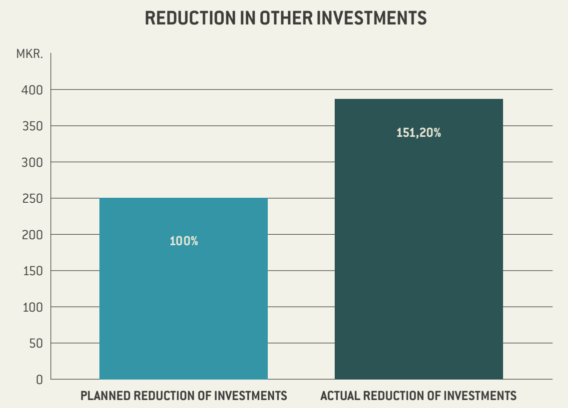
*Net liabilities are interest bearing liabilities minus cash and cash equivalents

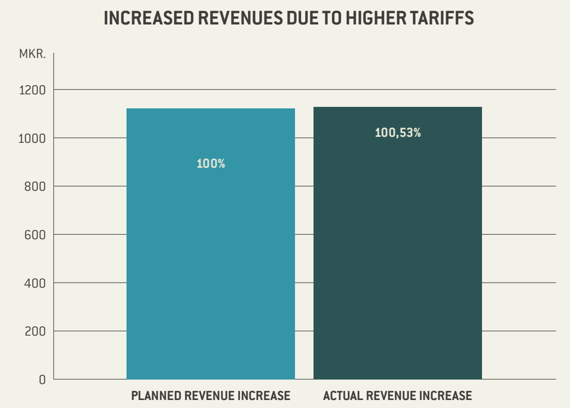
ACTION PLAN OF ORKUVEITA REYKJAVÍKUR AND ITS OWNERS

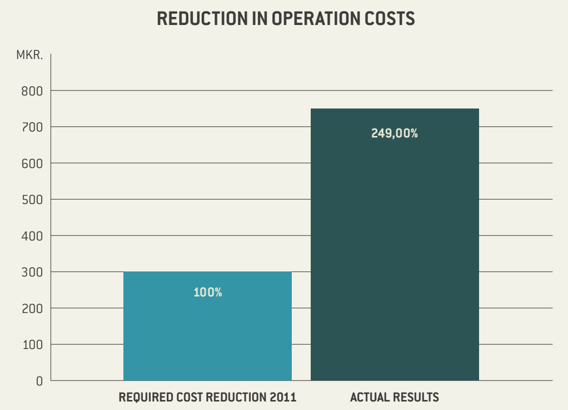
In the beginning of the year 2011 it was clear that actions Orkuveita Reykjavíkur had undertaken after the economic collapse in 2008 were insufficient and further actions were needed. At the end of March 2011 the board of directors of Orkuveita Reykjavíkur and its owners' municipal authorities approved an action plan designed to address the company's poor financial position. The goal of the plan, referred to simply as "the Plan", is to improve the cash position of Orkuveita Reykjavíkur by ISK 50 billion in the period from 2011 to year-end 2016. Progress reports are published on a quarterly basis. A summary of the overall progress of "the Plan" and the status of its main components as at year-end 2011 is set out below.

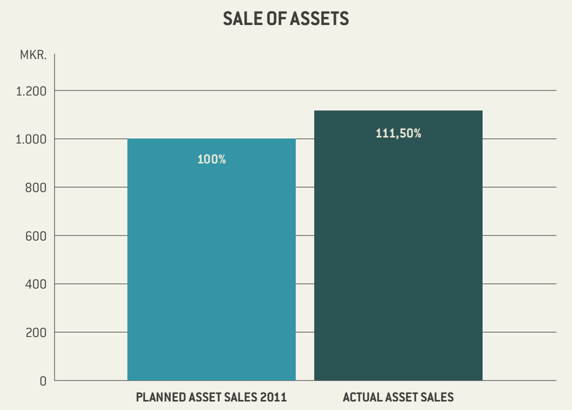












"THE PLAN"

	2011	2012	2013	2014	2015	2016	TOTAL
Actions in ISK million	**11.877**	**10.170**	**15.005**	**6.813**	**2.940**	**4.458**	**51.263**
Reduction of investments in utility systems	1.205	3.518	2.690	2.518	2.410	2.659	15.000
Reduction in other investments	250	200	200	200	200	200	1.250
Increased revenues due to higher tariffs	1.122	1.552	1.215	1.295	1.330	1.499	8.013
Reduction in operation costs	300	900	900	900	1.000	1.000	5.000
Sales of assets	1.000	2.000	5.100	1.900	0		10.000
Subordinated loans from owners	8.000		4.000				12.000

PROGRESS OF "THE PLAN" IN 2011.	FORECAST 2011	ACTUAL 2011
Reduction of investments in utility systems	1.205	1.825
Reduction in other investments	250	378
Increase revenues due to higher tariffs	1.122	1.128
Reduction in operation costs	300	747
Sales of assets	1.000	1.115
Subordinated loans from owners	8.000	7.925
Total	**11.877**	**13.119**


03 //
THE YEAR AT A GLANCE

THE YEAR AT A GLANCE

1ST JANUARY
Orkuveita Reykjavíkur takes over the collection of water and sewage charges in four municipalities.

7TH FEBRUARY
The board of directors of Orkuveita Reykjavíkur decides to appoint Bjarni Bjarnason as CEO. He took up the post on the 1st of March.

1ST MARCH
Private entities open the Geothermal Energy Exhibition at the Hellisheidi plant.

29TH MARCH
Action plan of Orkuveita Reykjavíkur and its owners announced, calling for an ISK 50 billion improvement in the company's cash flow in the period from 2011 to 2016.

Mr Suma, the head of MHI in Nagasaki gives Bjarni Bjarnason a bow and arrow for the Japanese archer, at the opening of the Sleggjan.

12TH APRIL
Serious heating utility disruptions cause damage to dozens of households in Árbaer.

23RD JUNE
At the first open annual meeting of Orkuveita Reykjavíkur, the mayor introduces a review committee of the company's operations and the chairman of the owners' committee introduces a draft owners' strategy for the company.

27TH JUNE
Employees celebrate the 90th anniversary of the Ellidaárstöd, Reykjavík's first hydropower plant.

3RD SEPTEMBER
The Pearl at Öskjuhlíd advertised for sale following the divestment of various non-core real estate assets owned by Orkuveita Reykjavíkur.

21ST SEPTEMBER
CarbFix, an international research project involving carbon sequestration at the Hellisheidi plant, receives a grant in the amount of EUR 1.6 million from the EU.

A borehole at Hellisheiði

1ST OCTOBER
Fundamental changes made to the organisation of the company with a focus on utility operations and customer service.

1ST OCTOBER
Development of electricity production at the Hellisheidi plant completed following the commissioning of two generators at a new station, given the name "Sleggjan".

17TH OCTOBER
Orkuveita Reykjavíkur hosts a well attended meeting with the residents of the town of Hveragerdi after re-injection at Húsmúli triggers a 3.7 magnitude earthquake which was noticeably felt in the town.

10TH NOVEMBER
In its comments on the master plan for hydro and geothermal resources in Iceland, Orkuveita Reykjavíkur urges politicians to follow the professional recommendations of scientists and place Bitra into a "pending" category.

18TH NOVEMBER
Orkuveita Reykjavíkur signs a memorandum of understanding concerning the development of a large greenhouse production facility near the Hellisheidi plant.

7TH DECEMBER
Implementation of the financial measures called for in the plan of Orkuveita Reykjavíkur and its owners ahead of schedule according to the first progress report.

8TH DECEMBER
An employee of Orkuveita Reykjavíkur's Procurement, Steini of the band Dúmbó and Steini, performs publicly for the first time in 30 years as part of the company's contribution to "Crazy Christmas", a campaign to raise funds for Gedhjálp, a mental health organisation in Iceland.

15TH DECEMBER
Cut-offs for failure to pay utility bills decrease by more than 50% from the years prior to the financial collapse, thanks to new collection methods.

28TH DECEMBER
Orkuveita Reykjavíkur's long-time partners at Lake Úlfljótsvatn, forestry societies and scouts, purchase the land from the company.

04 //
CORPORATE GOVERNANCE

CORPORATE GOVERNANCE

Orkuveita Reykjavíkur is a partnership company governed by Act No. 139/2001 on the establishment of the partnership Orkuveita Reykjavíkur and Regulation No. 297/2006. Its activities are also subject to various special laws that apply to its fields of operation. The owners of Orkuveita Reykjavíkur are the City of Reykjavík (93.539%), the town of Akranes (5.528%) and the municipality of Borgarbyggd (0.933%). The owners' partnership agreement, which, inter alia, sets out the company's governance structure, dates from 2004. The Chief Executive Officers of the municipalities concerned - the Mayor of Reykjavík, the Mayor of Akranes and the Municipal Commissioner of Borgarbyggd - exercise the owners' votes at annual general meetings.

The values of Orkuveita Reykjavíkur are; Foresight, Efficiency and integrity.

The City of Reykjavík appoints five of the six members of the company's board of directors, while one member is appointed by the town of Akranes. Borgarbyggd has had an observer at meetings of the board since 2006. The board is composed of Haraldur Flosi Tryggvason, Chairman, Brynhildur Davídsdóttir, Vice-Chairman, Gylfi Magnússon, Kjartan Magnússon, Sóley Tómasdóttir and Hrönn Ríkhardsdóttir. Björn Bjarki Thorsteinsson is an observer.

The board follows rules of procedure first established in 2003. Orkuveita Reykjavíkur has had an internal auditor since 2006, who has been subject to the authority of the board since 2008. In 2011 the rules of procedure of the board were amended to provide for the appointment of an audit committee charged with supervising the work of the internal auditor.

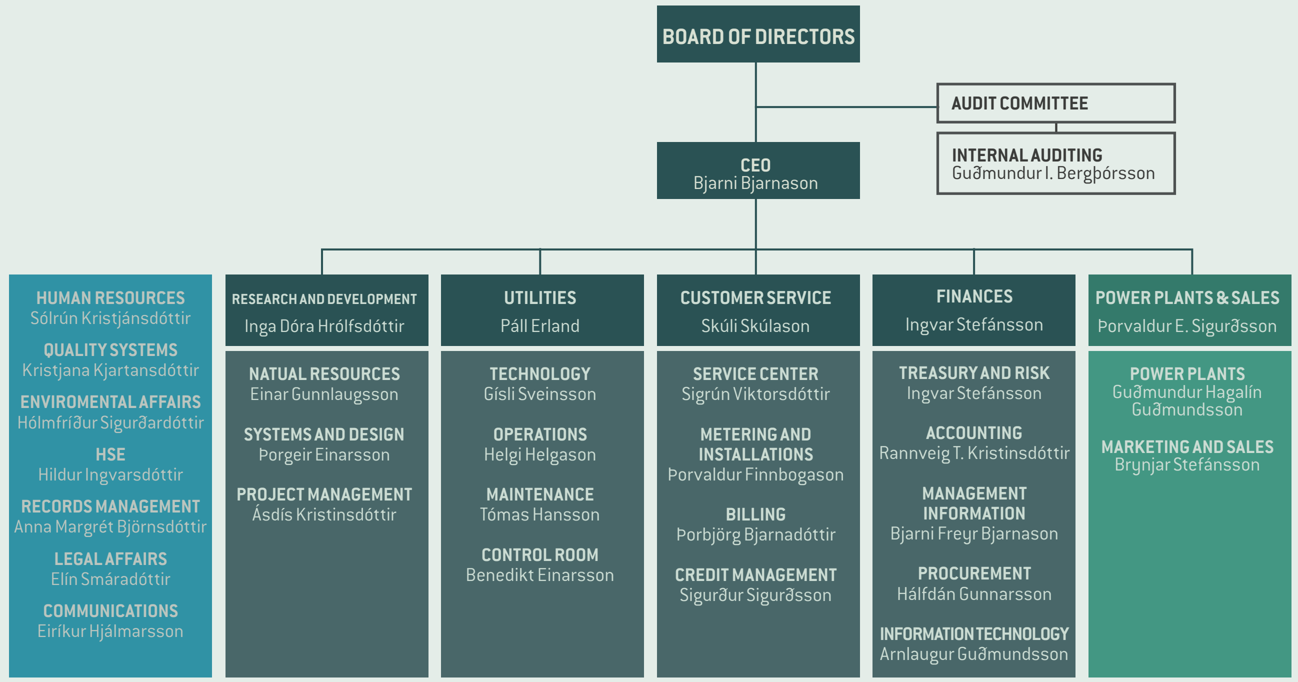
The financial position of Orkuveita Reykjavíkur was the most pressing issue requiring the attention of the board in 2011. The first months of the year were spent developing the action plan of Orkuveita Reykjavíkur and its owners, which was then followed up by the board during the remainder of the year. Regular meetings of the board are held once a month. However, a total of 26 meetings were held in 2011 owing to the extensive financial measures required and the appointment of a new CEO in the early part of the year.

The annual general meeting was held in June, in conjunction with the open yearly meeting of Orkuveita Reykjavíkur, which was held for the first time. A draft owners' strategy for Orkuveita Reykjavíkur, developed by an owners' committee composed of representatives of the owner municipalities, was presented at the annual meeting. Following the presentation at the yearly meeting, the committee requested comments from the public on the draft.

QUALITY SYSTEM

Orkuveita Reykjavíkur 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.



MANAGEMENT AND ORGANISATIONAL CHART

Bjarni Bjarnason is the CEO of Orkuveita Reykjavíkur. He is a geologist and an engineer and has previously been in charge of Landsvirkjun Power, Kísilidjan (a diatomite plant) at Lake Mývatn and Icelandic Alloys at Grundartangi,

In addition to support units, the activities of Orkuveita Reykjavíkur are divided into five units, headed by the following managers:

Ingvar Stefánsson, Director of Finances, holds a degree in business administration, specialising in accounting, and a master's degree in financial management. Mr. Stefánsson joined Orkuveita Reykjavíkur in 2011, after previously serving as a managing director at Íslandsbanki.

Páll Erland, Director of Utilities, studied industrial operations engineering before completing a degree in business administration and an MBA. Mr. Erland has been with Orkuveita Reykjavíkur since 2001. He previously worked as a sales and marketing director abroad and did consultancy work.

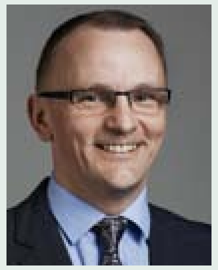
Inga Dóra Hrólfsdóttir, Director of Research and Development, holds a masters degree in civil engineering. She has been with Orkuveita Reykjavíkur since its foundation, after previously working for the Reykjavík Municipal District Heating Utility from 1996. She has served as the head of various units at the company.

Skúli Skúlason, Director of Customer Services, holds a degree in business administration and a master's degree in strategic management. Mr. Skúlason has been with Orkuveita Reykjavíkur since 2009. He previously served as the Chief Financial Officer of the Sports and Leisure Council of Reykjavík and has done consultancy work.

Þorvaldur E. Sigurðsson, Director of Power Plants and Sales, is an electrical engineer with management experience from the IT and telecommunications sector. He joined the company at the end of 2011.

The organisational chart above has been in effect from 2nd March 2012.

05 //
SERVICES



Skúli Skúlason, Managing Director of Customer Services

Customers come first with us, and we try our utmost to provide them with quality service and resolve any problems swiftly and expediently.

SERVICES

Orkuveita Reykjavíkur is a utility service company that puts its customers first. The company aims at providing quality services to customers with a focus on secure and reliable delivery and swift resolution of any issues that may arise.

In 2011 increased emphasis was placed on Orkuveita Reykjavíkur's service role and the integration of customer services. To that end, Customer Services was strengthened and made one of the core divisions of the company. Under the leadership of Customer Services, a service strategy has been developed with a focus on three main pillars:

- Basic service components
- Service processes
- Skills and expertise of service personnel

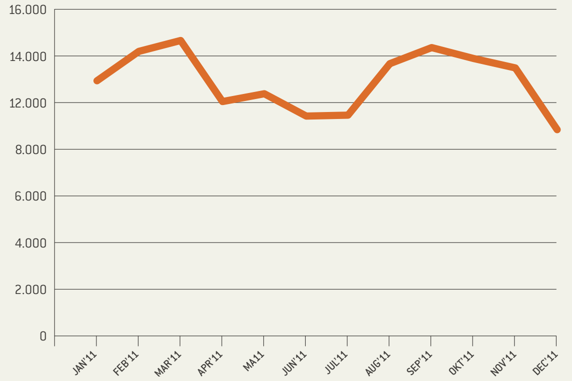
The basic service components reflect the company's values and strategy. Orkuveita Reykjavíkur is currently working on defining service promises so that its customers can know what to expect. The basic service components are:

- An aspiration to meet customer needs and initiate improvements
- Respect for customers and inspiration of their confidence
- Imparting to customers a sense of the value of the services they receive

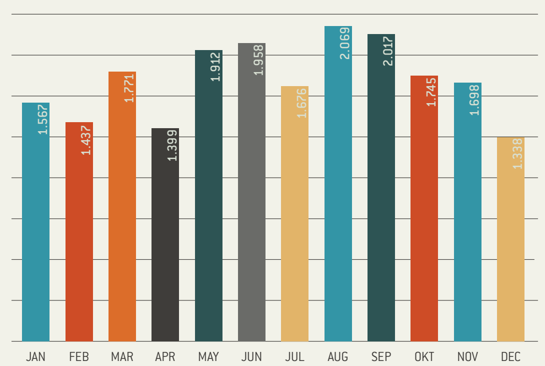
It is important that customers should feel that their communications with the company are being noted and that Service Centre personnel are able to quickly get up to speed on previous exchanges and current situations. Customers' enquiries should be dealt with at the first point of contact with the company rather than being passed around from one employee to another.

Focused employee training is an important part of ensuring service integration and coordinated records of communications. Orkuveita Reykjavíkur's Service Training Academy, established at the end of 2011, plays a role in the training of employees. The Academy is intended to improve the service skills of all Orkuveita Reykjavíkur employees.

NUMBER OF PHONE CALLS 2011



CUSTOMER TRANSFER



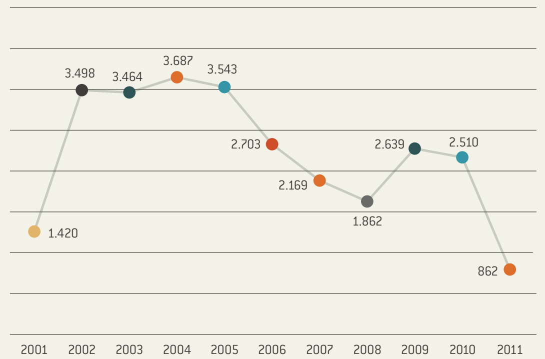
ORGANISATION OF CUSTOMER SERVICES

In 2011, a comprehensive reorganisation of Orkuveita Reykjavíkur's Customer Services was initiated. The division's structure was changed by discontinuing departmentalisation and enhancing collaboration across the division. Emphasis is now placed on the dissemination of knowledge among employees and giving them more freedom to take action. The division's operations have become more flexible with a focus on interchangeability among employees.

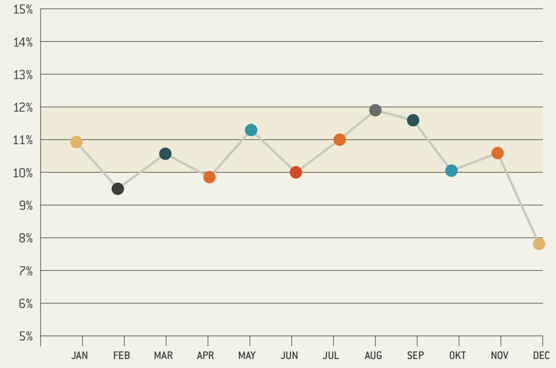
The Customer Services division is now split into four teams: The Service Centre; divided into a general service centre and a technical service centre, Metering and Installation; divided into meter reading and house connection services, Credit management and Customer Services had 78 employees at year-end 2011. The main tasks of the four teams are outlined below.

- The Service Centre receives and resolves all phone calls from the public, service requests and notifications of malfunctions received by the company. On average, the Service Centre receives around 12,000 phone calls each month and around 900 service requests via e-mail. The Service Centre has 25 employees.
- Metering and Installation handles the reading of meters relating to billing and house connection services. An ever-increasing number of customers now read their meters themselves and enter the readings on Orkuveita Reykjavíkur's customer website, www.orkanmin.is. Metering and Installation has 26 employees.
- The Billing team handles billing for Orkuveita Reykjavíkur, Gagnaveita Reykjavíkur and the Mosfellsbaer Heating Utility. Every month around 250 thousand bills are sent out, Billing has 9 employees.
- The Credit management team handles collections for Orkuveita Reykjavíkur and the Mosfellsbaer Heating Utility. It also handles cut-offs for retailers of electricity in Orkuveita Reykjavíkur's distribution area. The use of different collection methods has led to improved collection results and a substantial decrease in cut-offs. The Collection team has 14 employees.
- Other tasks besides those listed above include the imposition of water and sewage charges, quality and safety issues and the management of the division's records. Four employees of Customer Services are assigned to these tasks.

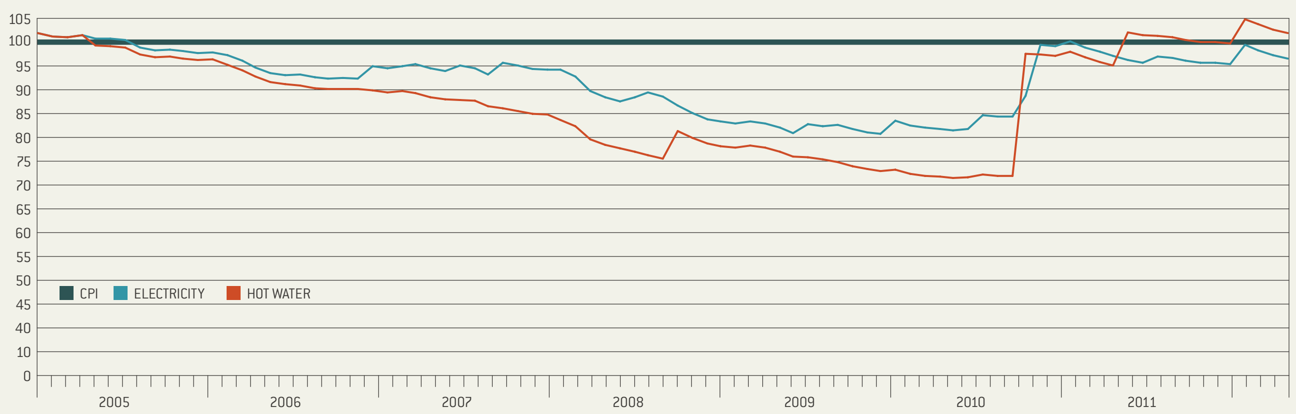
NUMBER OF CUT-OFFS



DEFAULTS AS A PERCENTAGE OF MONTHLY SALES 2011



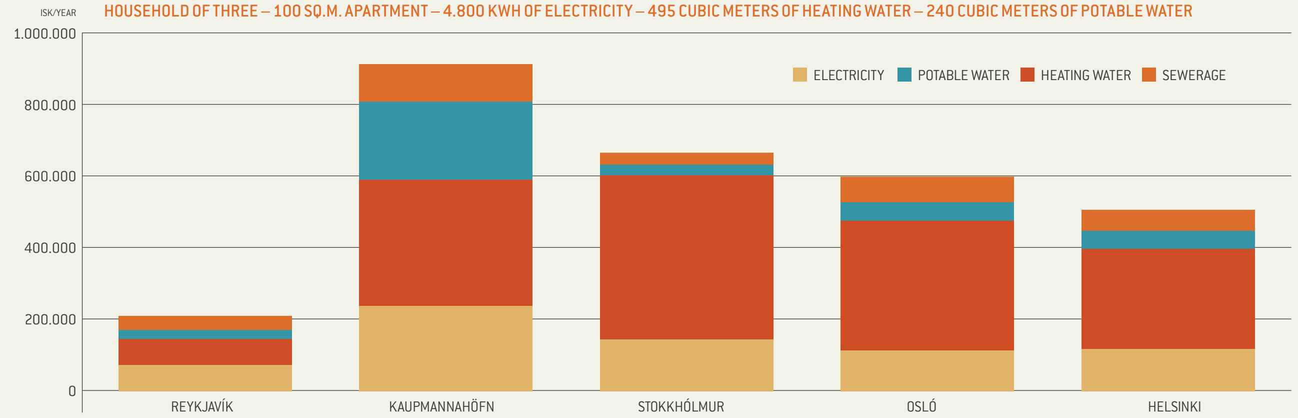
TARIFF DEVELOPMENT OF ELECTRICITY AND HOT WATER IN COMPARISON TO CPI



The graph shows the development of Orkuveita Reykjavíkur's tariffs for electricity and heat in real terms, compared to the Icelandic Consumer Price Index. The CPI is drawn at a constant level of 100 and the tariffs proportionate to that. It is obvious how real value of the tariff constantly decreased from early 2005 until late 2010, when they were raised. At that time the real value of the heat tariff had shrunk by 30% and that of electricity by approximately 20%.

ENERGY AND UTILITY COSTS IN THE NORDIC COUNTRIES

HOUSEHOLD OF THREE – 100 SQ.M. APARTMENT – 4.800 KWH OF ELECTRICITY – 495 CUBIC METERS OF HEATING WATER – 240 CUBIC METERS OF POTABLE WATER



In the graph a comparison is made between tariffs for utilities in the Nordic capitals. It is based on the annual expenses of a family of three, living in an average apartment. The difference between the extremes is quadruple; Reykjavik, Iceland, being the cheapest and Copenhagen, Denmark, the most expensive. Each of the services is cheapest in Reykjavik except for sewerage, in which case the inhabitants of Stockholm pay less. The comparison was made in April 2012 and was based on tariffs of the largest utility in each city. The basic assumption was that the usage of services was comparable.

06 //
FINANCES

FINANCES

Orkuveita Reykjavikur's finances have been the main concern in recent years. A great emphasis has been placed on the analysis of operations and securing sufficient liquidity of cash by selling assets that are not part of the core business and reducing the financial risk of the Company.

ORGANISATIONAL CHANGES OF FINANCE

The various tasks undertaken by the financial department as a result of the Plan; an action plan approved at the end of March 2011 to address the financial problems being experienced by the company put a great deal of strain on employees.

A new CFO was hired in the middle of 2011 and organisational changes were made. Management of the company´s properties, which were previously managed by a separate unit, was discontinued and the management directed to the appropriate departments. The Finance department also manages certain properties owned by and utilised by the company. Finance also took over the management of all vehicles run by the company and in 2012 a decision was made to relocate the IT department to the Finance department.

FINANCE ORGANISATIONAL CHART

Finance is made up of five units serving other departments of Orkuveita Reykjavíkur and communicates with various parties outside of the company.

Treasury and Risk, is responsible for the execution of the Risk Policy and treasury management as well as interactions with the various financial institutions. More emphasis has been put into improving communications and information access to lenders.
A new Risk Policy was prepared and approved by the Board of Directors in the beginning of 2012. It defines the main types of risks, a risk measurement scale and the main methods and limits used in daily risk control of the Company.

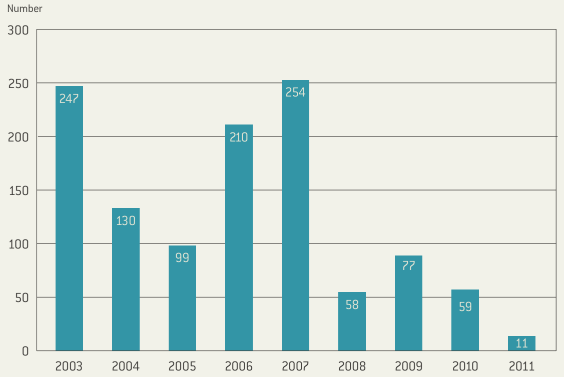
Accounting, is responsible for book-keeping and financial statements as well as ensuring that laws and regulations regarding book-keeping are followed and that tax issues are addressed correctly. It also ensures that the separation between regulated and competitive operations in the financial statements is adequate. In the year 2011, a great deal of effort went into setting up possible scenarios regarding the intended split up of the company, in cooperation with its owners.

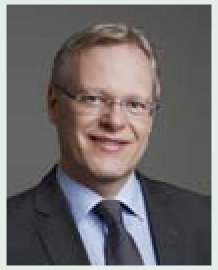
Management information, is responsible for budgeting and cost control. An intensive analysis was done on the company´s operations, in cooperation with other departments. The goal was to improve procedures, increase efficiency and reduce costs More emphasis was put into monitoring the operations and gap analysis as well as improving procedures in budgeting.

Procurement, is responsible for tenders, sale and the maintenance of properties and vehicles.
Procurement launched the sale of assets that are not defined as a part of the core business. The extent of procurement has decreased dramatically and monitoring of procurement strengthened. Over 90% of the company´s procurement was done after tendering or price queries and this proved to be very effective.

Information Technology, is responsible for the operations and development of IT systems.
Cost efficiency measures have had a positive effect on operations in the IT unit regarding procurement of services from IT software contractors and equipment for end users. As an example, renewal of computers has been greatly reduced these last years.

PROCUREMENT OF COMPUTERS





Ingvar Stefánsson, Managing Director of Finance

The action plan of the owners and directors of Orkuveita Reykjavíkur is extremely important for the company's reorganisation and provides the foundation for the development of a sound company on a solid base.

07 //

UTILITIES

UTILITIES

The Utilities division is responsible for the development, operation, monitoring and maintenance of all of Orkuveita Reykjavíkur's supply systems and for responses to breakdowns 24 hours a day. The systems supply customers with electricity, hot and cold water, waste water disposal and other related services to the quality standard that the company has stipulated and in compliance with requirements of law, regulations and standards.

The Utilities division is responsible for the development, operation, monitoring and maintenance of all of Orkuveita Reykjavíkur's supply systems and for responses to breakdowns 24 hours a day. The systems supply customers with electricity, hot and cold water, waste water disposal and other related services to the quality standard that the company has stipulated and in compliance with requirements of law, regulations and standards.

Organisational changes at Orkuveita Reykjavíkur took effect on the 3rd of October, 2011. The Utilities division was merged with the part of the Construction Division and is now responsible for all maintenance and supervision of utility systems. The Utilities division is now divided into four units: Technical, Operations, Maintenance and Control Room.

In all the basic operations of Utilities, new projects and operations in 2011 were kept to a minimum. Only the most urgent improvements needing immediate attention were undertaken. Nevertheless, general operations of the utilities were continued normally and no compromises were made regarding customer security and services.

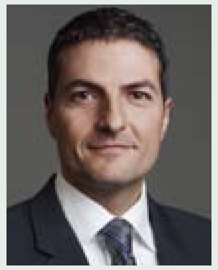
The Utilities division's standby teams are an integral aspect of operations. All systems are subject to 24-hour monitoring with standby teams ready to respond in the event of any emergency.

AREA OF SERVICE

At year-end 2011 the area serviced by Utilities extended to 20 municipalities in southern, south-western and western Iceland, which represents over 2/3 of the Icelandic population. The metropolitan area of the capital represents the core of Orkuveita Reykjavíkur's operations, together with Akranes, where the company operates all four of the utilities: electricity, hot water, cold water and waste water disposal. In western Iceland Orkuveita Reykjavíkur is also responsible for the operation of the heating and water utilities and waste water disposal in Borgarfjordur, the water and heating utilities in Stykkisholmur, while in Grundarfjordur Orkuveita Reykjavíkur is responsible only for the water utility. In south Iceland Orkuveita Reykjavíkur is primarily responsible for the hot water supply systems, in addition to one cold water utility.

SPACE HEATING UTILITY

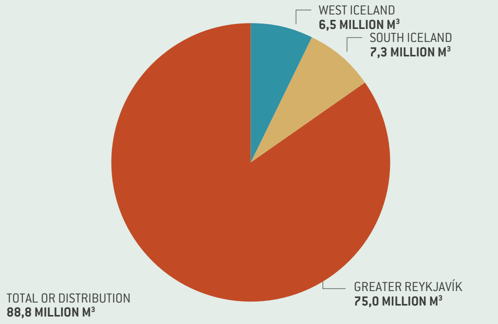
Orkuveita Reykjavíkur sold approximately 75 million tons of hot water in the metropolitan area of the capital in 2011, with approximately 27 million tons deriving from the Nesjavellir plant, about 35%, of sales and approximately 7 million tons from the Hellisheidi plant, i.e. about 10% of sales. Extraction of hot water from low-temperature reservoirs amounted to approximately 41 million tons, which corresponds to about 55% of the total production of the heating utility in the capital area.



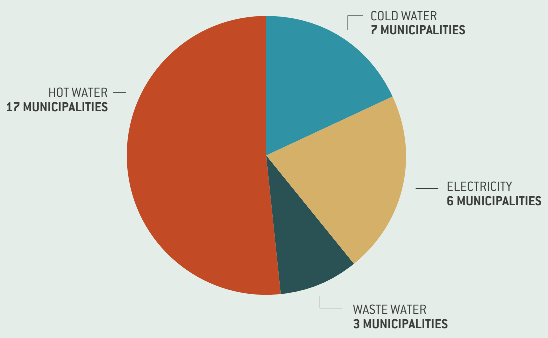
Páll Erland, Managing Director of Utilities

The supply systems connect Icelanders with their natural resources. Our role is to ensure that the connection is efficient and secure.

TOTAL DISTRIBUTION OF HOT WATER



NUMBER OF MUNICIPALITIES SERVED



All in all, the operation of the hot water supply system was successful over the year. No difficulties arose as regards transport capacity in times of cold weather and peak loads. A decisive factor was the addition of water from the Hellisheidi geothermal plant into the capital area supply system in the course of the year.

A breakdown occurred in a main pipeline that supplies hot water to the Hlídar district in Reykjavik. The pipe is enclosed in a concrete channel and water entered a house, causing water damage. Following the breakdown, work was begun on preventive maintenance in order to prevent the reoccurrence of damage of this kind.

COLD WATER

The operation of the water supply system over the year was successful and consistent with budget projections. There were few disruptions in the operation of the system, although leaks occurred in some older pipelines, which were repaired. The most extensive breakdown occurred in a 600 m main line extending from a valve station at Saebraut by the Ellidavogur bridges.

The water extraction clearly illustrates the extent of water distribution in the supply area. Orkuveita Reykjavíkur's total extraction of cold water amounted to 26.1 million m^3 in 2011, which is the same quantity as in 2010. Water distributed in Álftanes, amounting to approximately 0.3 million m3, is purchased from Gardabaer. Wholesale supplies to municipalities amounted to approximately 1.9 million m^3. Utilities' share in the distribution therefore amounted to 24.5 million m^3 in 2011.

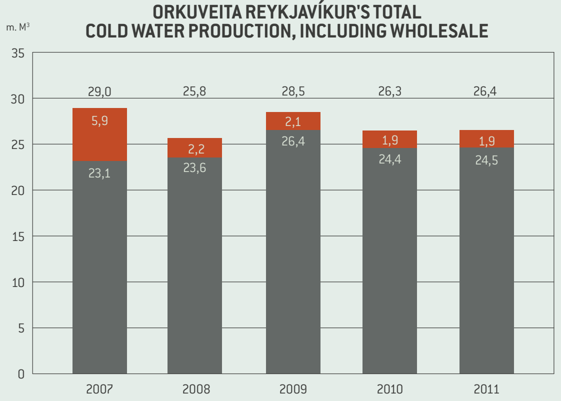
ELECTRICITY

As in the past two years, Orkuveita Reykjavíkur's investments in 2011 were restricted by the tight financial position. Only the most necessary construction work, requiring urgent attention was performed. Great efforts were made to ensure the sound operation of the electricity distribution system and minimising the frequency of malfunctions.

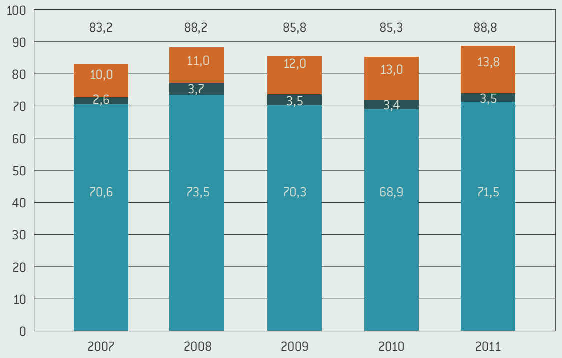
Work is continually in progress on reducing the number of abrupt disruptions in the system; load-testing of high-voltage transmission lines is an important part of this work. Among the inspections conducted was a load test of the 11 kV transmission line extending from Substation 1. Many of the cables in the station are old, and tests indicate that it will be necessary to undertake extensive renewals as soon as possible.

The chart on page 42 shows the changes in the number of abrupt disturbances in the distribution system in the past five years. In 2011 a total of 153 disruptions were experienced in the electricity distribution system, 123 in the low-voltage system and 30 in the substation and high-voltage system.

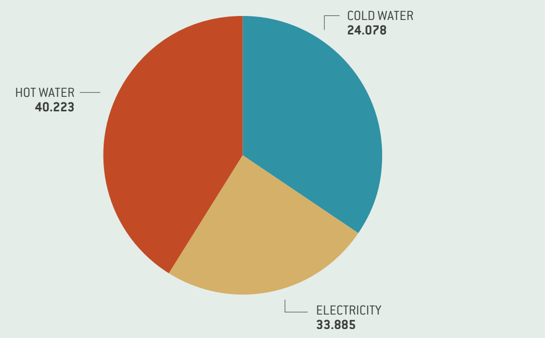
ORKUVEITA REYKJAVÍKUR'S TOTAL COLD WATER PRODUCTION, INCLUDING WHOLESALE



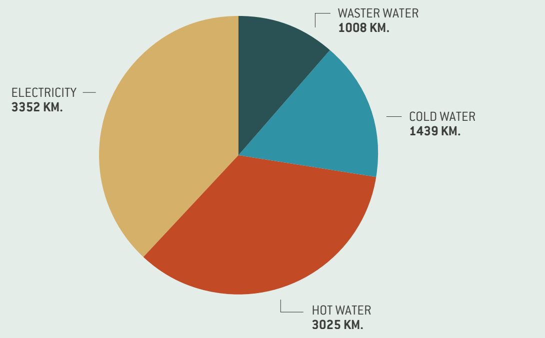
ORKUVEITA REYKJAVÍKUR'S TOTAL HOT WATER PRODUCTION, INCLUDING WHOLESALE



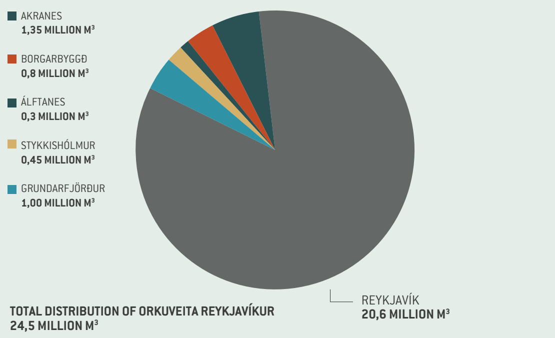
NUMBER OF HOUSE CONNECTIONS



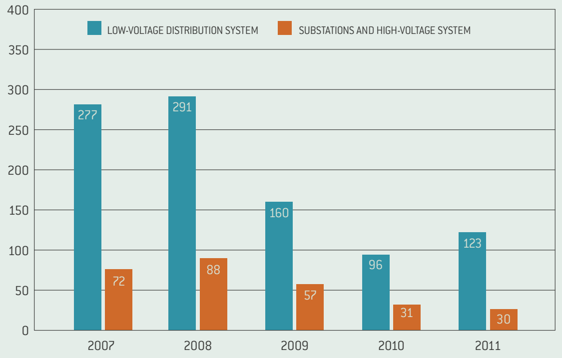
TOTAL LENGTH OF PIPES AND CABLES



TOTAL DISTRIBUTION OF COLD WATER



2007-2011: NUMBER OF ABRUPT OPERATING DISRUPTIONS



WASTE WATER DISPOSAL

The operation of the waste water disposal system was successful over the year, with no major breakdowns. Work remains in progress on lining the parts of the pipe system which are in the poorest condition; approximately 700 m of pipes were lined over the year.

Invitations to tender for the renewal of submarine pipes extending from the coastline of Reykjavík were posted; the pipes are some 13.5 km in length and the oldest pipes are about 20 years old. This stage of the renewal process is scheduled for completion in 2012.

The operation of pumping and sewage treatment stations was successful, with no major breakdowns and minimal stoppages. The operation of pumping and sewage treatment stations was successful, with no major breakdowns and minimal stoppages. About 80 million tons of sewage was treated over the year, slightly in excess of 2010, which is largely explained by the greater rainfall level of last year.

The largest single investment in the year was the treatment facilities in Akranes, which were purchased by contract in 2007.

KEY FIGURES FOR THE WASTE WATER DISPOSAL SYSTEM

Pipes	km	1008
Pumping stations	Number	24
Pumping wells	Number	14
Treatment stations	Number	6
Sediment basins	Number	17
Treated sewage	t	80.000.000

08 //
RESEARCH & DEVELOPMENT

RESEARCH & DEVELOPMENT

For Orkuveita Reykjavíkur it is important to look to the long-term future as regards the operation and growth of supply systems and the use of natural resources. The establishment of its Research and Development Division reflects the company's focus on a strong future vision.

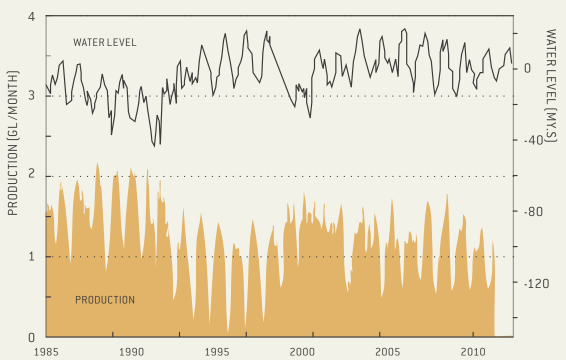
RESOURCES

Sustainable use of natural resources is essential, and for this reason it is necessary to monitor carefully the impact of utilisation on extraction sites, both of cold and hot water. This is achieved by means of a variety of measurements, which are compared to computer models to enable prediction of the sites' future response to utilisation. The R&D staff is responsible for the design and maintenance of the computer models, which are under continual development.

The water protection area in Heidmörk is in close proximity to urban development, which makes it extremely important to monitor the groundwater and pollution situation in the area. The benchmark for the groundwater position has been set at 80 m above sea level to ensure sustainable use. The ground water level has never fallen below the benchmark.

In low-temperature areas, i.e. Laugarnes, Ellidaár, Reykir and Reykjahlid, changes in the water level resulting from pumping from the areas are monitored. It is essential for a balance to be maintained between the utilisation and water level in Orkuveita Reykjavíkur's low-temperature areas in order to ensure sustainability and to even out the utilisation over the long term. If this balance is disrupted, the pumping has to be reduced.

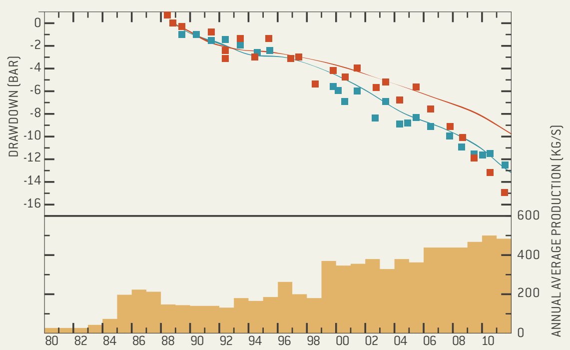
CORRELATION BETWEEN PRODUCTION AND WATER LEVEL



The impact of power development in the high-temperature areas in Hellisheidi and Nesjavellir is carefully monitored. The decrease in pressure is monitored and compared to the predictions of models that simulate the temperature and the pumping from the areas. The models are under constant review based on new data, and this provides a better knowledge of the behaviour of the area and the best means of controlling extraction in the area in question to ensure maximum sustainability.

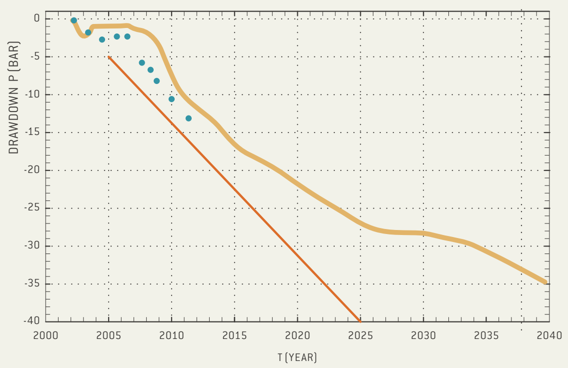
Yield in measurement boreholes at Nesjavellir. The unbroken curves are calculated in accordance with the model, while the dots show the actual measured values. Blue denotes the drawdown in borehole NJ-15, while the red shows the drawdown in borehole NJ-18.

PRESSURE DRAWDOWN IN MONITORING WELLS IN NESJAVELLIR



Drawdown in borehole HE-4 in Hellisheidi. The yellow curve denotes the calculated drawdown pursuant to the model, while the blue dots show the measured values. The red line shows the reference levels according to the development permit.

PRESSURE DRAWDOWN IN WELL HE-4 IN HELLISHEIÐI.



Inga Dóra Hrólfsdóttir, Managing Director of Research and Development

Active research will deliver future success for Orkuveita Reykjavíkur in the development and operation of utilities and the sustainable use of natural resources. Effective project management of investment projects will ensure quality and minimise costs.

SYSTEM RESEARCH

In addition to monitoring resources, the staff of the division engages in system research. Several such projects were in progress during the year, including the projects described below.

A design model was prepared for a heating utility distribution system based on the general design specifications of Orkuveita Reykjavíkur's supply systems. The model is Excel-based and has a very convenient graphic user interface. The calculation of pressure and water temperature is based on a ladder method with iteration for pressure, and optimisation is used to determine pipe types. The model is intended to ensure better and more precise design.

Work was performed on a load forecast for substation transformers which will provide the basis for the development of the supply system for the coming years.

A forecasting model for primary energy demand and models for internal and external supply systems and secondary energy were in daily use and continuing development. Also, work was in progress on the preparation of a predictive model for energy use in heavy industry.

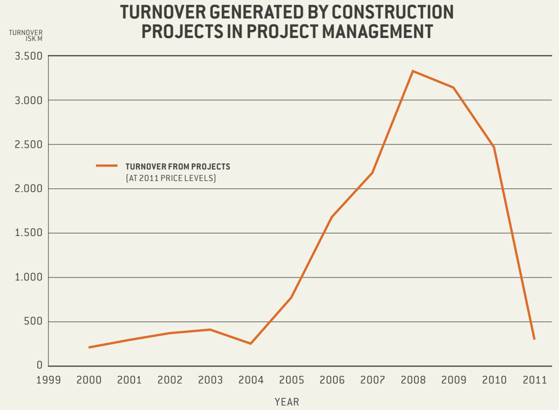
In the course of the year work was begun on devising a predictive model for the daily fluctuations of hot water use in the metropolitan area of Reykjavik. The model forecasts the water need in the system for each hour of the following 7-14 days and the maximum water need for seven days. It is important to anticipate the hot water needs with a few days' advance notice in special circumstances, e.g. in the event of curtailed capacity of the supply system owing to breakdowns or maintenance, or in the event of adverse weather forecasts. This can contribute to improved operating security and reduce the risk of unforeseen eventualities.

Work was continued on studying and assessing unutilised capacity in the low-voltage electricity supply system in order to determine how the system will cope with new uses, e.g. charging electrically powered vehicles in domestic households.
Various simulation projects were in progress in the water and sewage systems. The staff dedicated considerable efforts to studying methodology in this field; the simulations will be used increasingly to support the sound and efficient operation of the supply systems.

DEVELOPMENT PROJECTS

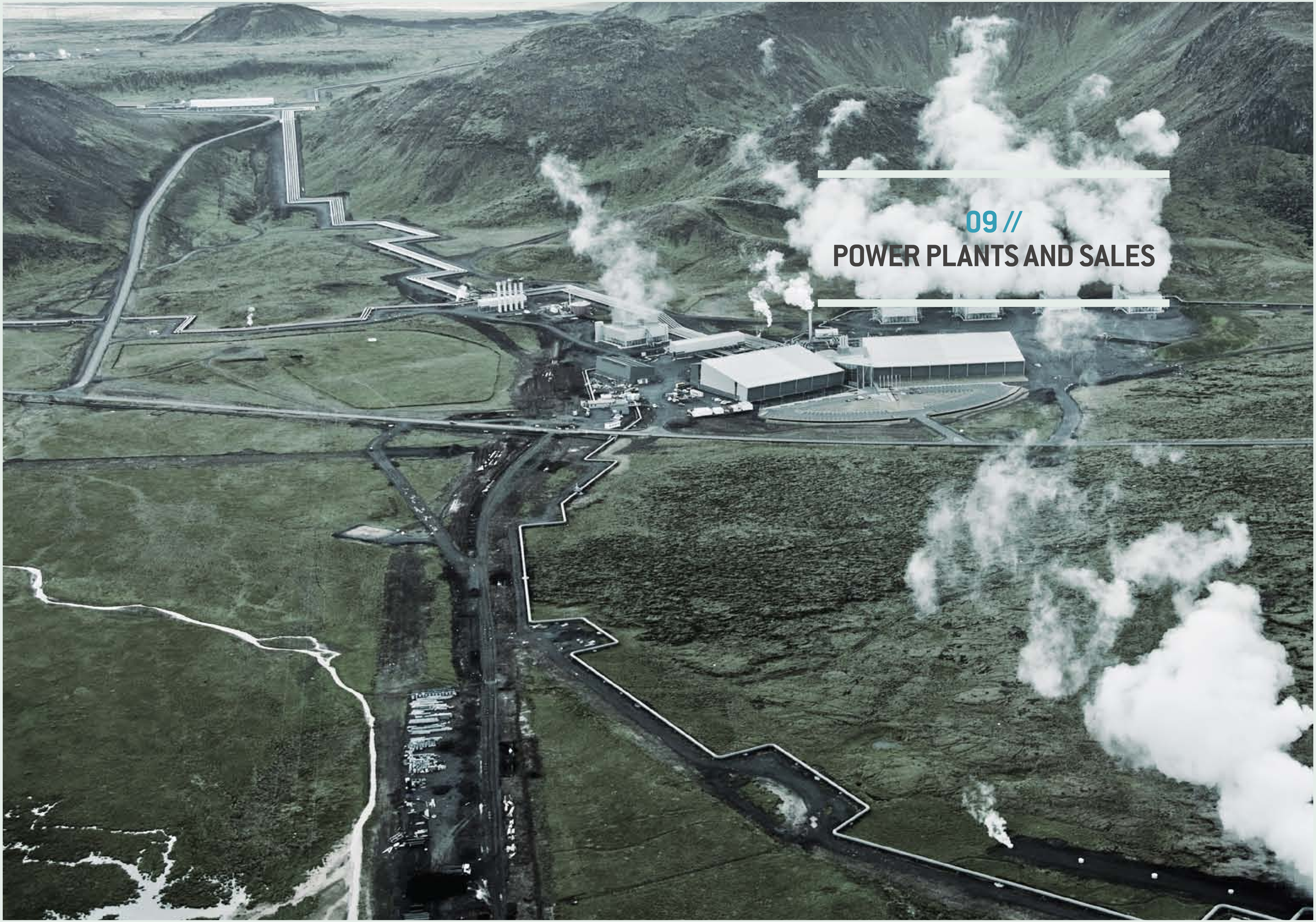
Project management of construction, design, preparations of tender specifications, work specifications and cost estimates are entrusted to the Research and Development division. The tasks of the division include supply systems, buildings, machinery, control systems and operating systems.
The number of standard construction projects was considerably decreased in 2011 owing to cutbacks and streamlining measures. As a result, the turnover of development projects was near the levels of 2004. The focus is increasingly on systems research projects designed to ensure proper prioritisation of development projects in the coming years.

TURNOVER GENERATED BY CONSTRUCTION PROJECTS IN PROJECT MANAGEMENT



GROUND WATER LEVEL OF BOREHOLE V-18 IN HEIDMÖRK

	2003	2004	2005	2006	2007	2008	2009	2010	2011
Average level	81,99	82,73	82,96	83,38	83,26	83,78	83,38	82,25	82,74
Maximum level	84,50	85,14	85,26	85,84	86,57	86,35	85,47	84,58	84,24
Minimum level	80,80	81,18	82,23	82,39	81,83	82,40	82,36	81,23	81,67



09 //
POWER PLANTS AND SALES

POWER PLANTS AND SALES

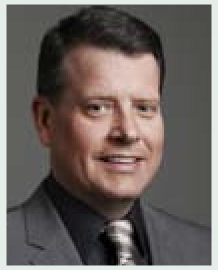
Orkuveita Reykjavíkur owns and operates four power plants: Nesjavellir Geothermal, Hellisheidi Geothermal, Ellidárdalur Hydropower and Andakílsá Hydropower. A focused sales and marketing strategy has been present at Orkuveita Reykjavíkur since its establishment of the division in 2006. In addition to the business consultancy services made available to companies, there is also a dynamic marketing division where information on effective energy saving measures is passed on to households in the country.

ELLIDAÁ POWER PLANT

The Ellidaá Power Plant has a generation capacity of 3.2 MW, but was not in operation in 2011. The stoppage is temporary for re-organisation reasons. The plant's penstock sprang a leak during the year, which was repaired. There are plans to start up the operation of the plant again in 2012.

ANDAKÍLSÁ POWER PLANT

The Andakílsá Power Plant has a generation capacity of 8.2 MW. The maintenance on plants was normal in the year. In addition, equipment was installed to enable remote monitoring.



Þorvaldur Sigurðsson, Managing Director of Power Plants and Sales

We are proud to improve the quality of living of about 80% of all Icelanders, bringing warmth and light to households and enterprises by environmentally friendly means.

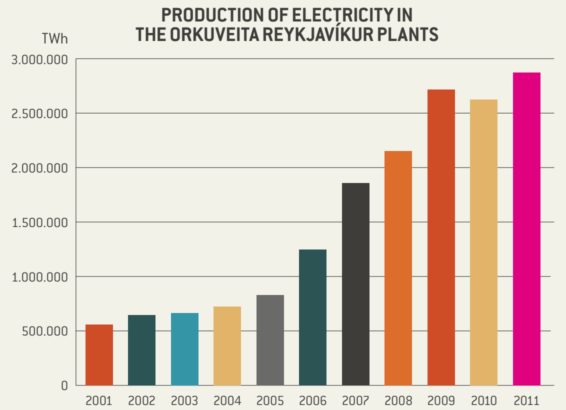
HELLISHEIDI POWER PLANT

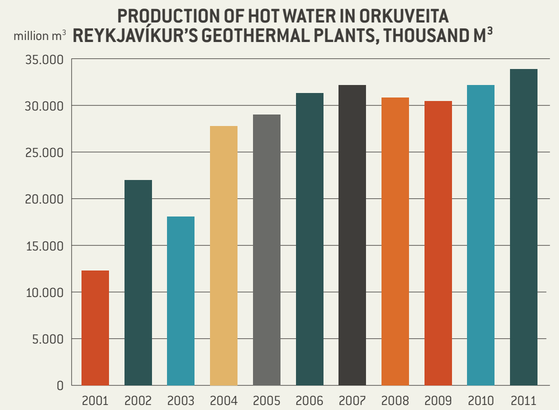
The Hellisheidi Power Plant has an electricity generation capacity of 303 MW and a heat generation capacity of 133 MW. Extensive changes were made in the Hellisheidi Power Plant steam generation in the course of the year. Twelve boreholes were connected to the system, and by year-end 2011 eleven of them were in operation. A new injection plant, Húsmúlaveita, was taken into use in the year, bringing the number of new injection boreholes connected to the system to four. The seismic activity from Húsmúlaveita came as a surprise, but it appears that the activity is now on the wane. Two 45 MW generators were started up in a new station building in Hellisheidi. Their activation concluded the construction of the Hellisheidi Power Plant, and now work must begin on cleaning up the area. The new station house was given the name of "Sleggjan" (the Sledge Hammer). Turbine 3 in Hellisheidi, which was scheduled for a major overhaul in 2012 was stopped in early December because of scaling in the steam turbine, which had begun to impair its capacity. Turbine 11 was turned off for maintenance and proved to be in good condition. On the whole, the operation of the Hellisheidi Power Plant was successful, and its generators were available for production for 97.26% of the year, on average.

THE NESJAVELLIR POWER PLANT

The Nesjavellir Power Plant has an electricity generation capacity of 120 MW of electricity and a heat generation capacity of 300 MW.

Turbine 1 in Nesjavellir was overhauled during the course of the year. The heating plant was shut down for three days, for cleaning. Steam supply system 1 was taken offline during the fall period for repairs of separator equipment. Also, cold-water boreholes at Nesjavellir were cleaned. The operation of the Hellisheidi Power Plant was successful over the year, and its generators were available for production for 96.21% of the year, on average.





GENERAL MARKET

Sales of electricity in the general market amounted to 1,158 GWh in 2001, slightly more than in the preceding year, when sales amounted to 1,144 GWh.

About 53% of the electricity sold by Orkuveita Reykjavíkur is purchased from Landsvirkjun, while about 45% is produced by the company's own plants. The other 2%, or slightly less, is purchased by Orkuveita Reykjavíkur from three small plants, the Árteigur Power Plant, the Ljósá Power Plant and the Lindir Power Plant.

The general market has shrunk slightly in the wake of the economic collapse, by some 4% from year-end 2008 to year-end 2011. There are signs of change in this trend and a renewed growth in the market.

HOUSEHOLD MARKET

In the course of the year Orkuveita Reykjavíkur launched a campaign to promote and provide advice on the responsible use of energy to the public; the campaign included the use of direct mail to households. Additional information was included on the Orkuveita Reykjavíkur website, as well as calculators that allowed users to assess their energy use in comparison with other similar households. The initiative was welcomed and will be continued. The number of customer visits to the website has grown steadily since its launch. The website is under constant development and numerous opportunities lie ahead to strengthen still further this useful medium of information and communication.

CORPORATE MARKET

In recent years, Orkuveita Reykjavíkur has been working on expanding its services to corporate customers. A great deal of effort has been put into consultation and developing various analytic tools to assist corporate customers in their selection of energy tariffs. A survey conducted in October revealed that the managers of almost 85% of Orkuveita Reykjavíkur's corporate customers were quite satisfied or very satisfied with the services they received. Of the corporations that purchase electricity from more suppliers than Orkuveita Reykjavíkur, over 75% were very satisfied or quite satisfied with Orkuveita Reykjavíkur's services.

WHOLESALE MARKET

Orkuveita Reykjavíkur bid for Landsnet's transmission losses in 2011, and a bid for a total of 109.6 GWh was accepted. This was a considerable increase from the preceding year. Electricity was also sold to other energy suppliers.

Landsnet has plans to establish a spot market for electricity, but the plans have been shelved temporarily due to the economic circumstances in Iceland. Orkuveita Reykjavíkur has a representative on a team of experts working on the preparation of this project.

POWER INTENSIVE USERS

Four power contracts have been concluded: one with Landsvirkjun and three with Nordurál for the aluminium plant at Grundartangi. These power contracts are made in dollars, and the price of the electricity is linked to the world market price of aluminium. In the course of the year contracts were signed with Geogreenhouse ehf, providing for the construction of a large greenhouse on the plain west of the Hellisheidi Power Plant. The plan is to produce tomatoes for export to foreign markets. Orkuveita Reykjavíkur will sell electricity for lighting, hot water for heating, and cold water for irrigation purposes.

STREET LIGHTING

The municipalities own the lamp posts and lighting equipment, while Orkuveita Reykjavíkur provides maintenance and supervision of lighting equipment connected to Orkuveita Reykjavíkur's street lighting system. Maintenance involves general maintenance of posts, cables and lighting equipment, including painting of the posts, straightening crooked posts, cleaning the lighting equipment and regular monitoring of the lighting, as well as changing light bulbs. Orkuveita Reykjavíkur is also responsible for decorative Christmas lighting, repairs of damage, renewals and new projects, all at the request of customers.

Two matters will become urgent in the coming years: on the one hand, lamp posts will need to be renewed in urban areas, and, on the other hand, an action plan will need to be prepared to respond to the EU's ban on the manufacture and import of mercury lamps, which will take effect in 2015. Orkuveita Reykjavíkur recently completed an age analysis of the street lighting system, which revealed that 1,850 posts are more than 40 years old, which is considered the normal lifetime for lamp posts. It will be necessary to examine and assess the condition of these posts so that the renewal can be prioritised to ensure ongoing traffic safety.

ORKUVEITA REYKJAVÍKUR'S CUSTOMERS IN STREET LIGHTING 2011

	MW (output)	No. of poles
Reykjavík	3,400	23.769
Road Administration	1,0	4.441
Kópavogur	0,916	6.291
Gardabaer	0,441	2.796
Mosfellsbaer	0,433	2.752
Akranes	0,253	1.617
Seltjarnarnes	0,139	873
Private lighting - businesses, co-ops	0,3	1.922
Total maintenance	**6,882**	**44.461**

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HUMAN RESOURCES

HUMAN RESOURCES

The achievement of Orkuveita Reykjavíkur's goals is made possible by its multitalented staff. One of the principal goals of the company's action plan, introduced in the spring of 2011, was to reduce general operating costs. One part of achieving this goal was a reduction in staff. This goal has been achieved through measures such as offers of severance to older staff members, but also through layoffs.

A general freeze was imposed on recruitment last year, and employees who left the company were not replaced. The number of permanent staff was reduced by 64 in 2011. Just over a third of this reduction resulted from employees' acceptance of severance offers.

Orkuveita Reykjavíkur had a staff of 453 employees in 2011, 326 men and 127 women. The average age of permanent employees was 48 years, and the average length of service was 13 years.

EMPLOYEE EDUCATION

Employees at Orkuveita Reykjavíkur feature a great variety of educational backgrounds, including engineering, technology, computer sciences, business, electrical technology, mechanical engineering, plumbing, law, library and information sciences, pedagogy and office training, underground cable laying and cooking.

The vast majority of employees in the power companies have traditionally consisted of male workers, largely owing to the type of jobs on offer. Orkuveita Reykjavíkur has made systematic efforts in recent years to increase the number of women on the company's staff. A new organisation chart was introduced last year, where the proportion of women in management positions was higher than ever before, at over 32%.

Orkuveita Reykjavíkur attaches great importance to life-long learning and continuous training in order to support changes in the company and provide employees with opportunities to improve their qualifications, for the benefit of both parties. A total of 42 educational events were organised within the company over the year, attended by 616 employees; in addition, employees attended a number of courses and conferences outside the company. The cost of training courses was approximately ISK 26 million, or 0.6% of total payroll costs over the year.

A workplace analysis was conducted for the fifth time in 2011 in order to verify the situation of the company's internal operation. The results of the workplace analysis include job satisfaction, morale, goals, stress and workload, working facilities, confidence in management, knowledge of the company's strategy and goals, feedback and incentives, to name a few features. The company will now undertake efforts to preserve the positive results of the analysis and remedy any deficiencies.

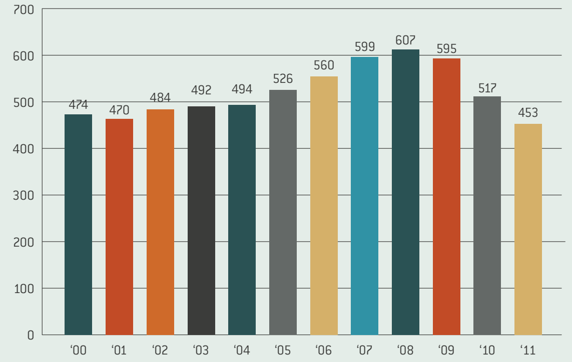
GENDER EQUALITY

An Equal Rights Committee is active in Orkuveita Reykjavíkur, charged with the task of monitoring the company's equal rights programme, oversee equal rights matters and ensure compliance by the company with Act No. 10/2008 on equal rights of men and women.

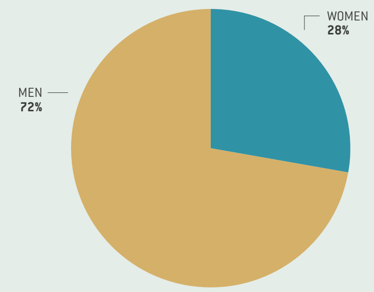
In 2011 the Equal Rights Committee organised a presentation of equal rights issues for Orkuveita Reykjavíkur's management and carefully monitored compliance with Orkuveita Reykjavíkur's equal rights programme when appointing staff to management positions. The Committee annually submits a summary outlining the gender ratios in the company from various viewpoints; the summary is then formally presented to Orkuveita Reykjavíkur's management team.

Orkuveita Reykjavíkur has periodically appointed external independent parties to analyse the gender equality situation in the company, e.g. by analysing salary structures. The objective is to verify whether Orkuveita Reykjavíkur is paying equal salaries and offering equal terms for jobs of equal value. The result of a study presented in the year showed that women had 6.9% lower total wages than men, and 3.1% lower base salaries. The result of the last study, conducted two years earlier, showed that women had 8.4% lower total wages than men, and 0.9% lower base salaries.

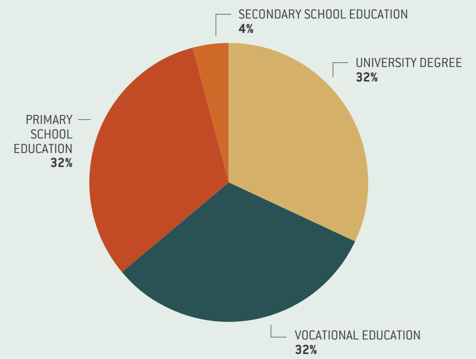
NUMBER OF STAFF SINCE THE ESTABLISHMENT OF ORKUVEITA REYKJAVÍKUR



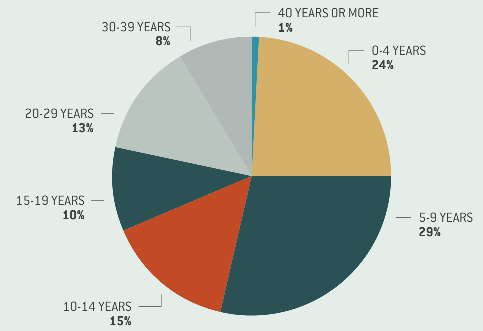
DIVISION OF STAFF BY GENDER



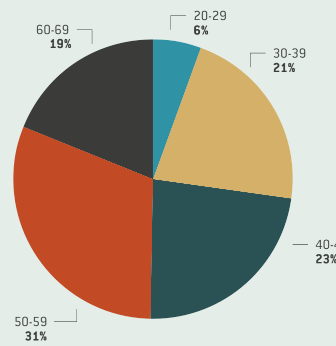
EMPLOYEE EDUCATION



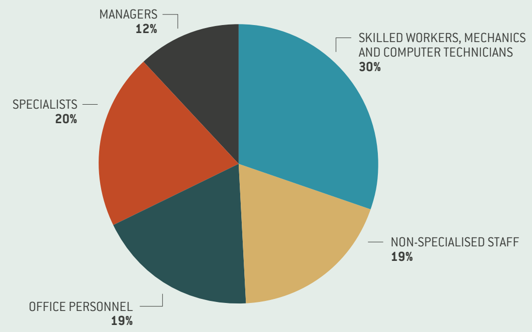
YEARS OF EMPLOYEMENT WITH ORKUVEITA REYKJAVÍKUR



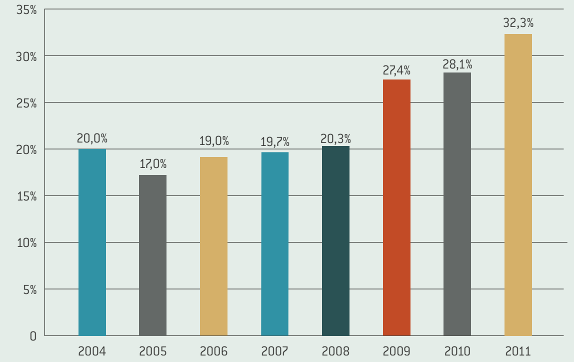
EMPLOYEE AGE DISTRIBUTION



JOB TYPE DISTRIBUTION



PROPORTION OF WOMEN IN MANAGEMENT



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HEALTH AND SAFETY

HEALTH AND SAFETY

Safety is a priority at Orkuveita Reykjavíkur. It is regarded as self-evident that employees should return to their homes, safe and sound, at the end of the working day, and Orkuveita Reykjavíkur' goal is that no one should be injured at work, and no one should suffer damage to their health at work. Orkuveita Reykjavíkur is certified to the OHSAS 18001 Occupational Health and Safety Management Standard.

A head of Health, Safety and Environment was appointed in 2011 and at the same time the job was changed and transferred under the direct supervision of the CEO. This arrangement results in an increased emphasis on this issue, and the Safety Officer has clear and unequivocal powers to take action. Also, the company's managers have been entrusted with responsibility for staff safety matters in their respective divisions.

There were eight lost time injuries during working hours among Orkuveita Reykjavíkur's employees in the year 2011. Lost time injury refers to an injury which results in an employee's absence from work on the following day. The two accidents that caused the longest absences resulted from falls on level ground.

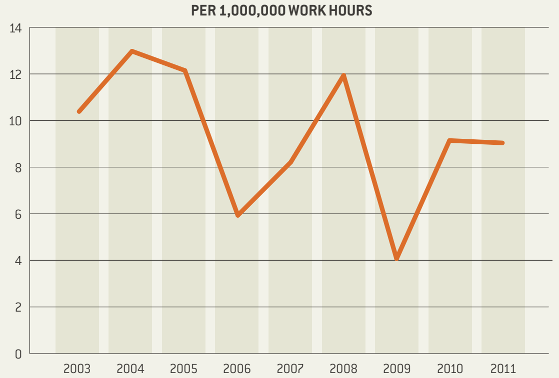
Development work conducted by Orkuveita Reykjavíkur in 2011 was limited in comparison with the preceding years. Work at the Hellisheidi Plant was substantially reduced as the year wore on, but at the same time increased attention was focused on safety matters. All contractors were required to assess the risk of their projects and in this they have been assisted by the company's Safety Officer. Orkuveita Reykjavíkur also lends to its contractors H_2S warning sensors and requires their unconditional use in designated areas. Also, an accident counter was set up at mid-year to count the days that have passed since the last absence accident in the work area. At year-end 2011 all permanent Orkuveita Reykjavíkur employees based in the Hengill area were issued a TETRA radio for use; previously, the stations had accompanied the shifts on duty. This represents one aspect of improving communications and improving employee safety in the area.

Among the points of focus of the year 2011 in Orkuveita Reykjavíkur Utilities was work relating to the increased safety of personnel working with hot water and on overhead utility lines. An initiative was launched with the employees of the Service division designed to improve working conditions and reduce injuries caused by strain. Extensive transfers of staff in Baejarháls also required a number of workplace audits. Three evacuation exercises were held with the participation of the fire department.

Orkuveita Reykjavíkur has three safety committees. Among other things, they perform a key role in reviewing accidents, "near misses" and suggestions relating to safety matters. The committees are intended to submit proposals for improvements. In October, representatives of the committees and 40 other employees visited a workplace run by Landsvirkjun and Ístak in Búdarháls in order to learn from their approaches to safety matters. The visit was part of an effort to increase the employees' safety awareness.

Orkuveita Reykjavíkur has an Emergency Board composed of over ten employees from various departments of the company. The board held regular meetings in the course of the year and also participated in an extensive and successful exercise with Landsnet and NSR, the joint crisis co-operative network of the electricity network. The Emergency Board was also on alert at the time of the eruption in Grímsvötn in May; the principal response of Orkuveita Reykjavíkur was to close air intakes and shut down ventilation and cooling in order to prevent ash from entering stations. The Emergency Board has also analysed the larger deviations in the operation of the utilities, e.g. a breakdown in Orkuveita Reykjavíkur's network systems and in a main artery in the heating utility in Árbaer in Reykjavík. These analyses are useful to improve technical arrangements, enhance employee safety and support the Control Centre and operators in such circumstances.

TREND IN THE NUMBER OF LOST TIME INJURIES
PER 1,000,000 WORK HOURS



*calculated based on active man-hours, holidays not included

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GAGNAVEITA REYKJAVÍKUR

GAGNAVEITA REYKJAVÍKUR

Gagnaveita Reykjavíkur ehf (GR) is a telecommunications company owned by Orkuveita Reykjavíkur. The company started operations January 1st, 2007, taking over the telecom operations from Orkuveita Reykjavíkur. GR's role is to build and operate a high-speed telecommunication network using fiber optic and IP network technology.

GR's fiber optic network is laid mostly in the metropolitan area, where tens of thousands of households and hundreds of companies have been connected. The fiber optic network also extends to western Iceland, Akranes, Borgarnes, Hvanneyri and Bifröst, as well as southern Iceland, to Hveragerdi, Hella, Hvolsvöllur and Vestmannaeyjar. Telecommunications companies such as Vodafone, Nova, Tal, Hringdu and Hringidan use the fiber optic network for various telecommunications services they offer to their customers. GR also operates an „open access" telecommunications network through it's fiber optic and IP networks, through which connected households in GR's service area can obtain high-speed Internet, television and telephony services from telecommunications companies. The number of households using this newest and most advanced means of fixed-line telecommunications is nearing 20 thousand.

Enterprises and public agencies are also large-scale users of GR's fiber optic network; their number is growing steadily, and their needs for high-speed network connections are also constantly increasing. GR currently has a staff of 26, but in addition to the staff itself a number of contractors and experts are involved in the development and operation of the network.

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HIGHLIGHTS FROM THE ENVIROMENTAL REPORT

HIGHLIGHTS FROM THE ENVIROMENTAL REPORT

Environmental matters are an important issue for Orkuveita Reykjavíkur. The company has established an environmental policy; it operates under an ISO 14001 certified environmental management system and keeps green accounts. The activities of Orkuveita Reykjavíkur are also certified under the HAACP monitoring system, in order to ensure the quality of potable water. The following is a highlights from Orkuveita Reykjavíkur's environmental report; the report itself is published in its entirety in Icelandic on the company's website:

http://www.or.is/Umhverfiogfraedsla/Umhverfismal/Umhverfisskyrslur/.

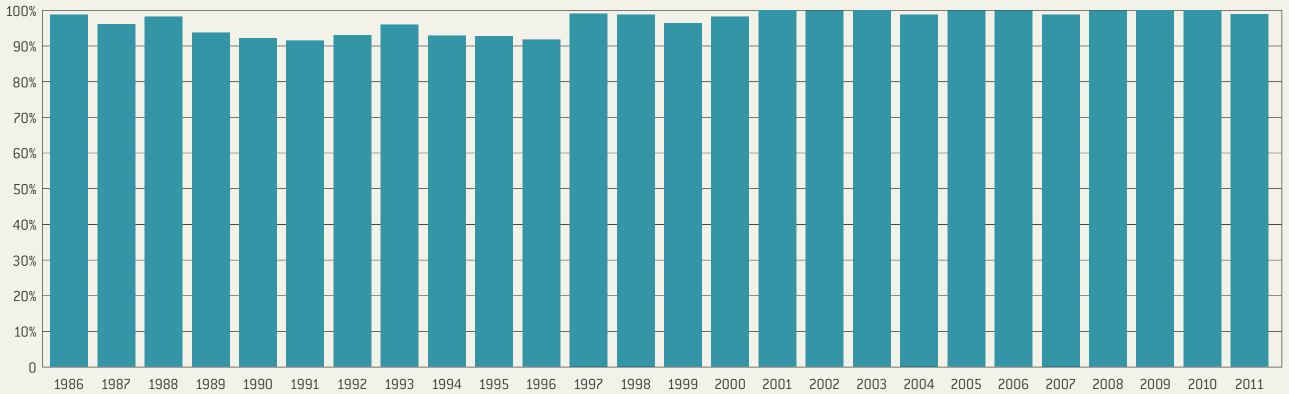
WATER QUALITY

Access to clean potable water is one of the most valuable resources of the inhabitants of Orkuveita Reykjavíkur's service area. Responsible use of groundwater in water protection areas is one of the key points of focus of the company. The purpose of Regulation No. 536/2001 on drinking water is to preserve human health by ensuring that water intended for consumption is wholesome and clean. Act No. 36/2011 on water management places increased emphasis on protecting water and its ecological system. Also, the act is intended to promote the long-term protection of the water resource.

Each year, samples are taken from all of Orkuveita Reykjavíkur's water utilities for microbial analysis; the results of these analyses are shown in the chart below. Samples are also taken for comprehensive chemical analysis. In 2011, 102 samples were taken in Reykjavík, and one sample did not meet quality requirements. The sample was taken at a time of extensive melting and rain, which might explain the increased number of microbes .

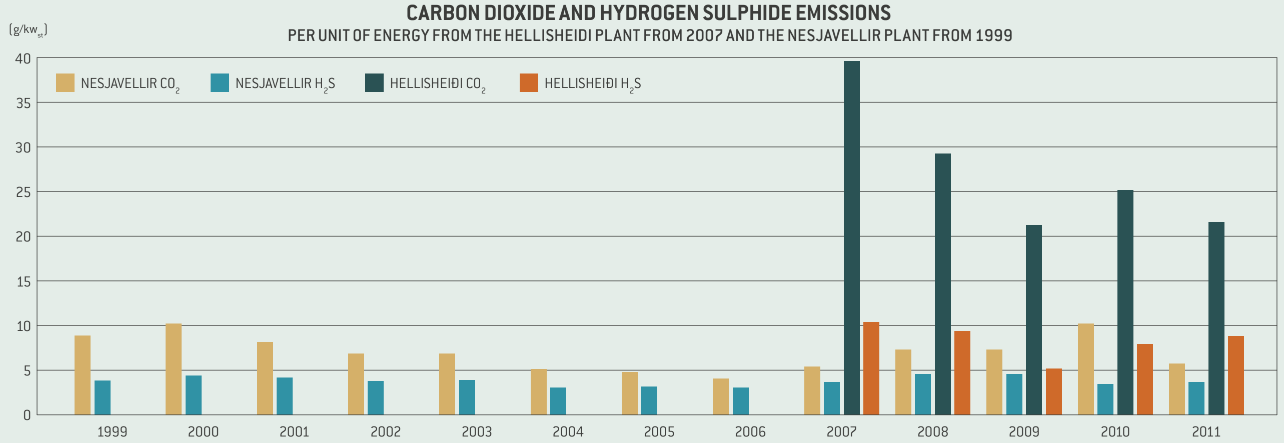
PROPORTION (%) OF SAMPLES THAT MET QUALITY REQUIREMENTS, 1986 – 2011

THE HAACP MONITORING SYSTEM WAS IMPLEMENTED IN 1997 TO ENSURE WATER QUALITY

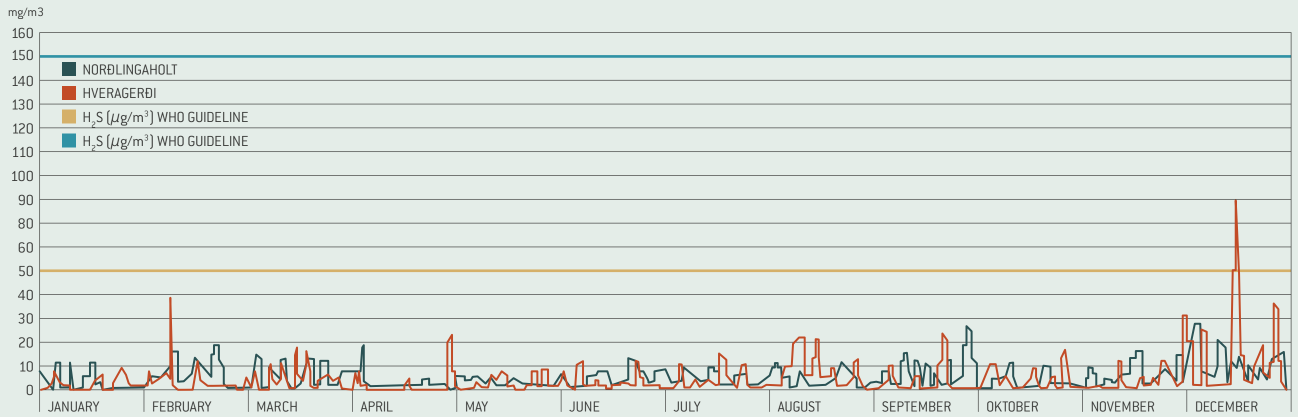


CARBON DIOXIDE AND HYDROGEN SULPHIDE EMISSIONS

PER UNIT OF ENERGY FROM THE HELLISHEIDI PLANT FROM 2007 AND THE NESJAVELLIR PLANT FROM 1999



RUNNING 24-HOUR AVERAGE CONCENTRATION OF HYDROGEN SULPHIDE IN HVERAGERDI AND NORDLINGAHOLT IN 2011



GAS EMISSIONS AND MONITORING OF RELEASE OF GEOTHERMAL GASES

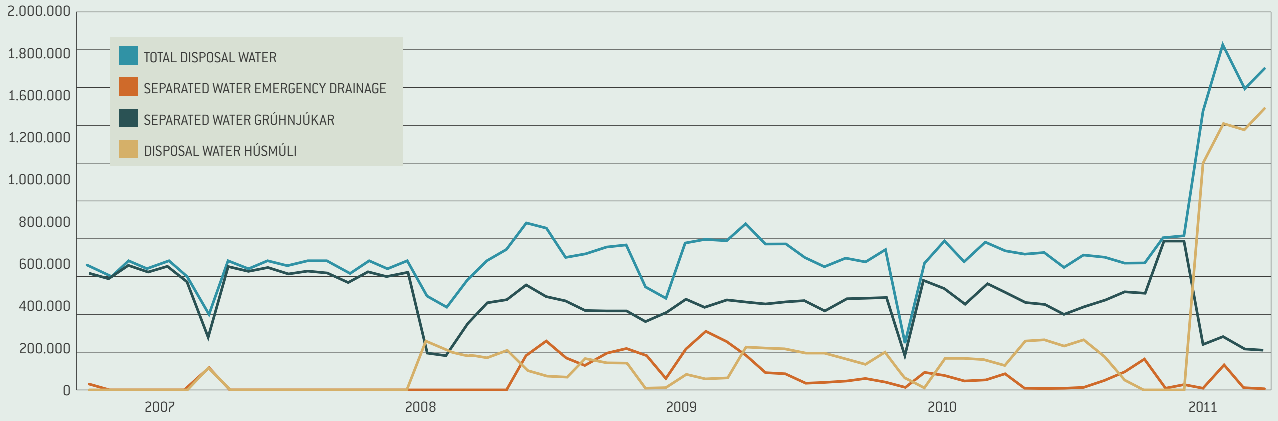
Carbon dioxide (CO_2) and hydrogen sulphide (H_2S) accrue in some quantities in connection with energy production at the Nesjavellir and Hellisheidi power plants. These geothermal gases have an environmental impact: carbon dioxide because of its greenhouse effects and hydrogen sulphide because of its smell and toxic effects in high concentrations.

HYDROGEN SULPHIDE (H_2S)

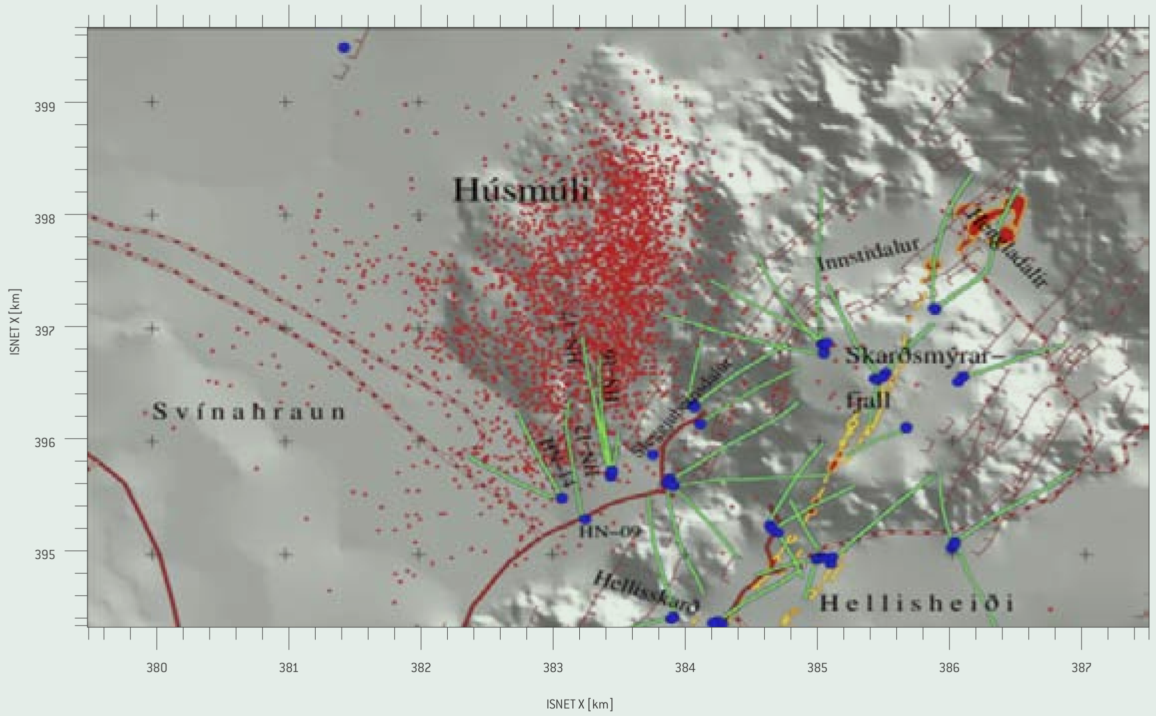
According to its operating licence, Orkuveita Reykjavíkur is required to limit air pollution from its activities to the extent possible. Among other things, the company is required to monitor hydrogen sulphide pollution in the atmosphere. The emission of hydrogen sulphide and the proportion of its elimination is one of the benchmarks used by Orkuveita Reykjavíkur. Regulation No. 514/2010 on the concentration of hydrogen sulphide in the atmosphere sets a health guideline providing for a maximum daily running 24-hour average of 50 μg/m³. Another limit provides for a maximum annual average of 5 μg/m³. Notification of environmental authorities is required when the concentration has been measured above 150 μg/m³ continuously for three hours. As of the 1st of July 2014, the notification level will be reduced to 50 μg/m³.

Orkuveita Reykjavíkur has set up three air quality chart recorders in Hveragerdi, in Nordlingaholt and in the industrial area at the Hellisheidi Plant. The results of the measurements can be accessed on the website of the Sudurland Board of Public Health www.heilbrigdiseftirlitid.is. In 2011, the concentration of hydrogen sulphide was below the annual average in Hveragerdi (3,7 μg/m³) and in Nordlingaholt (4,0 μg/m³). In Nordlingaholt the concentration of H_2S was below the reference limit for the daily running 24-hour average, but exceeded the limit in Hveragerdi three times, see chart above. In the course of the year changes were made in the equipment of the plants, on the recommendation of the Environment and Food Agency. Fluctuations have appeared in the baseline of the measurements, which have not been explained. Work is in progress on improvements.

QUANTITY OF DISPOSAL WATER (TONS/MONTH) FROM THE HELLISHEIDI POWER PLANT 2007 – 2011 BY DISPOSAL METHODS



MAP OF THE HÚSMÚLI AREA AT THE HELLISHEIDI POWER PLANT



The reinjection wells (HN-09, HN-12, HN-14, HN-16, and HN-17) are directionally drilled into the Húsmúli formation. Well heads are depicted with blue dots and green lines show the trajectories of the wells. Red dots show the epicenters of earthquakes that have occurred from the beginning of September till the end of December 2011

CARBFIX AND SULFIX INNOVATION PROJECTS

Since 2007 work has been in progress on innovation projects at the Hellisheidi plant, which are intended to reduce the emission of hydrogen sulphide, without the formation of sulphur or sulphuric acid (SulFix project) and without the emission of carbon dioxide (CarbFix project) from the plants in the Hengill area. Hydrogen sulphide and carbon dioxide will be injected through boreholes deep into the bedrock, where it is anticipated that the compounds will be permanently bound in solid form. Injection in the SulFix project began in early December 2011. Owing to moisture in the pumped gas, the experiment had to be halted temporarily, but work is in progress on improving the process.

REINJECTION OF DISPOSAL WATER AND GROUNDWATER MONITORING

HELLISHEIDI POWER PLANT

According to the conditions in the development permit and operating licence for the Hellisheidi Power Plant, separated water must be injected from the plant below 800m in the geothermal system. Orkuveita Reykjavíkur is required to protect groundwater, minimise the impact of development on its quality and monitor the impact by means of regular measurements.

Separated water from the Hellisheidi power plant has been disposed of by injecting into boreholes at Gráuhnúkar, at Húsmúlar and at the surface near Húsmúlar by emergency disposal of geothermal fluids, as shown in the chart above. Over thirty holes have been drilled at the Hellisheidi Power Plant in order to monitor the groundwater and the impact of the plant. No significant increase in chlorine and sulphate, the most volatile elements in the geothermal fluid, has been noted in the monitoring holes.

EARTHQUAKES

Considerable seismic activity occurred in the Húsmúli area when injection into the bedrock began in September 2011. The largest series of quakes occurred on the morning of the 15th of October, 2011 with two quakes of almost 4 on the Richter scale, see figure above. Since then the seismic activity has been much reduced, and the tremors have generally been smaller.

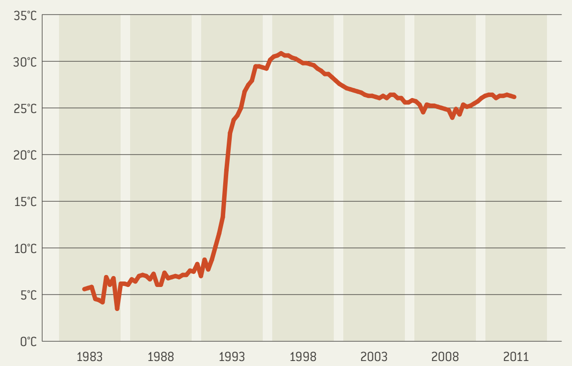
THE NESJAVELLIR POWER PLANT

According to the operating licence issued to the Nesjavellir Power Plant, separated water is directed into an underground tank before channelling into a drain. Orkuveita Reykjavíkur is required to protect groundwater, minimise the impact of the plant operation on its quality and monitor the impact by means of regular measurements. These factors are to be monitored separately in Lake Thingvallavatn.

Separated water is disposed of into three boreholes which extend into the lower groundwater system (400-800 m) but are not connected with the geothermal system. A part of the separated water and condensed water has been disposed of on the surface and the rest of the condenced water into a shallow borholе. Consultations were begun with the issuers of the company's licence on the reinjection of geothermal fluids from the plant, and this work is currently in progress.

Over a dozen holes have been drilled at the Nesjavellir Power Plant to study the groundwater. The results of measurements in the boreholes show that a stream of warm groundwater extends from the plant to Lake Thingvallavatn. The temperature rose in Varmagjá at Thingvallavatn in 1998 – 2006, but fell again with the installation of a cooling tower in 2005. However, the temperature has increased again since 2010, see chart to the left. Work is in progress on improvements.

WATER TEMPERATURE (°C) IN VARMAGJÁ 1983-2011



14 // CONSOLIDATED FINANCIAL STATEMENTS

Orkuveita Reykjavíkur

Consolidated
Financial Statements 2011

Orkuveita Reykjavíkur
Bæjarhálsi 1
110 Reykjavík

reg no. 551298-3029

Contents

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 that produces and distributes electricity and distributes geothermal water for heating and cold water for consumption. It also operates sewage systems and fibre-optic cable system in its service area.

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

Loss of the operations of Orkuveita Reykjavíkur during the year amounted to ISK 556 million. According to the statement of financial position the Company´s assets amount to ISK 296.385 million, book value of equity at the end of the year amounted to ISK 61.643 million and the Company´s equity ratio is 20,8%

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

	Share
Reykjavíkurborg	93.539%
Akraneskaupstaður	5.528%
Borgarbyggð	0.933%

The Company´s Board of Directors do not propose dividend payments to the Company´s shareholders in the year 2012 due to the operating year 2011.

In an agreement with the owners of Orkuveita Reykjavíkur, the Company´s operations have been significantly strengthened with a subordinated loan amounting to ISK 12 billion. In the year 2011 close to ISK 8 billion of the loan was paid and it is scheduled to receive ISK 4 billion in the year 2013. Further cash flow improvements are expected with curtailing and by delaying both new investments and maintenance investments as far as possible in the utility systems.

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 work is defined and also that of the Managing Director. The procedures also include rules on order at meetings and writing of Board minutes, of professional secrecy and confidentiality, on the Audit Committee, on disqualification of Board members, on information to be given by the Managing Director to the Board etc. Further information on the Boards procedures will be introduced in the Company´s Annual Statements that will be published late spring 2012.

Endorsement by the Board of Directors and the Managing Director, contd.

Statement by the Board of Directors
According to the best knowledge of the Board of Directors of Orkuveita Reykjavíkur, the company´s consolidated financial statements are in accordance with International Financial Reporting Standards as adopted by the EU. It is the opinion of the Board of Directors that the consolidated financial statements give a fair view of the Company's assets, liabilities and financial position at 31 December 2011 and the company´s operating return and changes in cash and cash equivalents for the year then ended.

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

The Board of Directors of Orkuveita Reykjavíkur hereby confirm the Company´s consolidated financial statements for the year 2011.

Reykjavík, 16 March 2012.

The Board of Directors:
Haraldur Flosi Tryggvason
Kjartan Magnússon
Hrönn Ríkharðsdóttir
Sóley Tómasdóttir
Reginn Freyr Mogensen
Gylfi Magnússon

Managing Director:
Bjarni Bjarnason

Independent Auditor´s Report

To the Board of Directors and owners of Orkuveita Reykjavikur.

We have audited the accompanying financial statements of Orkuveita Reykjavíkur, which comprise the statement of financial position as at December 31, 2011, the income startement, the statement of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management´s Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted by the EU, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor´s Responsibility
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion
In our opinion, the financial statements give a true and fair view of the financial position of Orkuveita Reykjavíkur as at December 31, 2011, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

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

Reykjavík, 16 March 2012.

KPMG ehf.
Hlynur Sigurðsson
Auðunn Guðjónsson

Income Statement 2011

	Notes	2011	2010
Operating revenue		33.626.215	27.915.590
Energy purchase		(5.016.487)	(4.938.923)
Salaries and salary related expenses	7	(3.836.419)	(4.151.180)
Other operating expenses		(3.538.078)	(4.874.365)
Operating expenses, total		(12.390.983)	(13.964.468)
EBITDA		21.235.231	13.951.122
Depreciation and amortisation	8	(8.880.736)	(7.962.448)
Results from operating activities, EBIT		12.354.496	5.988.675
Interest income		126.924	149.941
Interest expenses		(5.689.628)	(4.030.068)
Other (expenses) income on financial assets and liabilities		(14.093.609)	14.632.717
Total financial income and expenses	9	(19.656.314)	10.752.590
Share in (loss) profit of associated companies	13	(5.400)	24.308
(Loss) profit before income tax		(7.307.218)	16.765.572
Income tax	10	6.750.946	(3.036.786)
(Loss) profit for the year		(556.272)	13.728.786
Attributable to:			
Equity holders of the Company		(556.291)	13.728.669
Minority interest in subsidiaries		20	117
(Loss) profit for the year		(556.272)	13.728.786

The notes on pages 12 to 54 are an integral part of these Consolidated Financial Statements.

Statement of Comprehensive Income for the year ended 31 December 2011

	2011	2010
(Loss) profit for the year	(556.272)	13.728.786
Other comprehensive income		
Effect of change in tax rate on the revaluation reserve	0	(1.534.410)
Revaluation reserve, increase	15.137.813	1.032.692
Revaluation reserve, decrease	(5.000.000)	0
Income tax effect of revaluation	(1.245.295)	(185.885)
Changes in fair value of assets available for sale	460.000	0
Total comprehensive profit for the year	8.796.246	13.041.183
Total comprehensive income attributable to:		
Equity holders of the Company	8.796.227	13.041.066
Minority interest in subsidiaries	20	117
Total comprehensive profit for the year	8.796.246	13.041.183

The notes on pages 12 to 54 are an integral part of these Consolidated Financial Statements.

Financial Statements of Orkuveita Reykjavikur 2011 6 Amounts are in ISK thousands
Financial Statements of Orkuveita Reykjavikur 2011 7 Amounts are in ISK thousands

Consolidated Statement of Financial Position
31 December 2011

	Notes	31.12. 2011	31.12. 2010
Assets			
Property, plant and equipment	11	258.802.010	248.030.995
Intangible assets	12	1.256.937	1.514.124
Investments in associated companies	13	118.148	313.364
Investments in other companies	14	1.983.269	2.062.445
Embedded derivaties in electricity sales contracts	15	17.168.462	18.809.205
Other financial assets	16	7.886.188	7.333.247
Deferred tax assets	17	1.932.007	206.742
Total non-current assets		289.147.020	278.270.120
Inventories	18	431.560	566.796
Trade receivables	19	4.227.536	3.661.642
Embedded derivatives in electricity sales contracts	15	514.508	1.601.900
Other financial assets	16	569	4.574
Other receivables	19	411.196	91.730
Cash and cash equivalents	20	1.652.484	2.343.648
Total current assets		7.237.853	8.270.289
Total assets		296.384.873	286.540.409

The notes on pages 12 to 54 are an integral part of these Consolidated Financial Statements.

Consolidated Statement of Financial Position
31 December 2011

	Notes	31.12. 2011	31.12. 2010
Equity			
Revaluation reserve		53.923.091	46.882.895
Fair value reserve		460.000	0
Retained earnings		7.255.202	5.959.171
Equity attributable to equity holders of the Company		61.638.293	52.842.065
Minority interest		4.724	4.704
Total equity	21	61.643.016	52.846.769
Liabilities			
Loans and borrowings	22	213.838.494	207.916.910
Retirement benefit obligation	23	460.874	441.487
Other financial liabilities	24	2.390	23.395
Deferred tax liabilities	17	0	3.780.403
Total non-current liabilities		214.301.758	212.162.196
Accounts payable	24	1.627.619	1.981.573
Loans and borrowings	22	16.384.762	17.273.990
Other financial liabilities	24	17.389	17.130
Other current liabilities	24	2.410.329	2.258.751
Total current liabilities		20.440.099	21.531.444
Total liabilities		234.741.857	233.693.640
Total equity and liabilities		296.384.873	286.540.409

The notes on pages 12 to 54 are an integral part of these Consolidated Financial Statements.

Financial Statements of Orkuveita Reykjavikur 2011 8 Amounts are in ISK thousand
Financial Statements of Orkuveita Reykjavikur 2011 9 Amounts are in ISK thousand

Consolidated Statement of Changes in Equity for the year 2011

	Revaluation reserve	Fair value reserve	Retained earnings (Accumulated deficit)	Attributable to equity holders of the Company	Minority interest	Total equity
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 effect of 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 of the year			(556.291)	(556.291)	20	(556.272)
Total comprehensive income	7.040.196	460.000	1.296.031	8.796.227	20	8.796.246
Equity at 31 December 2011	53.923.090	460.000	7.255.201	61.638.291	4.725	61.643.015
The year 2010						
Equity at 1 January 2010	49.417.335	0	(8.816.337)	40.600.998	56.487	40.657.485
Effect of change in tax rate	(1.534.410)			(1.534.410)		(1.534.410)
Revaluation, increase	1.032.692			1.032.692		1.032.692
Income tax effect of revaluation	(185.885)			(185.885)		(185.885)
Depreciation transferred to retained earnings (deficit)	(1.846.838)		1.846.838	0		0
Profit for the year			13.728.669	13.728.669	117	13.728.786
Total comprehensive income	(2.534.441)	0	15.575.507	13.041.066	117	13.041.183
Other changes				0	(51.899)	(51.899)
Dividends paid			(800.000)	(800.000)		(800.000)
Equity at 31 December 2010	46.882.894	0	5.959.170	52.842.064	4.705	52.846.769

The notes on pages 12 to 54 are an integral part of these Consolidated Financial Statements.

Consolidated Statement of Cash Flows for the year 2011

	Notes	2011	2010
Cash flows from operating activities			
Cash generated from operations before interest and taxes	26	20.574.517	14.905.234
Received interest income		127.147	147.930
Paid interest expenses		(3.777.307)	(3.230.597)
Dividend received		43.840	16.159
Paid due to other financial income and expenses		(38.063)	(250.463)
Net cash from operating activities		16.930.134	11.588.263
Cash flows from investing activities			
Acquisition of property, plant and equipment		(10.203.833)	(14.305.870)
Acquisition of intangible assets		(80.258)	(96.926)
Proceeds from sale of property, plant and equipment		582.268	0
Acquisition of subsidiaries		0	(150.000)
Acquisition of associated companies		179.000	4.708
Acquisition of other financial assets		(16.887)	(93.176)
Proceeds and repayment of other financial assets		1.036	99.228
Net cash used in investing activities		(9.538.674)	(14.542.036)
Cash flows from financing activities			
Proceeds from new borrowings		0	17.800.643
Repayment of borrowings		(10.449.874)	(4.592.913)
Proceeds from new borrowings from the owners		7.925.360	0
Dividends paid		0	(800.000)
Credit facility, change		(6.771.507)	(5.494.835)
Current liabilities, change		1.227.863	(4.693.303)
Net cash from financing activities		(8.068.157)	2.219.591
(Decrease) in cash and cash equivalents		(676.698)	(734.182)
Cash and cash equivalents at year beginning		2.343.648	2.943.303
Effect of currency fluctuations on cash and cash equivalents		(14.468)	134.528
Cash and cash equivalents at year end		1.652.483	2.343.649
Investments and financing without payment effects:			
Acquisition of property, plant and equipment		(302.915)	(723.246)
Proceeds from sale of property, plant and equipment		135.000	0
Acquisition of other companies, change		0	(23.898)
Proceeds from sale of other companies		149.541	0
Other financial assets, change		0	23.898
Receivables, change		(284.541)	0
Current liabilities, change		302.915	723.246
Other information:			
Working capital from operation		17.231.251	10.594.560

The notes on pages 12 to 54 are an integral part of these Consolidated Financial Statements.

Financial Statements of Orkuveita Reykjavikur 2011 10 Amounts are in ISK thousand

Notes to the Financial Statements

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 Reykjavik. The Company's consolidated financial statements include the financial statements of the parent company and its subsidiaries, (together referred to as "the Company") and a share in associated companies.
The consolidated financial statements of Orkuveita Reykjavikur is a part of the consolidated financial statements of Reykjavik 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 consolidated financial statements were approved by the Board of Directors on 16 March 2011.

b. *Basis of measurement*

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

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

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

c. *Functional and presentation currency*

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

d. *Use of estimates and judgements*

The preparation of the financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

In particular, information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements is included in the following notes:
- note 11 - Property, plant and equipment
- note 14 - Investments in other companies
- note 15 - Embedded derivatives in electricity sale contracts
- note 16 - Other financial assets
- note 17 - Deferred tax assets and liabilities
- note 23 - Retirement benefit obligations

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 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.

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. 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 reveivables

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.

3. Significant accounting policies, contd.

c. *Financial instruments, contd.*

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.

ii) Derivative financial instruments

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

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

Other embedded derivatives

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

3. Significant accounting policies, contd.

d. *Property, plant and equipment*

i) Recognition and measurement

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

Cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to a working condition for its intended use, and the costs of dismantling and removing the items and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

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

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

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

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

ii) Subsequent costs

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

iii) Depreciation

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Land is not depreciated. Estimated useful lives are specified as follows:

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

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

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Financial Statements of Orkuveita Reykjavikur 2011 17 Amounts are in ISK thousand

3. Significant accounting policies, contd.

e. Intangible assets

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

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

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

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

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

Heating rights	100 years
Software	3-7 years

f. Leased assets

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

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

g. Inventories

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

3. Significant accounting policies, contd.

h. Impairment

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

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

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

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

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

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

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

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

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

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

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 period 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**
Revenue from the sale of cold water and sewer take into account the size of housing plus a fixed fee. In addition revenue is stated for cold water according to measurement from specific industries.

iii) **Connection revenues**
Upon connection of new users to distribution systems of electricity, water and sewer or upon renewal of connection an inital 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.

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

m. ***Financial income and expenses***

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

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

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

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

n. ***Income tax***

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

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. The income tax ratio is 36.0%, but a part of the operation is exempt from tax (operation of cold water supply and sewer).

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax was measured in accordance with the current tax rate, which is 36.0% for partnerships and 20.0% for companies with limited liability.

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

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

o. ***Segment reporting***

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

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

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

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

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

The Group has implemented all international accounting standards, their interpretation and changes on existing standards that were effective at year end 2011 and are related to the Group´s operation. The Group has not beforehand implemented international accounting standards, their interpretation and changes which are affective after 31 December 2011. Adoption of these standards are not considered to have a significant effect on the preparation of the Group´s financial statements.

4. **Determination of fair values**

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

a. ***Property, plant and equipment***

The fair value of production systems that have undergone a revaluation is determined on the basis of the depreciated replacement cost, which consists in the assessment of changes in construction cost of comparable assets and both cost and accumulated depreciation are 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 special licence and income limits are mainly based on changes in the building cost index. This is taken into account when determining the fair value.

The fair value of property, plant and equipment taken over upon a merger is based on the market value. The market value is the amount that can be obtain 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.

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

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

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

c. ***Derivatives***

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

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

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

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

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

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

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

e. ***Non-derivative financial liabilities***

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

Notes

5. Segment reporting

Business divisions and sectors

Orkuveita Reykjavíkur´s service area is mainly in the Reykjavík city area, but it also extends to the southern and western parts of Iceland. The Company is divided into three seperate 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 exclusivly 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, exept for operations regarding cold water and sewer but they are regulated by law no. 33/2004 concerning cold water suppliers of municipalities and law no. 9/2009 concerning the operations of sewer. The provision of hot water supply is subject to law no. 58/1967, concerning earnings from hot water. The distribution of electricity is subject to law no. 65/2003, which stipulates revenue caps that are decided by the National Energy Authority.

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

Customers that have significant effect on the Company´s revenues

One customer has significant effect on the Company´s revenues in the year 2011, i.e. Norðurál Grundartangi ehf. In the year 2010 revenues from Reykjavík City were over 10% but have decreased in the year 2011.

Revenues from Norðurál Grundartangi ehf., a customer of the Company´s Production and Sale´s division, represents approximately ISK 5.652 million or 16.8% of total revenues. (2010: ISK 5.504 million, 18.1% of total revenue.)

Revenues from Reykjavík City, a customer of all of the Company´s divisions and sectors, represents approximately ISK 1.288 million or 3.8% of total revenues. (2010: ISK 3.678 million, 13.2% of total revenue.)

Notes

5. Segment reporting

Segment information is presented by the Group's business segments according to the Group's organisation and internal reporting. Business segments consist of *Utilities, Production and Sale*, and *Other Operation*. In addition, information is provided on the Group's sectors, which are *Electricity, Hot water*, *Cold water*, *Sewer* and *Fibre-optic cable systems*.

Business segments - divisions **The year 2011**	**Utilities**	**Production and sale**	**Other Operation**	**Adjust- ments**	**Total**
External revenue	21.439.485	11.956.289	230.441		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)
The year 2010					
External revenue	17.186.751	10.677.632	51.207	0	27.915.590
Inter-segment revenue	303.681	2.831.725	597.100	(3.732.506)	0
Total segment revenue	17.490.432	13.509.357	648.307	(3.732.506)	27.915.590
Segment result	5.417.246	2.022.303	(126.524)	0	7.313.025
Unallocated expenses					(1.324.350)
Results from operating activities					5.988.675
Financial income and expenses					10.752.589
Share of profit of associated companies					24.308
Income tax					(3.036.786)
Profit for the year					13.728.786

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5. Segment reporting, contd.

Business segments - divisions, contd.

The year 2011	**Utilities**	**Production and sale**	**Other Operation**	**Adjust-ments**	**Total**
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
Investsments:					
Property, plant and equipment	2.208.265	7.382.796	0	154.095	9.745.156
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
The year 2010					
Balance sheet (1.1. 2010)					
Property, plant and equipment	122.791.706	116.906.563	284.930	8.047.796	248.030.995
Intangible assets			171.862	1.342.262	1.514.124
Shares in associates					313.364
Other unallocated assets					36.681.926
Total assets					286.540.409
Unallocated liabilities					233.693.640
Investsments:					
Property, plant and equipment	3.781.507	10.082.147	7.227	142.595	14.013.476
Intangible assets	0	0	14.372	82.555	96.927
Depreciation, amortization:					
Property, plant and equipment	4.466.743	2.894.159	0	383.625	7.744.527
Intangible assets	0	0	90.000	127.920	217.920

5. Segment reporting, contd.

Business segments - sectors

The year 2011	**Electricity**	**Hot water**	**Cold water**	**Sewer**	**Fibre-optic cable system**	**Adjust-ments**	**Total**
Income							
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)							
Property, plant and equipment	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							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

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Notes

5. **Segment reporting, contd.**

Business segments - sectors, contd.

The year 2010

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

Notes

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 2011	Hot water 2011	Electricity 2010	Hot water 2010
Power plant at Nesjavellir				
Revenue	8.575.389	1.520.000	2.522.255	950.000
Operating expenses	(984.606)	(500.517)	(615.279)	(534.543)
Depreciation	(2.794.359)	(406.192)	(649.287)	(250.621)
Profit before financial expenses	4.796.424	613.291	1.257.689	164.837
Return on investment	4.8%	5.4%	8.8%	3.2%

7. **Salaries and salary related expenses**

Salaries and salary related expenses are specified as follows:

	2011	2010
Salaries	3.291.423	3.704.640
Defined contribution pension expenses	465.721	493.130
Defined benefit pension expenses	37.721	(9.079)
Other salary related expenses	407.350	377.251
Expensed salaries and salary related expenses due to early retirement plan and laid-off employees 1)	176.433	0
Expensed salaries and salary related expenses due to the resignation period of laid-off employees	0	246.654
Total salaries and salary related expenses	4.378.648	4.812.596

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

	2011	2010
Expensed in the income statement	3.836.419	4.151.180
Capitalised on projects	542.228	661.416
Total salaries and salary related expenses	4.378.648	4.812.596

Number of employees:

	2011	2010
Number of annual working units	532	630

Management's salaries and benefits for the parent company and subsidiaries are specified as follows:

	2011	2010
Salaries to the Board of Directors of the Parent Company	15.439	16.190
Salaries to the Director and five/four Managing Directors of the Parent Company	79.187	73.066
Salaries to the Board of Directors and Managing Directors of subsidiaries	20.771	22.178
Defined contribution pension expenses	14.598	13.663
Termination expenses, pension expenses included 2)	20.034	28.656
	150.029	153.753

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) Anna Skúladóttir left her position as CFO of the parent company in January 2011. Expenses due to the termination of her employment, salary related expenses included, were all expensed upon her departure from the company.

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Financial Statements of Orkuveita Reykjavikur 2011 29 Amounts are in ISK thousand

8. Depreciation and amortisation

	2011	2010
Depreciation and amortisation is specified as follows:		
Depreciation of property, plant and equipment, cf. note 11	8.583.676	7.744.527
Amortisation of intangible assets, cf. note 12	297.060	217.920
Depreciation and amortisation recognised in the income statement	8.880.736	7.962.447

9. Financial income and expenses

	2011	2010
Financial income and expenses are specified as follows:		
Interest income	126.924	149.941
Interest expense	(4.899.197)	(3.314.077)
Guarantee fee to owners 1)	(790.431)	(715.990)
Total interest expenses	(5.689.628)	(4.030.067)
Fair value changes of embedded derivatives in electricity sales contracts	(2.728.135)	246.832
Fair value changes of assets available for sale 2)	(611.169)	(148.489)
Fair value changes of financial assets and financial liabilities through P/L	679.855	(542.044)
Forward currency swaps		(18.817)
Foreign exchange difference	(11.479.306)	15.079.076
Dividends	45.145	16.159
Total of other income (expenses) on financial assets and liabilities	(14.093.609)	14.632.717
Total financial income and expenses	(19.656.313)	10.752.591

1) Orkuveita Reykjavíkur paid a guarantee fee to current and former owners of the company for guarantees they have made on the Groups loans and borrowings according to a decision made on the annual meeting of Orkuveitu Reykjavíkur in 2005. The fee is 0.375% on yearly basis. The calculation of the fee is done at the end of each quarter. The guarantee fee amounted to ISK 790 million in 2011 (2010: ISK 716 million) and is accounted for among interest expenses.

Capitalised financing cost

Financing cost due to construction of a power plant to the amount of ISK 1.287 million is capitalised and has been recognised as reduction of financial expenses (2010: ISK 702 million). Current power plant constructions were completed in the end of September 2011, therefore financing cost is not capitalised for the last quarter of the year.

Interest ratio used to calculate capitalised financing cost for the year 2011 is 7.46% (2010: 3.1%).

The interest ratio is determined from the ratio of interest expense during the period on average remainder of all Company loans calculated from the currency rate/index of the borrowing day of each loan.
When determing the rate the average monthly REIBOR fixings for the year are used. From January to end of September 2011 this ratio was 4.32%. On top of this ratio there is added a margin that reflects the Group´s terms from the Icelandic banks, it is 2.76% for the same period. In addition the Company´s owners guaranty fee is added, which is 0.375% on yearly basis.

If there is exchange currency gain on the loans in the reporting period, the interest ratio is determined as the ratio between interst expenses during the period of the average remaining loans according to the currency rate/index of the borrowing date of each loan.

If there is exchange currency loss during the period, it is taken into consideration when determining the interest ratio. The interest ratio will not, however, be higher than the comparative interest rate in Icelandic krona. The interest ratio is calculated from an estimate of the Icelandic interest rates that would have given a good indication of the interest terms the Group would have received, if the power plant constructions were financed in ISK during the construction period. This is done to reflect that the foreign currency denominated interest rates of the Group's debt portfolio does not give a good indication of interest incurred during construction time when there is exchange currency loss.

9. Financial income and expenses, contd.

	2011	2010
Interest expense is specified as follows:		
Interest expenses, charged in the income statement	(5.689.628)	(4.030.067)
Capitalised finance cost	(1.287.642)	(702.137)
Interest expenses	(6.977.270)	(4.732.204)

Generally accepted valuation methods are used to determine the fair value of certain financial assets and financial liabilities, further discussed in note 4 and 25 e. Change in fair value that is recognised in the income statement amounts to expense of ISK 2.659 million. (2010: expense ISK 444 million).

10. Income tax

Orkuveita Reykjavikur 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:	2011	2010
Change in deferred income tax	(6.750.946)	3.036.786
Income tax recognised in the income statement	(6.750.946)	3.036.786

Reconciliation of effective tax rate:		2011		2010
(Loss) profit before income tax		(7.307.218)		16.765.572
Income tax according to current tax ratio	36.0%	(2.630.598)	32.7%	5.482.342
Effect of change in tax rate	0.0%	0	(7.3%)	(1.228.722)
Effect of valuation of exploitation of deferred tax losses	63.7%	(4.655.873)	0.0%	0
Non-taxable operation of water supply and sewer	(2.9%)	208.881	(7.8%)	(1.304.633)
Effect of various tax rates in the Group	(0.7%)	54.575	(0.1%)	(14.386)
Other items	(3.7%)	272.069	0.6%	102.185
Effective income tax	92.4%	(6.750.946)	18.1%	3.036.786

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11. Property, plant and equipment

Property, plant and equipment is specified as follows:

The year 2011	Production system	Utility system	Other real estates	Other equipment	Total
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
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

The year 2010	Production system	Utility system	Other real estates	Other equipment	Total
Cost or deemed cost					
Balance at year beginning	181.419.827	189.223.393	8.338.751	5.391.704	384.373.675
Reclassification of assets	0	0	0	13.285	13.285
Additions during the year	10.579.537	3.288.896	29.189	115.854	14.013.476
Revaluation, increase	0	1.227.348	0	0	1.227.348
Balance at year end	191.999.364	193.739.637	8.367.940	5.520.843	399.627.784
Depreciation					
Balance at year beginning	49.965.530	89.853.132	1.549.340	2.289.605	143.657.607
Depreciated during the year	3.951.970	3.499.331	141.921	151.305	7.744.527
Revaluation, increase	0	194.656	0	0	194.656
Balance at year end	53.917.500	93.547.119	1.691.261	2.440.910	151.596.790
Carrying amounts					
At 1.1. 2010	131.454.297	99.370.261	6.789.411	3.102.099	240.716.068
At 31.12. 2010	138.081.864	100.192.518	6.676.679	3.079.933	248.030.994
Thereof assets in construction at year end	28.392.186	2.271.439	0	0	30.663.625

Assets in construction

In a draft Parliamentary Resolution submitted by the Minister of Industry 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. The book value of OR's assets and research in the area is ISK 785 million. If the draft Parliamentary Resolution will be approved unchanged regarding this item, most of this amount will be depreciated.

11. Property, plant and equipment, contd.

Revaluation

Revaluation was carried out for cold water and sewage in the distribution system in the end of September 2011 and for hot water and electricity at the end of the year as a part of the regular revaluation of the group´s assets. The revaluation led to an increase of book value of those assets, amounting to ISK 13.359 million. Revaluation was also done for hot water and electricity in the production system at year end 2011. The revaluation led to an increase of book value of production assets in hot water amounting to ISK 1.779 million but to a decrease in the production assets for electricity amounting to ISK 5.000 million. The revaluation did not lead to a change in book value of production assets for cold water. Revaluation was last executed as specified in the following table:

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.

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.

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 3.56% to 6.56%,
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 for hot and cold water stood the impairment test. On the other hand the production system for electricity did not stand the test which resulted in de-recognition of previous revaluation in that sector, amounting to ISK 5.000 million.

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11. Property, plant and equipment, contd.

Information on revalued assets at year end

	Production system	Distribution system	Total
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	179.262.368
The year 2010			
Revalued carrying amount	138.081.864	100.192.518	238.274.382
Thereof effect of revaluation	(32.678.679)	(31.130.251)	(63.808.930)
carrying amount before effect of revaluation	105.403.185	69.062.267	174.465.452

Rateable value and insurance value

The rateable value of the Group's assets measured in the rateable value assessment amounted to ISK 24.879 million at year end 2011 (31.12.2010: ISK 23,626 million). The fire insurance value of the Group's assets amounted to ISK 37.046 million at the same time (31.12.2010: ISK 32.360 million). Among those assets are real estates capitalised among production and distribution systems.

Obligations

In May 2008 the Company entered into a contract concerning purchase of equipment for power plants. The equipment will be delivered in the year 2014. The contract and other contracts regarding developments at Hellisheiði amount to ISK 12.4 billion as per exchange rate at year end (31.12.2010: ISK 32.5 billion). More information regarding these contracts can be found in note 29. Furthermore, the Company has entered into contracts and placed purchase orders with suppliers and developers concerning work on production and distribution systems. The balance of these contracts and purchase orders at year end 2011 is estimated at ISK 1.2 billion (31.12.2010: ISK 1.8 billion).

12. Intangible assets

Intangible assets are specified as follows:

	Heating rights	Preparation cost	Software	Total
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	1.256.937
The year 2010				
Cost				
Balance at year beginning	1.427.031	247.492	2.895.665	4.570.188
Reclassification of assets	0	0	(13.285)	(13.285)
Additions during the year	0	14.372	82.554	96.926
Balance at year end	1.427.031	261.864	2.964.934	4.653.829
Amortisation				
Balance at year beginning	424.631	0	2.497.153	2.921.784
Amortisation during the year	13.939	90.000	113.981	217.920
Balance at year end	438.570	90.000	2.611.134	3.139.704
Carrying amounts				
At 1.1. 2010	1.002.400	247.492	398.512	1.648.404
At 31.12. 2010	988.461	171.864	353.800	1.514.124

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13. Investments in associated companies

Investments in associated companies are specified as follows:

	2011		2010	
	Share	Carrying amount	Share	Carrying amount
Enex-Kína ehf.	0.0%	0	19.53%	174.946
Envent Holdings ehf.	24.5%	45.000	24.5%	45.000
Iceland American Energy Inc.	83.7%	0	83.7%	0
Vistorka ehf.	28.95%	42.591	28.95%	42.591
Metan hf.	35.4%	3.568	35.4%	13.730
Netorka hf.	21.9%	25.708	22.6%	30.416
Reykjavik Energy Grad. School hf.	50.0%	1.281	33.3%	6.681
Total		118.148		313.364

The Company's share in the loss of its associated companies amounted to ISK 5,4 million in the year 2011 (2010: profit of ISK 24,3 million).

14. Investments in other companies

Investments in other companies are specified as follows at year end:	2011	2010
HS Veitur hf.	957.000	1.566.631
Landsnet hf.	860.000	400.000
Other shares in companies	166.269	95.814
Other shares in companies, total	1.983.269	2.062.445

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

15. Embedded derivatives in electricity sales contracts

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

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

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

15. Embedded derivatives in electricity sales contracts, contd.

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

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

	2011	2010
Fair value of embedded derivatives at the beginning of the year	20.411.105	20.164.273
Fair value changes during the period	(2.728.135)	246.832
Fair value of embedded derivatives at the end of the period	17.682.970	20.411.105

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

Non-current embedded derivatives	17.168.462	18.809.205
Current embedded derivatives	514.508	1.601.900
Total embedded derivatives at the end of the period	17.682.970	20.411.105

The embedded derivative with Norðurál Helguvík ehf. (NH) is stated at the book value of ISK 2.4 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 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. At this stage management doesn´t see reason to move down the book value of the embedded derivative.
If the contract will be terminated or renegotiated on other terms, the book value of the embedded derivative would be fully expensed through P/L.

16. Other financial assets

	2011	2010
Non-current assets		
Financial assets at fair value through profit or loss:		
Bonds	7.868.334	7.184.527
Bonds and other receivables:		
Bonds	17.854	148.719
	7.886.188	7.333.246
Current assets		
Bonds	569	4.574

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 seperated from the bond. All of the Company´s bonds are determined to be third level in the fair value hierarchy as further is explained in note 25 e.

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17. Deferred tax assets and liabilities

Deferred tax assets and liabilities is specified as follows:

2011	Tax assets	Tax liabilities	Net amount
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
Current tax liabilities	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	1.932.006	0	1.932.006

2010			
Deferred tax assets/liabilities at the beginning of the year	1.194.314	10.963	1.183.351
Effect of change in income tax rate on revaluation	(20.435)	1.513.975	(1.534.410)
Calculated income tax for the year	(781.321)	2.255.465	(3.036.786)
Effect of change in income tax rate on revaluation account	(185.885)	0	(185.885)
Other changes	68	0	68
Deferred tax assets/liabilities at year end	206.741	3.780.403	(3.573.661)

Deferred tax assets and liabilities are attributable to the flollowing:

	31.12. 2011		31.12. 2010	
	Tax assets	Tax liabilities	Tax assets	Tax liabilities
Property, plant and equipment	(17.056.401)	0	(433.321)	17.023.296
Embedded derivatives	(6.365.869)	0	0	7.347.998
Other items	888.700	0	(25.549)	1.286.811
Effect of carry forward taxable loss	24.465.576	0	665.612	(21.877.702)
Deferred tax assets/liabilities at year end	1.932.007	0	206.742	3.780.403

Carry forward taxable loss

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

	2011	2010
Unadjusted taxable loss for the year 2006, usable until year 2016	0	2.896.521
Unadjusted taxable loss for the year 2007, usable until year 2017	0	76.416
Unadjusted taxable loss for the year 2008, usable until year 2018	65.631.854	70.920.224
Unadjusted taxable loss for the year 2009, usable until year 2019	4.953.017	5.179.713
Unadjusted taxable loss for the year 2010, usable until year 2020	0	182.079
Carry forwards taxable loss at year end 2011	70.584.870	79.254.953

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

18. Inventories

Inventories are specified as follows at year end:	2011	2010
Inventory of materials	431.560	566.796

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

19. Other financial assets

Trade receivables is specified as follows at year end:	2011	2010
Trade receivables, industrial consumers	537.146	451.120
Trade receivables, retail	3.969.640	3.511.002
Trade receivables, receivables	4.506.786	3.962.122
Allowance for doubtful accounts	(279.250)	(300.481)
	4.227.536	3.661.641

Other current receivables are specified as follows at year end:

Value added tax	23.617	16.457
Pre-paid expenses	185.715	6.712
Capital income tax	35.382	15.159
Accrued interest income	23.035	43.789
Receivables from employees	8.275	9.520
Other receivables	135.172	92
	411.196	91.729

20. Cash and cash equivalents

Cash and cash equivalents at year end are specified as follows:	2011	2010
Bank balances	1.652.484	2.343.648

21. Equity

Equity ratio of the Group at year end is 20.8% (31.12.2010: 18.4%). Return on equity was negative by 1.0% in the year 2011 (2010: positive by 34.4%).

Dividend was not paid to the owners of the parent Company in the year 2011. (2010: ISK 800 million.)

The Company's Board of Directors do not propose divident to be paid to the owners of the parent company in the year 2012 due to the operating year 2011. The owners of the parent company decide on dividend payments.

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22. Loans and borrowings

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

Non-current liabilities	**31.12. 2011**	**31.12. 2010**
Bank loans	195.380.948	193.902.191
Subordinated loan from owners of the Company	8.211.459	0
Credit facilities	2.381.700	8.766.600
Bond issuance	22.191.286	21.692.110
	228.165.393	224.360.901
Current portion on non-current liabilities	(14.326.899)	(16.443.990)
	213.838.494	207.916.911
Current liabilities		
Current portion on non-current liabilities	14.326.899	16.443.990
Short-term bank loans	2.057.863	830.000
	16.384.762	17.273.990
Total interest bearing loans and borrowings	230.223.257	225.190.901

Terms of interest-bearing loans and borrowings

Liabilities in foreign currencies:

		31.12. 2011		31.12. 2010	
	Date of maturity	Average interest rate	Carrying amount	Average interest rate	Carrying amount
Liabilities in CHF	26.6.2036	0.47%	43.999.890	0.58%	41.746.713
Liabilities in EUR	6.12.2032	2.04%	67.075.409	1.29%	75.620.884
Liabilities in USD	8.11.2030	1.61%	39.089.748	1.37%	37.772.740
Liabilities in JPY	26.6.2036	0.50%	23.450.772	0.57%	21.949.837
Liabilities in GBP	26.6.2036	1.86%	7.372.326	1.69%	7.078.811
Liabilities in SEK	5.10.2027	2.75%	11.923.887	1.61%	13.548.619
			192.912.031		197.717.605
Liabilities in Icelandic kronas:					
Indexed	10.1.2037	4.76%	35.253.362	4.92%	26.643.296
Non-indexed	15.1.2011	7.5%	2.057.863	7.5%	830.000
			37.311.225		27.473.296
Total interest-bearing loans and borrowings			230.223.256		225.190.901

22. Loans and borrowings, contd.

Repayment on non-current liabilities are specified as follows on the next years:	**31.12. 2011**	**31.12. 2010**
The year 2011	-	16.443.990
The year 2012	14.326.899	12.605.836
The year 2013	29.277.537	27.976.909
The year 2014	15.883.347	14.881.311
The year 2015	13.141.900	12.369.891
The year 2016	22.652.881	16.518.803
Later	132.882.829	123.564.160
Total non-current liabilities, including next year's repayment	228.165.393	224.360.901

Guarantees and pledges

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

Covenants

Loans for the amount of ISK 14.933 million have certain covenants (2010: ISK 14.313 million). Management regularly evaluate the covenants and in their view there is not danger of them being breached.

23. Retirement benefit obligation

Upon the estabilshment of Orkuveita Reykjavíkur, an accrued retirement benefit obligation due to employees at that time was settle. 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 477 million at year end 2011, discounted based on 2% interests and taken into account the share in the net asset of the pension fund (2010: ISK 457 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 obliagation in the year is based on general increase in salaries taken into account interests. The increase of the obliagation 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 2012 is recognised among current liabilities.

Retirement benefit obligation is specified as follows:	**2011**	**2010**
Retirement benefit obligation at the beginning of the year	457.308	480.367
Contribution due to pension payments during the year	(18.334)	(13.981)
Increase in the pension fund obligation during the year	37.721	(9.079)
Retirement benefit obligation at year end	476.695	457.307
Non-current component of retirement benefit obligation	460.874	441.488
Current component of retirement benefit obligation	15.820	15.820
	476.694	457.308

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Financial Statements of Orkuveita Reykjavikur 2011 41 Amounts are in ISK thousand

24. Other financial liabilities

Non-current liabilities	**2011**	**2010**
Other financial liabilities at fair value through profit or loss:		
Currency swaps	2.390	23.395
Current liabilities		
Accounts payable	1.627.619	1.981.573
Other financial liabilities at fair value through profit or loss:		
Aluminium swaps	12.372	0
Currency swaps	5.017	17.130
	17.389	17.130
Other current liabilities:		
Unpaid taxes	560.809	265.395
Unpaid salaries and salary related items	681.513	715.844
Accrued interest expenses	909.373	656.553
Current component of retirement benefit obligation	15.820	15.820
Other liabilities	242.814	605.138
	2.410.329	2.258.750

25. Risk management and financial instruments

a. *Overview*

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

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

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

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

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

Financial risk is divided into:

• Market risk
• Liquidity risk
• Credit risk

25. Risk management and financial instruments, contd.

b. *Market risk*

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

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

i) Currency risk

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

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

Approx. 83.8% of the Group's non-current loans are in foreign currencies. The currency risk is hedged in accordance with the Company's policy on risk management where the interest cost of the loans is assessed together with the currency risk. Interest rate of loans in foreign currencies was considerably lower than for loans in Icelandic kronas. The Group has entered into long term electricity sales contracts in a foreign currency (USD). The expected future revenues from these contracts on the accounting date amount to approx. ISK 165.840 millions. That amount is based on the future price of aluminium on LME (London Metal Exchange) on the accounting date and expectations of price development of aluminium for the next 25 years according to the assessment of CRU, an independent evaluation party, as available on the accounting date.

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

	2011	**2010**	**31.12. 2011**	**31.12. 2010**
	Average exchange rate		**Exchange rate at year end**	
CHF	131,188	116,827	130,795	122,845
EUR	161,416	161,341	158,780	153,800
USD	116,067	122,193	122,320	114,910
JPY	1,458	1,465	1,590	1,413
GBP	186,005	188,535	190,140	178,430
SEK	17,876	17,351	17,843	17,135
CAD	117,309	118,484	120,095	115,160
TWI	216,843	216,303	217,195	207,090

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Financial Statements of Orkuveita Reykjavikur 2011 43 Amounts are in ISK thousand

25. Risk management and financial instruments, contd.

b. Market risk, contd.

i) Exposure to currency risk

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

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)
Accounts payables			(293.119)		(782)			(5.515)	(299.416)
Trade receivables		27.324	588.749	10.696					626.769
Bank deposits	470	711.445	638.435	212	183	3.338	3.039	85	1.357.207
Aluminium derivatives			17.682.970						17.682.970
Swaps	(377.996)		(12.372)	370.589					(19.779)
Other financial assets			7.868.334						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 2012			7.539.896						7.539.896
Estim. Purch. in 2012		(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)

25. Risk management and financial instruments, contd.

b. Market risk, contd.

i) Exposure to currency risk, contd.

2010	CHF	EUR	USD	JPY	GBP	CAD	SEK	DKK	Total
Loans and borrowings	(41.746.713)	(75.620.884)	(37.772.740)	(21.949.837)	(7.078.811)	0	(13.548.619)	0	(197.717.605)
Accounts payables		(139.201)	(63.820)		(85)		(1.902)	(665)	(205.673)
Trade receivables			504.502						504.502
Bank deposits	55	474.769	669.812	79	998	347	7.867		1.153.928
Aluminium derivatives			20.411.105						20.411.105
Swaps	(538.046)			497.521					(40.525)
Other financial assets			7.184.527						7.184.527
Balance sheet risk	(41.746.657)	(75.285.316)	(9.066.614)	(21.949.758)	(7.077.898)	347	(13.542.654)	(665)	(168.709.740)
Estimated sale in 2011			6.853.028						6.853.028
Estim. Purch. in 2011		(1.385.737)	(30.098)	(853.697)				(536)	(2.270.068)
Balance sheet risk	0	(1.385.737)	6.822.930	(853.697)	0	0	0	(536)	4.582.960
Net risk	(41.746.657)	(76.671.053)	(2.243.683)	(22.803.455)	(7.077.898)	347	(13.542.654)	(1.201)	(164.126.780)

Sensitivity analysis

Strengthening by 10% of the Icelandic krona against the following currencies at year end 2011 would have increased (decreased) equity and profit or loss by the amounts shown below, taking into account tax effects.

	Profit or (loss)								
	CHF	EUR	USD	JPY	GBP	CAD	SEK	DKK	Total
The year 2011	2.840.155	4.245.545	807.472	1.476.434	471.867	(214)	762.934	348	10.604.541
The year 2010	2.706.221	4.818.260	580.263	1.372.943	452.985	(22)	866.730	43	10.797.423

This analysis assumes that all other variables, in particular interest rates, remain constant. The analysis was performed on the same basis for 2010. 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.

25. Risk management and financial instruments, contd.

b. *Market risk, contd.*

ii) Interest rate risk

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

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

Fixed rate instruments	**31.12. 2011**	**31.12. 2010**
Financial assets	7.886.757	7.337.821
Financial liabilities	41.570.434	28.229.743
	33.683.677	20.891.922
Variable rate instruments		
Financial liabilities	188.672.600	197.001.682
	188.672.600	197.001.682

Fair value sensitivity analysis for fixed rate instruments
The Group´s financial instruments with fixed rates are not accounted for at fair value through profit or loss, exept for a loan further discussed in note 16. Derivatives, i.e. currency swaps, are not designated as hedging instruments under a fair value hedge accounting model.

	Profit or (loss)	
The year 2011	**100 p increase**	**100 p decrease**
Fixed rate instruments	(222.376)	234.983
Cash flow sensitivity, net	(222.376)	234.983
The year 2010		
Fixed rate instruments	(243.544)	259.703
Cash flow sensitivity, net	(243.544)	259.703

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

	Profit or (loss)	
The year 2011	**100 p increase**	**100 p decrease**
Variable rate instruments	(1.194.255)	1.194.255
Cash flow sensitivity, net	(1.194.255)	1.194.255
The year 2010		
Variable rate instruments	(1.255.499)	1.255.499
Cash flow sensitivity, net	(1.255.499)	1.255.499

25. Risk management and financial instruments, contd.

b. *Market risk, contd.*

iii) Aluminium price risk

The Group has entered into electricity sales contracts where the sales price of electricity is based on among other things the world market price of aluminium. The Group has not hedged specifically against aluminium price changes. Revenue from the electricity sales contracts related to aluminium price level amounted to 19.1% in the year 2011 (2010: 20.4%) of the Group's total revenue for the year.

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

	Profit or (loss)	
	31.12. 2011	**2010**
Increase by 10%	6.915.302	6.797.375
Decrease by 10%	(6.941.107)	(6.827.243)

iv) Other market risk

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

c. *Liquidity risk*

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

The Group's cash and cash equivalents at year end amounted to ISK 1.7 billion. Furthermore, the Group had unused loan authorisations and a open credit line to the total amount of approx. ISK 5.9 billion. The Group had thus in total ensured capital at year end to the amount of approx. ISK 7.6 billion. In the beginning of 2012 a contract was signed for a credit line amounting to ISK 2 billion. The corresponding amount at year end 2010 amounted to ISK 8.3 billion.

In accordance with the action plan between the Company and its owners from 29 March 2011, the Company is to recieve a loan from it´s owners, amounting to ISK 12 billion, granted proportionally in conformity with their ownership. In this respect the Company received a loan amounting to ISK 8 billion in April this year and ISK 4 billion will be granted in the year 2013. The loans have a 15 year duration with the best terms the Municipality Credit Iceland Plc. offers. The loans are without repayment of the principal for the first five years.

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Financial Statements of Orkuveita Reykjavikur 2011 47 Amounts are in ISK thousand

25. Risk management and financial instruments, contd.

c. *Liquidity risk, contd.*

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

The year 2011

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	230.223.256	(264.177.326)	(18.557.103)	(32.346.083)	(61.363.182)	(151.910.958)
Accounts payable	1.627.619	(1.627.619)	(1.627.619)			
Other liabilities	2.410.329	(2.410.329)	(2.410.329)			
Derivative financial instruments						
Currency swaps	7.407	(6.841)	(4.886)	(1.955)		
Aluminium derivatives	12.372	(12.375)	(12.375)			
	234.280.983	(268.234.490)	(22.612.312)	(32.348.038)	(61.363.182)	(151.910.958)

The year 2010

Non-derivative financial instruments

	Carrying amount	Contractual cash flows	Less than 1 year	1 - 2 years	2 - 5 years	More than 5 years
Interest-bearing liabilities	225.190.900	(287.602.690)	(20.199.148)	(16.505.776)	(70.305.962)	(180.591.804)
Accounts payable	1.981.573	(1.981.573)	(1.981.573)			
Other liabilities	2.258.751	(2.258.751)	(2.258.751)			
Derivative financial instruments						
Currency swaps	40.525	(42.350)	(17.086)	(14.079)	(11.185)	0
	229.471.749	(291.885.364)	(24.456.558)	(16.519.855)	(70.317.147)	(180.591.804)

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

25. Risk management and financial instruments, contd.

d. *Credit risk*

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

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

	31.12. 2011	31.12. 2010
Trade receivable	4.227.536	3.661.642
Other current receivables	411.196	91.730
Other financial assets	7.886.757	7.337.821
Cash and cash equivalents	1.652.484	2.343.648
	14.177.973	13.434.840

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

Trade receivable, industrial consumers	537.146	451.120
Trade receivable, retail	3.690.390	3.210.522
	4.227.536	3.661.642

Impairment

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

	31.12. 2011		31.12. 2010	
	Gross balance	Allowance	Gross balance	Allowance
Not past due receivables	3.167.551	73.317	2.902.451	81.489
Past due, 1 to 30 days	870.132	30.514	141.469	7.004
Past due, 31 to 90 days	67.067	2.721	281.275	8.319
Past due, 91 days and older	402.036	172.698	636.928	203.669
	4.506.786	279.250	3.962.123	300.481

e. *Fair value*

Fair values versus carrying amounts

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

	31.12. 2011		31.12. 2010	
	Carrying amount	Fair value	Carrying amount	Fair value
Interest-bearing liabilities	(230.223.256)	(224.628.071)	(225.190.900)	(217.643.060)

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.

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25. Risk management and financial instruments, contd.

e. *Fair value, contd.*

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

	31.12. 2011	31.12. 2010
Embedded derivatives in electr. sales contr.	1.94% to 10.12%	1.68% to 7.74%
Other financial assets	6.63% to 7.11%	5.44% to 7.22%
Interest bearing loans	1.87% to 4.99%	1.54% to 5.57%

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

Level 1: Quoted prices (unadjusted) in active markets for identical assets og liabilities.
Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices).
Level 3: Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

31.12. 2011	Level 2	Level 3	Total
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

31.12. 2010	Level 2	Level 3	Total
Shares in companies	0	2.062.445	2.062.445
Embedded derivatives in sales contracts	0	20.411.105	20.411.105
Other financial assets	0	7.184.527	7.184.527
Other financial liabilities	(40.525)	0	(40.525)
	(40.525)	29.658.077	29.617.552

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

25. Risk management and financial instruments, contd.

f. *Overview of financial instruments*

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

	31.12. 2011			31.12. 2010		
	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			1.983.269			2.062.445
Embedd. electr. sales contracts ..		17.682.970			20.411.105	
Other financial assets	18.423	7.868.334		153.293	7.184.527	
Trade receivabl. .	4.227.536			3.661.642		
Other receivabl. ..	411.196			91.730		
Cash	1.652.484			2.343.648		
Interest-bearing .. liabilities	(230.223.256)			(225.190.900)		
Other financial liabilities		(19.779)			(40.525)	
Account payabl. .	(1.627.619)			(1.981.573)		
Other current liabilities	(2.410.329)			(2.258.751)		
	(227.951.565)	25.531.525	1.983.269	(223.180.911)	27.555.107	2.062.445

26. Statement of cash flows, details

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

	2011	2010
(Loss) profit for the year	(556.291)	13.728.669
Adjusted for:		
Financial income and expenses	19.656.314	(10.752.590)
Minority interest	20	117
Share of (loss) profit of associated companies	5.400	(24.308)
Income tax	(6.750.946)	3.036.718
Depreciation and amortisation	8.880.736	7.962.448
Profit from sale of assets and other changes	(143.338)	0
Retirement benefit obligation, change	19.387	(23.059)
Working capital from operation before interest and taxes	21.111.280	13.927.995
Inventories, decrease	135.236	241.395
Trade and other receivables, change	(899.899)	(46.098)
Payables and other current liabilities, change	227.900	781.942
Cash generated from operations before interests and taxes	20.574.517	14.905.234

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27. Related parties

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

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

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

Sale to related parties:	2011	2010
Reykjavik City	898.467	3.001.588
Institutions and companies controlled by Reykjavik City	256.930	501.275
Subsidiaries	470.432	545.007
Associates	12.534	21.944
Board members and key employees	0	71
	1.638.363	4.069.885
Purchases from related parties:		
Reykjavik City	22.050	27.212
Institutions and companies controlled by Reykjavik City	5.797	25.183
Subsidiaries	14.808	52.978
Associates	54.038	59.868
Board members and key employees	0	484
	96.694	165.724
Receivables for related parties:		
Reykjavik City	316.143	165.142
Institutions and companies controlled by Reykjavik City	34.094	3.164
Subsidiaries	76.930	26.999
Subsidiaries, interest bearing loans	6.623.659	6.229.505
Associates	0	1.380
	7.050.825	6.426.190
Payables for related parties:		
Reykjavik City	2.650	14.001
Institutions and companies controlled by Reykjavik City	120	162
Subsidiaries	339.156	1.042.259
Associates	0	114
	341.927	1.056.535
Interest bearing loans from owners of the parent Company:		
Reykjavik City	7.753.254	0
Akranes town	458.204	0
	8.211.458	0
Interest expense on loans from owners of the parent Company:		
Reykjavik City	234.042	0
Akranes town	13.831	0
	247.873	0

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

28. Group entities

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

			Share	
Subsidiaries	Main operation	Nominal value	31.12. 2011	31.12. 2010
Gagnaveita Reykjavíkur ehf.	Data transfer	4.736.841	100.0%	100.0%
Reykjavík Energy Invest ehf.	Investments	510.223	100.0%	100.0%
Úlfljótsvatn frítímabyggð ehf.	Preperation company	225.000	100.0%	100.0%
Hrafnabjargavirkjun	Preperation company	6.000	60.0%	60.0%

Main changes in the Group during the year
In August 2011 the share capital in Reykjavik Energy Invest ehf. (REI) was decreased by ISK 2.5 billion, or from ISK 3.005 million to ISK 510 million. The decrease was on one hand to level out REI´s deficit that amounted to ISK 1.5 billion and on the other hand to depreciate the mother company´s payment obligation amounting to ISK 1.0 million.

29. Other issues

Embedded derivatives in electricity sales contracts
Among the embedded derivatives are contracts with Norðurál-Grundartanga ehf. and Norðurál-Helguvík ehf. From 1 October Norðuál have reduced their orders of electricity based on these contracts, the reduction amounts to approximately ISK 655 million per year given the current price of aluminium and exchange rate. Orkuveita Reykjavíkur does not accept Norðurál´s interperation regarding this matter and objects to their reduction in payments and is therefore in a dispute with Norðurál.

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 Helguvik ehf. (NH). A review of energy sales contracts is ongoing with Norðurál. 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 concern contracts 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 11. Since uncertainty remains regarding investments, 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 interim financial statements regarding the matter at this point. The management is confident that solutions which should lower these costs considerably will be realised.
The contract with Jarðboranir regarding drilling for power plant projects has been terminated. The total cost of delay and termination of the contract amounted to ISK 692 million, but ISK 675 million were expensed in the financial statements for the year 2010 and ISK 18 million are expensed through P/L in the current reporting period.

Orkuveita Reykjavikur - Risk management
A new OR risk management policy was approved by the Board 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.

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Financial Statements of Orkuveita Reykjavikur 2011 53 Amounts are in ISK thousand

30. Other issues, contd.

Effect of fluctuations in foreign exchange rates and aluminium prices on the Company´s standing
16 March 2012, the day Orkuveita Reykjavíkur´s financial statements for the year 2011 were authorised for issue, the TWI is 228.4399 but was 217.1952 at the reporting date 31 December 2011. If interest bearing loans and borrowings would be accounted for according to the foreign exchange rates on 16 March 2012 they would have amounted to ISK 235.6 billion or ISK 7.4 billion higher than accounted for at the end of the accounting period. Embedded derivatives in sales contracts, when taken into consideration changes in aluminium price and currency exchange rates, would have amounted to ISK 23.3 billion on the reporting date or 5.6 billion higher than on the accounting date. Further information about the effect of changes in the exchange rates and aluminium prices can be found in note 25.

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

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