Orkuveita Reykjavíkur

Consolidated

Financial Statements 2008

Orkuveita Reykjavíkur
Bæjarhálsi 1
110 Reykjavík

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 consumptions. It also operates sewage systems and fibre-optic cable systems in its service area.

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

Loss on the operation of Orkuveita Reykjavíkur during the year 2008 amounted to ISK 73,037 million. According to the balance sheet the Company's assets amount to ISK 259,373 million, book value of equity at year end amounted to ISK 48,359 million and the Company's equity ratio is 18.6%.

The development of the ISK has been quite different in the period than were set forth in the financial schedules of the Company. This development causes significant increase in financial expenses during the period which consequently

Expectations for the currency index (TWI) in the budget for Orkuveita Reykjavíkur was 155 at year end 2008. This conclusion was drawn from economic research departments of the banks and public institutions in Iceland.

The TWI at year end was 216,3 but on 26 February 2009 the TWI was 187,0 If interest-bearing loans and borrowings are accounted for according to the TWI on 26 February 2009 they would amount to ISK 178.7 billion, i.e. ISK 27.1 billion lower than accounted for at year end 2008. Accordingly embedded derivatives in electricity sales contracts would amount to ISK 8.4 billion or ISK 0.7 billion lower than accounted for at year end 2008.

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

	Share
Reykjavíkurborg	93.539%
Akraneskaupstaður	5.528%
Borgarbyggð	0.933%

The Company's Board of Directors proposes that a dividend of ISK 800 million be paid to the Company's shareholders in the year 2009 due to the operating year 2008.

Statement by the Board of Directors and the Director

According to the best knowledge of the Board of Directors and the Managing Director of Orkuveita Reykjavíkur, the Company's financial statements are in accordance with International Financial Reporting Standards as adoped by the EU. It is the opinion of the Board of Directors and the Managing Director that the financial statements give a fair view of the Company's assets, liabilities and financial standing at year end 2008 and the Company's operating return and changes in cash and cash equivalents in the year 2008.

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

The Board of Directors and the Managing Director of Orkuveita Reykjavíkur hereby confirm the Company's financial statements for the year 2008.

Reykjavik, 27 February 2009.

The Board of Directors:

Guðlaugur G. Sverrisson
Gunnar Sigurðsson
Dagur B. Eggertsson
Dofri Hermannsson
Vigdís Hauksdóttir
Jórunn Frímannsdóttir

Managing Director:

Hjörleifur B. Kvaran

Independent Auditor´s Report

To the Board of Directors and owners of Orkuveita Reykjavíkur.

We have audited the accompanying financial statements of Orkuveita Reykjavíkur, which comprise the balance sheet as at 31 December 2008, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

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. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

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 relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of 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 judgement, 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 31 December 2008, 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.

Reykjavik, 27 February 2009.

KPMG hf.

Hlynur Sigurðsson

Auðunn Guðjónsson

Income Statement for the year 2008

	Notes	2008	2007
Operating revenue		24.168.198	21.363.792
Energy purchase		(4.363.581)	(4.220.409)
Salaries and salary related expenses	7	(3.973.674)	(3.320.260)
Other operating expenses		(4.179.325)	(3.908.736)
Depreciation and amortisation	8	(6.952.772)	(5.538.300)
Results from operating activities		4.698.846	4.376.087
Interest income		792.526	266.869
Interest expenses		(5.334.364)	(3.347.331)
Other (expenses) income on financial assets and liabilities		(87.981.638)	7.135.640
Total financial income and expenses	9	(92.523.476)	4.055.178
Share in (loss) of associated companies	13	(276.339)	(121.124)
(Loss) profit before income tax		(88.100.969)	8.310.141
Income tax	10	15.064.266	(1.794.317)
(Loss) profit for the year		(73.036.703)	6.515.824

Attributable to:

	2008	2007
Equity holders of the Company	(72.959.710)	6.508.956
Minority interest in subsidiaries	(76.993)	6.868
(Loss) profit for the year	(73.036.703)	6.515.824

The notes on pages 11 to 51 are an integral part of these Consolidated Financial Statements.

Financial Statements of Orkuveita Reykjavíkur 2008 5 Amounts are in ISK thousand

Balance Sheet 31 December 2008

	Notes	2008	2007
Assets			
Property, plant and equipment	11	226.970.432	162.416.937
Intangible assets	12	1.680.693	1.439.988
Investments in associated companies	13	574.470	831.339
Investments in other companies	14	10.026.011	9.923.322
Embedded derivatives in electricity sales contracts	15	9.091.449	7.341.316
Other financial assets	16	105.331	140.848
Deferred tax assets	17	4.169.441	190.443
Total non-current assets		252.617.827	182.284.193
Inventories	18	1.544.565	969.092
Trade receivables	19	3.292.480	2.750.350
Embedded derivatives in electricity sales contracts	15	0	812.988
Other financial assets	16	111.374	226.494
Other receivables	19	563.279	697.023
Cash and cash equivalents	20	1.243.639	3.751.013
Total current assets		6.755.337	9.206.960
Total assets		259.373.164	191.491.153

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31 December 2008

Equity	Notes	2008	2007
Revaluation reserve		55.842.384	23.374.919
(Accumulated deficit) retained earnings		(7.517.523)	65.490.687
Equity attributable to equity holders of the Company		48.324.860	88.865.606
Minority interest		33.770	122.764
Total equity		48.358.630	88.988.370
Liabilities			
Loans and borrowings	22	196.098.760	88.032.626
Retirement benefit obligation	23	456.027	395.338
Other financial liabilities	24	34.468	60.550
Deferred tax liabilities	17	0	4.716.084
Total non-current liabilities		196.589.255	93.204.598
Accounts payable	24	2.443.340	2.692.213
Loans and borrowings	22	9.681.610	4.608.003
Other financial liabilities	24	17.645	122.474
Current tax liabilities	17	218	11.169
Other current liabilities	24	2.282.466	1.864.326
Total current liabilities		14.425.279	9.298.185
Total liabilities		211.014.534	102.502.783
Total equity and liabilities		259.373.164	191.491.153

The notes on pages 11 to 51 are an integral part of these Consolidated Financial Statements.

Amounts are in ISK thousand

Statement of Equity for the year 2008

	Revaluation reserve	(Accumulated deficit) Retained earnings	Attributable to equity holders of the Company	Minority interest	Total equity
Year 2008					
Equity at 1 January 2008	23.374.919	65.490.687	88.865.606	122.764	88.988.370
Effect of change in tax rate	537.295		537.295		537.295
Revaluation	40.345.385		40.345.385		40.345.385
Income tax effect of revaluation	(6.895.739)		(6.895.739)		(6.895.739)
Solvence of revaluation due to depreciation	(1.519.476)	1.519.476	0		0
Loss for the year		(72.959.710)	(72.959.710)	(76.993)	(73.036.703)
Total recognised income and expense for the year	32.467.465	(71.440.234)	(38.972.769)	(76.993)	(39.049.762)
Other changes				(12.000)	(12.000)
Dividends paid		(1.567.976)	(1.567.976)		(1.567.976)
Equity at 31 December 2008	55.842.384	(7.517.523)	48.324.861	33.770	48.358.630
Year 2007					
Equity at 31 December 2006	8.731.162	57.823.705	66.554.867	115.896	66.670.763
Changes due to adoption of IFRS		2.687.759	2.687.759		2.687.759
Equity at 1 January 2007, IFRS	8.731.162	60.511.464	69.242.626	115.896	69.358.522
Revaluation	18.865.462		18.865.462		18.865.462
Income tax effect of revaluation	(4.221.705)		(4.221.705)		(4.221.705)
Profit for the year		6.508.956	6.508.956	6.868	6.515.824
Total recognised income and expense for the year	14.643.757	6.508.956	21.152.713	6.868	21.159.581
Dividends paid		(1.529.733)	(1.529.733)		(1.529.733)
Equity at 31 December 2007	23.374.919	65.490.687	88.865.606	122.764	88.988.370

The notes on pages 11 to 51 are an integral part of these Consolidated Financial Statements.

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Statement of Cash Flows for the year 2008

	Notes	2008	2007
Cash flows from operating activities			
Cash generated from operations before interest and taxes	26	9.813.640	9.530.469
Received interest income		763.308	223.874
Paid interest expenses		(3.424.224)	(2.680.243)
Dividend received		101.615	0
Paid due to other financial income and expenses		444.184	350.529
Net cash from operating activities		7.698.523	7.424.629
Cash flows from investing activities			
Acquisition of property, plant and equipment		(30.938.902)	(21.257.849)
Acquisition of intangible assets		(345.652)	(211.927)
Proceeds from sale of property, plant and equipment		0	912.987
Acquisition of associated companies		(707.494)	(602.662)
Acquisition of other companies		(468.013)	(8.908.724)
Proceeds from sale of other assets		87.549	120.940
Net cash used in investing activities		(32.372.512)	(29.947.235)
Cash flows from financing activities			
Proceeds from new borrowings		15.275.025	31.308.399
Repayment of borrowings		(3.636.999)	(4.329.977)
Dividends paid		(1.567.976)	(1.529.733)
Credit facility, change		9.958.393	(104.794)
Current liabilities, increase		1.456.560	706.571
Net cash from financing activities		21.485.003	26.050.466
(Decrease) increase in cash and cash equivalents		(3.188.686)	3.527.859
Cash and cash equivalents at year beginning		3.751.013	253.171
Effect of currency fluctuations on cash and cash equiv.		681.612	(30.017)
Cash and cash equivalents at year end		1.243.639	3.751.013
Investments and financing without payment effects:			
Acquisition of property, plant and equipment		(987.713)	(871.622)
Acquisition of other companies		0	(654.161)
Proceeds from sale of property, plant and equipment		0	553.000
Other financial assets, change		0	(553.000)
Current liabilities, increase		987.713	1.525.783
Other information:			
Working capital from operation		7.982.781	7.415.843

The notes on pages 11 to 51 are an integral part of these Consolidated Financial Statements.

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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 Group") and a share in associated companies.

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

2. Basis of preparation

a. ***Statement of compliance***

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

The financial statements were approved by the Board of Directors on 27 February 2009.

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 was revalued at fair value.
- derivative agreements are stated at fair value.
- financial instruments at fair value through profit and loss are stated at fair value.
- Assets held for sale 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 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 electric power sale contracts
- Note 17 - Deferred tax assets and liabilities
- Note 23 - Retirement benefit obligations
- Note 29 - Other issues

Notes

3. **Significant accounting policies**

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by Group entities. Certain comparative amounts have been reclassified in notes 11, 12 and 15.

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 ransactions, 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.

3. Significant accounting policies, contd.

c) ***Financial instruments***

(i) Non-derivative financial instruments

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

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

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

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

Cash and cash equivalents comprise cash balances and call deposits.

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

Held-to-maturity investments

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

Available-for-sale financial assets

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

Financial assets at fair value through profit or loss

An instrument is classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial instruments are designated at fair value through profit or loss if purchase and sale decisions are based on their fair value. Financial instruments at fair value through profit or loss are measured at fair value, and changes therein are recognised in profit or loss. Direct transaction cost is recognised in the income statement as it is incurred.

Other

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

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

c) ***Financial instruments, contd.***

(ii) Derivative financial instruments

The Group holds derivative financial instruments to hedge against foreign currency, interest rate and aluminium pric risk exposures. 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.

Financial hedges

The Company uses derivatives to limit interest rate risk. Hedge accounting is not applied. Fair value changes in such derivatives are recognised in the income statement.

Economic hedges

Hedge accounting is not applied to derivative instruments that economically hedge monetary assets and liabilities denominated in foreign currencies. Changes in the fair value of such derivatives are recognised in the income statement as part of foreign currency gains and losses.

Other embedded derivatives

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

d) ***Property, plant and equipment***

(i) Recognition and measurement

Items of property, plant and equipment, excepting distribution and production 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.

Notes

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

d) ***Property, plant and equipment, contd.***

The Group's distribution and production systems, with the exeption of the 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	5-50 years
Heating distribution systems	7-50 years
Cold water distribution systems	5-50 years
Sewer distribution system	15-50 years
Fibre-optic distribution system	7-25 years
Other real estates	17-50 years
Other equipment	3-20 years

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

e) ***Intangible assets***

(i) 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 cost

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.

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3. Significant accounting policies, contd.

e) ***Intangible assets, contd.***

(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	5-10 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.

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.

3. Significant accounting policies, contd.

h) ***Impairment, contd.***

(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.

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.

i) ***Employee benefits***

(i) Defined contribution plans

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

(ii) Defined benefit plans

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

j) ***Obligations***

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

k) ***Revenue***

Revenue from the sale of electricity and water, together with transport and distribution of electricity is recognised in the income statement according to measured delivery to purchasers during the period. Other revenue is recognised when generated or upon delivery of good or services.

Upon connection of new users to distribution systems 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.

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 usefule 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.

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 23,5%, 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

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.

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.

Notes

3. Significant accounting policies, contd.

p) ***New standards and interpretations effective in 2008***

IFRIC 11 IFRS 2—*Group and Treasury Share Transactions* and IFRIC 14 IAS 19—*The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction* became mandatory for the Group's 2008 financial statements but their adoption had no impact on the Group's 2008 financial statements.

q) ***New standards and interpretations not yet adopted***

A number of new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2008, and have not been applied in preparing these consolidated financial statements:

IFRS 8 *Operating Segments* introduces the "management approach" to segment reporting. IFRS 8, which becomes mandatory for the Group's 2009 consolidated financial statements, will require a change in the presentation and disclosure of segment information based on the internal reports regularly reviewed by the Group's Chief Operating Decision Maker in order to assess each segment's performance and to allocate resources to them. Currently the Group presents segment information in respect of its sectors and divisional segments (see note 5). IFRS 8 will be complied with by the Group in the year 2009.

Revised IAS 1 *Presentation of Financial Statements* (2007) introduces the term total comprehensive income, which represents changes in equity during a period other than those changes resulting from transactions with owners in their capacity as owners. Total comprehensive income may be presented in either a single statement of comprehensive income (effectively combining both the income statement and all non-owner changes in equity in a single statement), or in an income statement and a separate statement of comprehensive income. Revised IAS 1, which becomes mandatory for the Group's 2009 consolidated financial statements, is expected to have a significant impact on the presentation of the consolidated financial statements. The Group plans to provide total comprehensive income in a single statement of comprehensive income for its 2009 consolidated financial statements.

Revised IAS 23 *Borrowing Costs* removes the option to expense borrowing costs and requires that an entity capitalise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. The revised IAS 23 will become mandatory for the Group's 2009 consolidated financial statements and will constitute a change in accounting policy for the Group. In accordance with the transitional provisions, the Group will apply the revised IAS 23 to qualifying assets for which capitalisation of borrowing costs commences on or after the effective date. Therefore there will be no impact on prior periods in the Group's 2009 consolidated financial statements.

Revised IFRS 3 *Business Combinations* (2008) incorporates the following changes that are likely to be relevant to the Group's operations:

– The definition of a business has been broadened, which is likely to result in more acquisitions being treated as business combinations.

– Contingent consideration will be measured at fair value, with subsequent changes therein recognised in profit or loss.

– Transaction costs, other than share and debt issue costs, will be expensed as incurred.

– Any pre-existing interest in the acquiree will be measured at fair value with the gain or loss recognised in profit or loss.

– Any non-controlling (minority) interest will be measured at either fair value, or at its proportionate interest in the identifiable assets and liabilities of the acquiree, on a transaction-by-transaction basis.

Revised IFRS 3, which becomes mandatory for the Group's 2010 consolidated financial statements if endorsed by the EU, will be applied prospectively and therefore there will be no impact on prior periods in the Group's 2010 consolidated financial statements.

Notes

3. Significant accounting policies, contd.

q) ***New standards and interpretations not yet adopted, contd.***

Amended IAS 27 *Consolidated and Separate Financial Statements* (2008) requires accounting for changes in ownership interests by the Group in a subsidiary, while maintaining control, to be recognised as an equity transaction. When the Group loses control of a subsidiary, any interest retained in the former subsidiary will be measured at fair value with the gain or loss recognised in profit or loss. The amendments to IAS 27, which become mandatory for the Group's 2010 consolidated financial statements if endorsed by the EU, are not expected to have a significant impact on the consolidated financial statements.

Amendment to IFRS 2 *Share-based Payment – Vesting Conditions and Cancellations* clarifies the definition of vesting conditions, introduces the concept of non-vesting conditions, requires non-vesting conditions to be reflected in grant-date fair value and provides the accounting treatment for non-vesting conditions and cancellations. The amendments to IFRS 2 will become mandatory for the Group's 2009 consolidated financial statements, with retrospective application. The Group has not yet determined the potential effect of the amendment.

Amendments to IAS 32 *Financial Instruments: Presentation* and IAS 1 *Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation* requires puttable instruments, and instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation, to be classified as equity if certain conditions are met. The amendments, which become mandatory for the Group's 2009 consolidated financial statements if endorsed by the EU, with retrospective application required, are not expected to have any impact on the consolidated financial statements.

Amendments to IAS 39 *Financial Instruments: Recognition and Measurement – Eligible Hedged Items* clarifies the application of existing principles that determine whether specific risks or portions of cash flows are eligible for designation in a hedging relationship. The amendments will become mandatory for the Group's 2010 consolidated financial statements if endorsed by the EU, with retrospective application required. The amendments are not expected to have any impact on the consolidated financial statements.

The International Accounting Standards Board made certain amendments to existing standards as part of its first annual improvement project. The effective dates for these amendments vary by standard and most will be applicable to the Group's 2009 consolidated financial statements if endorsed by the EU. The Group does not expect these amendments to have any significant impact on the consolidated financial statements.

IFRIC 13 *Customer Loyalty Programmes* addresses the accounting by entities that operate, or otherwise participate in, customer loyalty programmes under which the customer can redeem credits for awards such as free or discounted goods or services. IFRIC 13, which becomes mandatory for the Group's 2009 consolidated financial statements, is not expected to have any impact on the consolidated financial statements.

IFRIC 15 *Agreements for the Construction of Real Estate* applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors. IFRIC 15, which becomes mandatory for the Group's 2009 consolidated financial statements if endorsed by the EU, is not expected to have any impact on the consolidated financial statements.

IFRIC 16 *Hedges of a Net Investment in a Foreign Operation* clarifies that:
– net investment hedging can be applied only to foreign exchange differences arising between the functional currency of a foreign operation and the parent entity's functional currency and only in an amount equal to or less than the net assets of the foreign operation
– the hedging instrument may be held by any entity within the group except the foreign operation that is being hedged
– on disposal of a hedged operation, the cumulative gain or loss on the hedging instrument that was determined to be effective is reclassified to profit or loss.

Notes

3. Significant accounting policies, contd.

q) ***New standards and interpretations not yet adopted, contd.***

The Interpretation allows an entity that uses the step-by-step method of consolidation an accounting policy choice to determine the cumulative currency translation adjustment that is reclassified to profit or loss on disposal of a net investment as if the direct method of consolidation had been used. IFRIC 16, which becomes mandatory for the Group's 2009 consolidated financial statements if endorsed by the EU, applies prospectively to the Group's existing hedge relationships and net investments. The Interpretation is not expected to have any impact on the consolidated financial statements.

IFRIC 17 *Distributions of Non-cash Assets to Owners* provides guidance on when and how a liability for certain distributions of non-cash assets to owners acting in their capacity as owners is recognised and measured, and how to account for settlement of that liability. IFRIC 17, which becomes mandatory for the Group's 2010 consolidated financial statements if endorsed by the EU, is not expected to have any impact on the consolidated financial statements

IFRIC 18 *Transfers of Assets from Customers* addresses the accounting for transfers of certain assets by entities that receive such transfers from their customers. If endorsed by the EU, IFRIC 18 applies prospectively to transfer of assets from customers received on or after 1 July 2009. The Interpretation is not expected to have any impact on the consolidated financial statements.

One interpretation, IFRIC 12 *Service Concession Arrangements*, is effective for the year ended 31 December 2008 but it has not been applied in preparing these consolidated financial statements because it has not yet been endorsed by the EU. IFRIC 12 provides guidance on certain recognition and measurement issues that arise in accounting for public-to-private service concession arrangements. The application of IFRIC 12, if endorsed by EU, is not expected to have any effect on the consolidated financial statements.

4. Determination of fair values

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

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

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

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

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

Notes

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

b. ***Intangible assets***

The fair value of intangible assets is based on the discounted cash flows expected to be derived from the use of the assets.

c. ***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.

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

The fair value of trade and other receivables is estimated as the present value of future cash flow, discounted at market rate of interest at the reporting date.

e. ***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.

f. ***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.

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 production, distribution 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 - divisons

	Production	Distribution	Sale	Other operation	Adjust-ments	Total
Year 2008						
External revenue	3.887.571	6.149.917	13.327.114	803.596	0	24.168.198
Inter-segment revenue	3.764.712	6.109.800	511.156	1.265.631	(11.651.299)	0
Total segment revenue	7.652.283	12.259.717	13.838.270	2.069.227	(11.651.299)	24.168.198
Segment result	926.031	4.059.985	851.673	(282.082)	0	5.555.607
Unallocated expenses						(856.761)
Results from operating activities						4.698.846
Financial income and expenses						(92.523.476)
Share of loss of associated companies						(276.339)
Income tax						15.064.266
(Loss) for the year						(73.036.703)
Year 2007						
External revenue	2.611.761	5.137.813	12.330.413	1.283.805	0	21.363.792
Inter-segment revenue	3.194.446	4.166.462	679.753	946.798	(8.987.459)	0
Total segment revenue	5.806.207	9.304.275	13.010.166	2.230.603	(8.987.459)	21.363.792
Segment result	933.955	1.918.608	2.275.556	181.138	0	5.309.257
Unallocated expenses						(933.170)
Results from operating activities						4.376.087
Financial income and expenses						4.055.178
Share of loss of associated companies						(121.124)
Income tax						(1.794.317)
Profit for the year						6.515.824

Amounts are in ISK thousand

5. Segment reporting, contd.

Business segments - divisons, contd.

	Production	Distribution	Sale	Other operation	Unallocated	Total
Year 2008						
Balance sheet: (31.12.2008)						
Property, plant and equipment .	117.845.312	99.886.587	41.725	448.305	8.748.503	226.970.432
Intangible assets	0	0	0	193.619	1.487.074	1.680.693
Shares in associates						574.470
Other unallocated assets						30.147.569
Total assets						259.373.164
Unallocated liabilities						211.014.534
Investments:						
Property, plant and equipment .	22.466.171	7.478.421	0	116.601	994.742	31.055.935
Intangible assets	0	0	0	128.731	216.920	345.651
Depreciation, amortization:						
Property, plant and equipment .	3.106.680	3.225.572	4.438	62	464.243	6.800.995
Intangible assets	0	0	0	0	151.777	151.777
Year 2007						
Property, plant and equipment .	77.251.497	76.542.354	46.163	375.272	8.201.651	162.416.937
Intangible assets	0	0	0	64.888	1.375.100	1.439.988
Shares in associates						831.339
Other unallocated assets						26.802.889
Total assets						191.491.153
Unallocated liabilities						102.502.783
Investments:						
Property, plant and equipment .	14.670.468	5.750.667	4.504	93.956	749.769	21.269.364
Intangible assets	0	0	0	64.888	156.925	221.813
Depreciation, amortization:						
Property, plant and equipment .	2.013.789	2.921.166	25.460	128	428.108	5.388.651
Intangible assets	0	0	0	0	149.649	149.649

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Notes

5. Segment reporting, contd.

Business segments - sectors

	Electricity	Hot water	Cold water	Sewer	Fibre-optic cable system	Adjust-ments	Total
Year 2008							
Income:							
External revenues	12.358.438	6.454.119	2.038.898	2.647.284	669.459	0	24.168.198
Inter-segment revenue	1.461.849	582.818	110.289	143.198		(2.298.154)	0
Total segment revenue	13.820.287	7.036.937	2.149.187	2.790.482	669.459	(2.298.154)	24.168.198
Assets (31.12.2008):							
Property, plant and equi .	113.379.586	52.682.272	17.755.777	35.568.377	7.584.420	0	226.970.432
Intangible assets	785.175	541.594	117.479	236.445	0	0	1.680.693
Unallocated assets							30.722.039
Total assets							259.373.164
Investments							
Property, plant and equi .	22.180.080	4.700.653	805.867	1.836.841	1.532.494	0	31.055.935
Intangible assets	109.327	181.877	18.221	36.226	0	0	345.651
Depreciation, amortization:							
Property, plant and equi ..	2.644.081	2.209.678	510.039	1.071.620	365.577	0	6.800.995
Intangible assets	65.298	44.274	13.206	28.999	0	0	151.777
Year 2007							
Income:							
External revenues	10.710.522	5.812.136	2.010.646	2.275.115	555.373	0	21.363.792
Inter-segment revenue	1.256.070	617.005	101.114	114.423	0	(2.088.612)	0
Total segment revenue	11.966.592	6.429.141	2.111.760	2.389.538	555.373	(2.088.612)	21.363.792
Assets (31.12.2007):							
Property, plant and equi .	73.002.300	41.466.271	13.997.831	27.533.032	6.417.503	0	162.416.937
Intangible assets	653.282	386.878	133.762	266.066	0	0	1.439.988
Unallocated assets							27.634.228
Total assets							191.491.153
Investments							
Property, plant and equi .	14.354.830	3.634.085	687.192	1.231.172	1.362.085	0	21.269.364
Intangible assets	68.447	107.274	15.185	30.907	0	0	221.813
Depreciation, amortization:							
Property, plant and equi ..	1.913.424	1.628.055	480.599	1.053.642	312.931	0	5.388.651
Intangible assets	49.386	51.125	15.575	33.563	0	0	149.649

Amounts are in ISK thousand

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 2008	Hot water 2008	Electricity 2007	Hot water 2007
Power plant of Nesjavellir				
Revenue	1.983.898	826.064	1.900.979	772.564
Operating expenses	(570.275)	(516.153)	(425.399)	(533.698)
Depreciation	(659.410)	(342.896)	(524.030)	(268.278)
Calculated financing cost (5.5%)	(559.725)	(278.065)	(469.209)	(226.146)
Return	194.488	(311.051)	482.341	(255.557)

Power plant of Hellisheiði

The Company has initiated delivery of electricity from the power plant of Hellisheiði, but delivery of hot water from the plant has not yet begun.

7. Salaries and salary related expenses

Salaries and salary related expenses are specified as follows:	2008	2007
Salaries	3.913.769	3.388.945
Defined contribution pension expenses	512.601	443.072
Defined benefit pension expenses	86.152	55.735
Salary related expenses	297.027	254.506
Total salaries and salary related expenses	4.809.549	4.142.258

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

Expensed in the income statement	3.973.674	3.320.260
Capitalised on projects	835.875	821.998
Total salaries and salary related expenses	4.809.549	4.142.258

Number of employees:

Number of annual working units	689	662

Management's salaries and benefits:

Salaries of the parent company's Board of Directors	15.174	15.486
Salaries of the Boards of Directors of subsidiaries	10.847	11.152
Salaries of Director of the parent company	27.719	27.380
Salaries of four Managing Directors of the parent company (five parties 2007)	73.804	82.327
Salaries of the Director and 2 Managing Directors of subsidiaries	40.191	30.452
Defined contribution pension expenses	27.814	25.322
Termination expenses, pension expenses included	42.118	0
	237.667	192.119

Included in salaries are car benefits.

Gudmundur Thoroddsson left his position as CEO of the company during the year 2008. Expenses due to the termination of his employment, salary related expenses included, were all expensed upon his departure from the

Directors´ of the parent company were reduced by one.

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Notes

8. Depreciation and amortisation

Depreciation and amortisation is specified as follows:

Depreciation of property, plant and equipment, cf. note 11	6.800.995	5.388.651
Amortisation of intangible assets, cf. note 12	151.777	149.649
Depreciation and amortisation recognised in the income statement	6.952.772	5.538.300

9. Financial income and expenses

Financial income and expenses are specified as follows:

	2008	2007
Interest income	792.526	266.869
Interest expenses	(5.034.238)	(3.193.223)
Guarantee fee to owners	(300.126)	(154.108)
Total interest expenses	(5.334.364)	(3.347.331)
Fair value changes of embedded derivatives in electricity sales contracts	937.145	4.454.314
Fair value changes of shares in other companies	(331.695)	102.003
Foreign exchange difference and forward currency swaps	(88.688.704)	2.580.261
Dividends	101.615	0
Loss on sale of shares in companies	0	(938)
Total of other income (expenses) on financial assets and liabilities	(87.981.639)	7.135.640
Total financial income and expenses	(92.523.477)	4.055.178

Financing cost due to construction of a power plant to the amount of ISK 2,685.7 million is capitalised and has been recognised as reduction of financial expenses (31.12.2007: ISK 309.7 million).

Capitalized finance cost 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. The average of monthly REIBOR fixings during 2008 is used, the average is 15.87%. A margin that reflects the Group's terms from the Icelandic banks during 2008 is added, this margin is 0.60%. In addition the Group's owners guaranty fee of 0.25% is added, in total the interest rate is 16,72%. The difference this year from last years is that capitalized finance cost was calculated based on the average interest rates of the Group's debt portfolio where the basis was the latest fixings with

Interest expenses, charged in the income statement	(5.334.364)	(3.347.331)
Capitalised finance cost	(2.685.659)	(309.669)
Interest expenses	(8.020.023)	(3.657.000)

Generally accepted valuation methods are used to determine the fair value of certain financial assets and financial liabilities. Change in fair value that is recognised in the income statement amounts to revenue of ISK 937 million. (2007: ISK 4,454 million)

Amounts are in ISK thousand

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.

In May 2008 the Icelandic Parliament approved a decrease in the income tax rate from 26% to 23.5% as of 1 January 2008 for partnerships. At the same time the income tax rate for limited companies decreased from 18% to 15%. The effect of this at the beginning of the year amounted to ISK 98 million and the decrease is recognised in the income statement.

Income tax recognised in the income statement is specified as follows:

	2008	2007
Current income tax	218	11.169
Change in deferred income tax	(15.064.484)	1.783.148
Income tax recognised in the income statement	(15.064.266)	1.794.317

Reconciliation of effective tax rate:		2008		2007
Profit (loss) before income tax		(88.100.969)		8.310.140
Income tax according to current tax ratio	23.5%	(20.703.728)	26.0%	2.160.636
Effect of change in tax rate	(0.1%)	98.329	0.0%	0
Non-taxable operation of water supply and sewer	(5.6%)	4.890.069	(3.1%)	(253.974)
Effect of various tax rates in the Group	(0.4%)	378.436	0.0%	0
Other items	(0.3%)	272.628	(1.4%)	(112.345)
Effective income tax	(17.1%)	(15.064.266)	21.6%	1.794.317

11. Property, plant and equipment

Property, plant and equipment is specified as follows:

	Production system	Distribution system	Other real estates	Other equipments	Total
Year 2008					
Cost or deemed cost					
Balance at year beginning	112.503.139	138.979.119	7.508.660	4.589.086	263.580.004
Reclassification of assets	272.626	(116.328)	(42.958)	(475.114)	(361.774)
Additions during the year	22.755.532	7.189.060	817.439	293.904	31.055.935
Revaluation	29.325.471	38.744.174	0	0	68.069.645
Balance at year end	164.856.768	184.796.025	8.283.141	4.407.876	362.343.810
Depreciation					
Balance at year beginning	34.657.781	63.034.380	1.207.577	2.263.329	101.163.067
Reclassification of assets	91.051	34.849	(770)	(440.075)	(314.945)
Depreciated during the year	3.207.411	3.174.612	185.011	233.961	6.800.995
Revaluation	8.225.299	19.498.962	0	0	27.724.261
Balance at year end	46.181.542	85.742.803	1.391.818	2.057.215	135.373.378
Carrying amounts					
At 1.1.2008	77.845.358	75.944.739	6.301.083	2.325.757	162.416.937
At 31.12.2008	118.675.226	99.053.223	6.891.323	2.350.661	226.970.433
Thereof ass. in constr. at year end	12.389.190	0	0	0	12.389.190

Amounts are in ISK thousand

Notes

11. Property, plant and equipment, contd.

Year 2007

Cost or deemed cost					
Balance at year beginning	75.661.692	127.517.196	7.197.529	4.246.748	214.623.165
Reclassification of assets	316.423	(421.864)	(3.584)	109.025	0
Additions during the year	15.049.991	5.671.345	314.715	233.313	21.269.364
Sold and disposed in the year	(646.876)	(1.474.000)	0	0	(2.120.876)
Revaluation	22.121.909	7.686.442	0	0	29.808.351
Balance at year end	112.503.139	138.979.119	7.508.660	4.589.086	263.580.004
Depreciation					
Balance at year beginning	25.380.305	57.352.782	1.041.275	1.925.861	85.700.223
Reclassification of assets	52.370	(154.307)	(3.772)	105.709	0
Depreciated during the year	2.090.770	2.896.048	170.074	231.759	5.388.651
Sold and disposed in the year	(128.182)	(740.514)	0	0	(868.696)
Revaluation	7.262.518	3.680.371	0	0	10.942.889
Balance at year end	34.657.781	63.034.380	1.207.577	2.263.329	101.163.067
Carrying amounts					
At 1.1.2007	50.281.387	70.164.414	6.156.254	2.320.887	128.922.942
At 31.12.2007	77.845.358	75.944.739	6.301.083	2.325.757	162.416.937
Thereof ass. in constr. at year end	11.004.598	0	0	0	11.004.598

Revaluation

At year end 2008, a revaluation was made on heating, electricity and water supply distribution systems and sewer systems. The revaluation lead to an increase in the carrying amount of those assets to the amount of ISK 19,245 million. At year end 2006 and 2007, this revaluation was also performed and lead to an increase in the carrying amount of those assets to the amount of ISK 14,103 million.

At year end 2007, a revaluation was made on the Group's production systems, which included assets used in the production of electricity, hot and cold water. The revaluation lead to an increase in the carrying amount of those assets to the amount of ISK 14,859 million. This revaluation was done again on 1 Oktober 2008 and lead to an increase in the carrying amount of these assets to the amount of ISK 21.100 million.

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

The fair value of production assets is determined on the basis of the depreciated replacement cost. This consists in that an assessment is made on changes in the construction cost of comparable assets and both cost and accumulated depreciations are revalued in accordance with those changes. The calculation is based on official information and real numbers from the Group's books on value changes of cost 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 same method is applied in the determination of the fair value of distribution systems, accounted at fair value. Revalued distribution systems are used in operations subject to special licence and income limits are primarily based on changes in the building cost index. This is also taken into account when determining the fair value.

Impairment tests were performed at year end in order to confirm that revaluation of assets would meet estimated future cash flows of these assets. Further explanation on impairment test is in note 3 (h).

Financial Statements of Orkuveita Reykjavíkur 2008 29 Amounts are in ISK thousand

Notes

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

Information on revalued assets at year end

Year 2008	Production system	Distribution system	Total
Revalued carrying amount	118.675.226	99.053.223	217.728.449
Thereof effect of a revaluation	(35.174.481)	(32.300.196)	(67.474.677)
Carrying amount before effect of revaluation	83.500.745	66.753.027	150.253.772

Year 2007			
Revalued carrying amount	77.845.358	75.944.739	153.790.097
Thereof effect of a revaluation	(14.863.872)	(13.615.497)	(28.479.369)
Carrying amount before effect of revaluation	62.981.486	62.329.242	125.310.728

Rateable value and insurance value

The rateable value of the Group's assets measured in the rateable value assessment amounted to ISK 27,976 million at year end 2008 (31.12.2007: ISK 24,842 million). The fire insurance value of the Group's assets amounted to ISK 29,037 million at the same time (31.12.2007: ISK 24,423 million). Among those assets are real estaes 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 years 2010 and later. The contract and other contracts regarding developments at Hellisheiði amount to ISK 35.5 billion as per exchange rate at the end of the period. 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 31 December 2008 is estimated at ISK 1.9 billion.

12. ## Intangible assets

Intangible assets are specified as follows:

Year 2008	Heating rights	Preparation cost	Software	Total
Cost				
Balance at year beginning	1.427.031	64.888	1.107.268	2.599.187
Reclassification of assets	0	0	422.025	422.025
Additions during the year	0	128.732	216.921	345.653
Balance at year end	1.427.031	193.620	1.746.214	3.366.865
Amortisation				
Balance at year beginning	390.881	0	768.318	1.159.199
Reclassification of assets	0	0	375.195	375.195
Amortisation for the year	19.793	0	131.984	151.777
Balance at year end	410.674	0	1.275.497	1.686.171
Carrying amounts				
At 1.1.2008	1.036.150	64.888	338.950	1.439.988
At 31.12.2008	1.016.357	193.620	470.717	1.680.694

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Notes

12. Intangible assets, contd.

Year 2007

Cost				
Balance at year beginning	1.417.145	0	960.229	2.377.374
Additions during the year	9.886	64.888	147.039	221.813
Balance at year end	1.427.031	64.888	1.107.268	2.599.187
Amortisation				
Balance at year beginning	371.276	0	638.274	1.009.550
Amortisation for the year	19.605	0	130.044	149.649
Balance at year end	390.881	0	768.318	1.159.199
Carrying amounts				
At 1.1.2007	1.045.869	0	321.955	1.367.824
At 31.12.2007	1.036.150	64.888	338.950	1.439.988

Heating rights have been separated from land in the financial statements. The effect is that heating rights are now accounted for as intangible assets but were part of property, plant and equipment. Amounts for comparison have been adjusted accordingly.

13. Investments in associated companies

Investments in associated companies are specified as follows:

	2008		2007	
	Share	Carrying amount	Share	Carrying amount
Enex hf.	26.4%	372.389	26.4%	638.938
Enex-Kína ehf.	33.3%	156.706	33.3%	97.941
Biliran Geothermal Inc.	0.0%	0	50.0%	33.863
Envent Holdings ehf.	50.0%	325	50.0%	325
Vistorka ehf.	35.6%	10.532	35.6%	29.625
Metan hf.	35.4%	9.291	35.4%	9.291
Netorka hf.	22.6%	25.227	22.6%	21.356
Total		574.470		831.339

The Group's share in the loss of its associated companies amounted to ISK 276.3 million in the year 2008, compared to loss of ISK 121.1 million in the year 2007.

14. Investments in other companies

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

	2008	2007
Investments at fair value throug profit or loss	294.909	593.938
Financial assets available for sale	9.731.102	9.329.384
Other shares in companies	10.026.011	9.923.322

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.

Financial Statements of Orkuveita Reykjavíkur 2008 Amounts are in ISK thousand

15. Embedded derivatives in electricity sales contracts

Four electricity sales contracts have been made to 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. 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. Due to uncertainties and an indication that CRU will revise their expectations, their forecast since October 2008 on aluminium prices has been lowered by USD 400 per metric ton. This change in assumptions amounts to ISK 4,325 million. From the expected net present value of cash flow of the contract on the accounting date the expected net present value based on premises on aluminium price on the initial date of the contract is deducted. The difference is the fair value change of the derivative. The valuation is based on the premises that the derivative has no value at the initial date of the contract.

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

The fair value of embedded derivatives due to electricity sales contracts, which have not yet been executed and that are uncertain, is calculated in the same way. Their fair value amounts to a total of ISK 8,257 million at year end 2008 (2007: ISK 2,885 million) and is not recognised in the financial statements.

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

	2008	2007
Fair value of embedded derivatives at the beginning of the year	8.154.304	3.699.990
Fair value changes during the year	937.145	4.454.314
Fair value of embedded derivatives at year end	9.091.449	8.154.304

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

	2008	2007
Non-Current embedded derivatives	9.412.328	7.341.316
Current emedded derivatives	(320.879)	812.988
Total embedded derivatives	9.091.449	8.154.304

16. Other financial assets

Non-current assets

	2008	2007
Financial assets at fair value through profit or loss		
Currency swaps	0	27.582
Bonds and other long term receivables		
Bonds	105.331	113.266
	105.331	140.848

Current assets

	2008	2007
Financial assets at fair value through profit or loss		
Currency swaps	0	152.995
Bonds and other receivables		
Bonds	111.374	73.499
	111.374	226.494

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17. Deferred tax assets and liabilities

Deferred tax assets and liabilities is specified as follows:

Year 2008	Tax assets	Tax liabilities	Net amount
Deferred tax assets/liabilities at the beginning of the year	190.443	4.716.084	(4.525.641)
Effect of change in income tax rate	0	(537.295)	537.295
Effects of a revaluation of non-current assets	(6.895.739)	0	(6.895.739)
Calculated income tax for the year	10.874.518	(4.189.747)	15.064.265
Current tax liabilities	218	0	218
Other changes	0	10.959	(10.959)
Deferred tax assets/liabilities at year end	4.169.440	0	4.169.440

Year 2007	Tax assets	Tax liabilities	Net amount
Deferred tax assets/liabilities at the beginning of the year	1.480.889	0	1.480.889
Effects of a revaluation of non-current assets	0	4.221.705	(4.221.705)
Calculated income tax for the year	(1.290.446)	503.871	(1.794.317)
Current tax liabilities	0	(11.169)	11.169
Other changes	0	1.677	(1.677)
Deferred tax assets/liabilities at year end	190.443	4.716.084	(4.525.641)

Deferred tax assets and liabilities are attributable to the flollowing:

	2008		2007	
	Tax assets	Tax liabilities	Tax assets	Tax liabilities
Property, plant and equipment	(11.085.420)	0	156.362	3.845.752
Embedded derivatives	(2.136.491)	0	0	2.120.119
Other items	171.992	0	5.841	(140.765)
Effect of carry forward taxable loss	17.219.360	0	28.240	(1.109.022)
Deferred tax assets/liabilities at year end	4.169.441	0	190.443	4.716.084

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:

	2008	2007
Unadjusted taxable loss for the year 2006, usable until year 2016	4.374.086	4.374.086
Unadjusted taxable loss for the year 2008, usable until year 2018	69.798.545	0
Carry forwards taxable loss at year end 2008	74.172.631	4.374.086

18. Inventories

Inventories are specified as follows at year end:

	2008	2007
Raw materials	1.544.565	969.092

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

Purchase of inventories amounting to ISK 906 million has been made through a two-year leasing agreement. At the end of the leasing period legal ownership of the inventories will be with Orkuveita Reykjavíkur. The leasing agreement is accounted for in non-current liabilities.

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Notes

19. Other financial assets

Trade receivables is specified as follows at year end:	2008	2007
Trade receivables, industrial consumers	478.427	190.515
Trade receivables, retail	3.041.343	2.659.349
Total trade receivables	3.519.770	2.849.864
Allowance for doubtful accounts	(227.290)	(99.514)
	3.292.480	2.750.350

Other current receivables are specified as follows at year end:

Value added tax	314.330	660.018
Pre-paid expenses	151.550	0
Capital income tax	63.257	4.857
Accrued interest income	15.104	8.702
Receivable from employees	16.984	22.707
Other receivables	2.054	739
	563.279	697.023

20. Cash and cash equivalents

Cash and cash equivalents at year end are specified as follows:

Bank balances	1.243.639	3.751.013

21. Equity

It is the Company's policy to maintain a strong equity standing in order to support stability and future development of the operation. Dividend payments have been determined as a percentage of equity, independent from the profit or loss of the relevant year. The owners' meeting makes the decision on dividend payments.

Equity ratio of the Group at the end of the year is 18.64% (31.12.2007: 46.5%). Return on equity was negative by 69.4% in the year 2008 (2007: positive by 8.6%).

In the year 2008, dividends were paid to the parent company's owners. The dividend payment amounted to a total of ISK 1,568 million but in the year 2007, it amounted to ISK 1,530 million.

The Company's Board of Directors proposes that ISK 800 million be paid as dividends to the owners of the parent company in the year 2009 due to the operating year 2008. The Board's proposal of dividend payment is not recognised in the consolidated financial statements of the Group for the year 2008.

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.

	2008	2007
Non-current liabilities		
Bank loans	178.925.311	83.695.057
Credit facility	15.059.998	0
Bond issuance	7.553.061	6.738.653
	201.538.370	90.433.710
Current portion on non-current liabilities	(5.439.610)	(2.401.084)
	196.098.760	88.032.626
Current liabilities		
Current portion on non-current liabilities	5.439.610	2.401.084
Bank loans	4.242.000	2.206.919
	9.681.610	4.608.003
Total interest-bearing loans and borrowings	205.780.370	92.640.629

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22. Loans and borrowings, contd.

Terms of interest-bearing loans and borrowings

		2008		2007	
	Date of maturity	Average interest rate	Carrying amount	Average interest rate	Carrying amount
Liabilities in foreign currencies:					
Liabilities in CHF	26.6.2036	2.31%	39.214.737	2.94%	19.248.482
Liabilities in EUR	26.6.2036	4.77%	76.654.728	3.67%	34.751.351
Liabilities in USD	10.3.2028	2.66%	31.994.843	4.46%	11.738.228
Liabilities in JPY	26.6.2036	1.10%	23.635.999	1.05%	9.358.629
Liabilities in GBP	26.6.2036	3.67%	3.282.738	6.29%	2.463.379
Liabilities in SEK	5.10.2027	4.26%	12.676.195	4.35%	8.082.088
Liabilities in CAD	30.12.2011	2.61%	6.317.637	5.36%	65.658
			193.776.877		85.707.815
Liabilities in Icelandic kronas:					
Indexed	10.1.2037	5.17%	7.761.493	5.15%	6.932.814
Non-indexed	19.1.2009	21.09%	4.242.000		0
			12.003.493		6.932.814
Total interest-bearing loans and borrowings			205.780.370		92.640.629

Repayment on non-current liabilities are specified as follows on the next years:

	2008	2007
Year 2008	0	2.401.084
Year 2009	5.439.610	3.012.120
Year 2010	5.060.784	2.345.727
Year 2011	24.159.150	5.055.364
Year 2012	9.927.624	5.295.980
Year 2013	28.769.781	6.088.684
Later	128.181.421	66.234.751
Total non-current liabilities, including next year's repayment	201.538.370	90.433.710

Guarantees and pledges

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

Financial Statements of Orkuveita Reykjavíkur 2008 35 Amounts are in ISK thousand

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.

According to an actuary assessment, the Company's accrued retirement benefit obligation amounted to ISK 472 million at year end 2008, discounted based on 2% interests and taken into account the share in the net asset of the pension fund. 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 2009 is recognised among current liabilities.

Retirement benefit obligation is specified as follows:	2008	2007
Retirement benefit obligation at the beginning of the year	400.938	356.459
Contribution due to pension payments during the year	(15.463)	(11.256)
Increase in the pension fund obligation during the year	86.152	55.735
Retirement benefit obligation at year end	471.627	400.938
Non-current component of retirement benefit obligation	456.027	395.338
Current component of retirement benefit obligation	15.600	5.600
	471.627	400.938

24. Other financial liabilities

Non-current liabilities:

Other financial liabilities at fair value through profit or loss

Currency swaps	34.468	60.550

Current liabilities:

Accounts payable

Various accounts payable	2.443.340	2.692.213

Other financial liabilities at fair value through profit or loss

Currency swaps	17.645	122.474

Other current liabilities

Unpaid salaries and salary related items	526.723	433.505
Accrued interest expenses	1.554.319	763.646
Unpaid share subscription	0	654.161
Current component of retirement benefit obligation	15.600	5.600
Other liabilities	185.824	7.414
	2.282.466	1.864.326

Financial Statements of Orkuveita Reykjavíkur 2008 Amounts are in ISK thousand

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 relates to the cash on electricity sale to industry consumers.

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

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

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) and Swedish kronas (SEK).

Approx. 94.2% of the Group's non-current loans are in foreign currencies and creates thus currency risk. This 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 172,208 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 30 years according to the assessment of CRU, an independent evaluation party, as available on the accounting date. Due to uncertainties and an indication that CRU will revise their expectations, their forecast since October 2008 on aluminium prices has been lowered by USD 400 per metric ton.

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

	Average exchange rate		Exchange rate at year end	
	2008	2007	2008	2007
CHF	80,698	53,339	113,905	55,503
EUR	127,457	87,601	169,470	91,955
USD	88,088	64,016	121,245	62,405
JPY	0,863	0,544	1,3402	0,557
GBP	159,361	128,072	176,745	125,050
SEK	13,195	9,470	15,523	9,743
CAD	81,585	59,750	98,750	63,655
TWI	166,444	118,000	216,3	120,85

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25. Risk management and financial instruments, contd.

b) ***Market risk, contd.***

ii) ***Exposure to currency risk***

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

Year 2008	CHF	EUR	USD	JPY	GBP	CAD	SEK	DKK	NOK	Total
Loans and borrowings	(39.214.737)	(76.654.728)	(31.994.843)	(23.635.999)	(3.282.738)	(6.317.637)	(12.676.195)			(193.776.877)
Accounts payable							(2.645)	(2.235)		(4.880)
Trade receivables	11.922	214.851	406.224		1.061			10.595		644.653
Bank deposits	2.516	26.204	428.906	81	7.104	44.489	2.833			512.133
Aluminium derivatives			9.091.449							9.091.449
Balance sheet risk	(39.200.299)	(76.413.673)	(22.068.264)	(23.635.918)	(3.274.573)	(6.273.148)	(12.676.007)	8.360	0	(183.533.522)
Estimated sale in 2009			4.235.432							4.235.432
Estimated purchase in 2009 ...		(2.852.531)	(143.411)	(1.650.829)	(538)	(1.183)	(6.890)	(528)		(4.655.910)
Off Balance-sheet risk	0	(2.852.531)	4.092.021	(1.650.829)	(538)	(1.183)	(6.890)	(528)		(420.478)
Swaps	(835.899)			783.787						(52.112)
Net risk	(40.036.198)	(79.266.204)	(17.976.243)	(24.502.960)	(3.275.111)	(6.274.331)	(12.682.897)	7.832	0	(184.006.112)

b) **Risk management and financial instruments, contd.**

b) ***Market risk, contd.***

ii) ***Exposure to currency risk, contd.***

Year 2007	CHF	EUR	USD	JPY	GBP	CAD	SEK	DKK	NOK	Total
Interest-bearing liabilities	(19.248.482)	(34.751.351)	(11.738.228)	(9.358.630)	(2.463.379)	(65.658)	(8.082.087)			(85.707.815)
Accounts payables	(143)	(123.224)	(27.021)		(670)			(5.767)	(5.822)	(162.647)
Trade receiveables			275.299				1.559			276.858
Bank deposits	1.925	557.967	273.259	623	2.000	6	2.001			837.781
Aluminium deriv.			8.154.304							8.154.304
Balance sheet risk	(19.246.700)	(34.316.608)	(3.062.387)	(9.358.007)	(2.462.049)	(65.652)	(8.078.527)	(5.767)	(5.822)	(76.601.519)
Estimated sale in 2008			2.492.966							2.492.966
Estimated purchase in 2008 ...		(1.645.850)		(683.954)						(2.329.804)
Off-balance sheet risk	0	(1.645.850)	2.492.966	(683.954)	0	0	0	0	0	163.162
Swaps	(468.225)	526.172	437.746	386.777	(1.037.912)					(155.442)
Forward agreements	(19)	(350)	(234)	(34)	(121)	(12)	(33)	(77)	(64)	(944)
Net risk	(19.714.944)	(35.436.636)	(131.909)	(9.655.218)	(3.500.082)	(65.664)	(8.078.560)	(5.844)	(5.886)	(76.594.743)

Sensitivity analysis

Strengthening by 10% of the Icelandic krona against the following currencies at 31 December would have increased (decreased) equity and profit or loss by the amounts shown below.

	Profit or (loss)									
	CHF	EUR	USD	JPY	GBP	CAD	SEK	DKK	NOK	Total
Year 2008	2.998.823	5.845.646	1.688.222	1.808.148	250.505	479.896	969.715	(640)	0	14.040.315
Year 2007	1.424.256	2.539.429	226.617	692.493	182.192	4.858	597.811	427	431	5.668.514

This analysis assumes that all other variables, in particular interest rates, remain constant. The analysis is performed on the same basis for 2007. Weakening by 10% of the Icelandic krona against the above currencies at 31 December 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.

Amounts are in ISK thousand

25. Risk management and financial instruments, contd.

b) ***Market risk, contd.***

(iii) ***Interest rate risk***

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

Fixed rate instruments	2008	2007
Financial assets	216.705	186.765
Financial liabilities	15.015.002	10.775.934
	14.798.297	10.589.169

Variable rate instruments		
Financial assets	0	27.582
Financial liabilities	190.817.481	82.047.719
	190.817.481	82.020.137

Fair value sensitivity analysis for fixed rate instruments

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

Cash flow sensitivity analysis for variable rate instruments

A change of 100 basis points in interest rates at the reporting date would have increased (decreased) equity and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular foreign currency rates, remain constant. The analysis is performed on the same basis for 2007.

	Profit or (loss)	
	100 p increase	100 p decrease
Year 2008		
Variable rate instruments	(2.435.472)	2.612.795
Cash flow sensitivity, net	(2.435.472)	2.612.795
Year 2007		
Variable rate instruments	(958.175)	999.368
Cash flow sensitivity, net	(958.175)	999.368

(iv) ***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 15.6% of the Group's total revenue for the year.

Sensitivity analysis

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

	Profit or (loss)	
	2008	2007
Increase by 10%	6.897.313	3.109.583
Decrease by 10%	(6.844.999)	(3.109.583)

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

(v) ***Other market risk***

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

(vi) ***Correlation of aluminium price and interest rates***

Our research has shown correlation in the price of aluminium and interest rates, an aluminium price change leads changes in interest rates. This correlation results in embedded hedging.

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 or risking damage to the Group's reputation.

Owners' guarantees for the Company's loans and a good credit rating has enabled the Company to obtain access to loans at good terms. The Company pays for owners' guarantee a 0.25% guarantee fee on the principal of the loans at each time. Power plant projects at Hellisheiði have primarily been financed with loans from the European Investment Bank (EIB), the Europe Development Bank (CEB) and the Nordic Investment Bank (NIB), but all of those banks have expressed an interest of continued participation in the financing of geothermal power plant projects, such as the power plant of Hellisheiði. The loans are long term and have been determined in accordance with long term agreements on sale of electricity in order to limit the Company's risk inherent with refinancing.

The Group's cash and cash equivalents at year end amounted to ISK 1.2 billion. Furthermore, the Group had unused loan authorisations and a open credit line to the total amount of approx. ISK 8,6 billion. In addition the Group had secured a bond issuance of ISK 5 billion. The Group had thus in total ensured capital at year end to the amount of approx. ISK 14,8 billion. The corresponding amount in 2007 amounted to ISK 23 billion.

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

	Carrying amount	Contractual cash flows	Less than 1 year	1 - 2 years	2 - 5 years	More than 5 years
Year 2008						
Non-derivative financial instruments						
Interest-bearing liabilities	205.780.370	(261.357.284)	(27.696.004)	(8.775.085)	(62.352.858)	(162.533.337)
Accounts payable	2.443.340	(2.443.340)	(2.443.340)			
Other liabilities	2.282.684	(2.282.684)	(2.282.684)			
Derivative financial instruments						
Currency swaps	52.113	(60.872)	(17.480)	(14.827)	(28.565)	0
	210.558.507	(266.144.180)	(32.439.508)	(8.789.912)	(62.381.423)	(162.533.337)
Year 2007						
Non-derivative financial instruments						
Interest-bearing liabilities	92.640.629	(133.391.720)	(8.378.826)	(6.596.026)	(22.626.844)	(95.790.024)
Accounts payable	2.692.213	(2.692.213)	(2.692.213)			
Other liabilities	1.875.495	(1.875.495)	(1.875.495)			
Derivative financial instruments						
Currency swaps	155.442	(236.417)	(136.629)	(26.949)	(61.015)	(11.824)
	97.363.779	(138.195.845)	(13.083.163)	(6.622.975)	(22.687.859)	(95.801.848)

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.

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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:

	Notes	2008	2007
Trade receivable	19	3.292.480	2.750.350
Other current receivables	19	563.279	697.023
Other financial assets	16	111.374	226.494
Cash and cash equivalents	20	1.243.639	3.751.013
		5.210.772	7.424.880

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

Trade receivable, industrial consumers	478.427	190.515
Trade receivable, retail	2.814.053	2.559.835
	3.292.480	2.750.350

Impairment

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

	2008		2007	
	Gross balance	Allowance	Gross balance	Allowance
Non-overdue receivables	2.707.804	68.112	2.080.265	49.096
Overdue receivables	811.966	159.178	769.599	50.418
	3.519.770	227.290	2.849.864	99.514

e) ***Fair value***

Fair values versus carrying amounts

The fair values of finacial assets and liabilities, together with the carrying amounts are specified as follows:

	2008		2007	
	Carrying amount	Fair value	Carrying amount	Fair value
Interest-bearing liabilities	(205.780.370)	(185.480.733)	(92.640.629)	(95.712.367)
Embedded derivatives in electicity sales contracts	9.091.449	9.091.449	8.154.304	8.154.304
Currency swaps	(52.113)	(52.113)	(155.442)	(155.442)
Forwards swaps	0	0	152.995	152.995

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

Interest rates used for determining fair value

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

	2007	2006
Interest-bearing liabilities	0.02%-18.575%	0.61%-5.99%
Embedded derivatives in electicity sales contracts	0.135%-2.743%	3.81%-5.03%

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26. Statement of cash flows

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

	2008	2007
(Loss) profit for the year	(72.959.710)	6.515.823
Adjustment for:		
Financial income and expenses	92.523.476	(4.055.178)
Effect of currency change on cash and cash equivalents	(681.612)	30.017
Minority interest	(76.993)	6.868
Share of loss of associated companies	276.339	121.124
Income tax	(15.064.266)	1.794.317
Depreciation and amortisation	6.952.772	5.538.300
Gain on sale of assets and other change	0	(241.575)
Retirement benefit obligation, increase	70.689	44.480
Working capital from operation before interests and taxes	11.040.695	9.754.176
Inventories, (increase)	(575.473)	(246.911)
Trade and other receivables, (increase)	(288.807)	(392.854)
Payables and other current liabilities, increase	(362.776)	416.058
Cash generated from operations before interests and taxes	9.813.639	9.530.469

27. Related parties

Definition of related parties

The parent company, associated companies, Board members, Directors and companies owned by them are considered as the Group's related parties. Their spouses 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. Information regarding Board members and Directors also include transascions of their spouses and children as well as companies owned by or managed by those in question. This information does not include sale of conventional household supplies to the related parties.

Sale to related parties	2008	2007
Reykjavík City	2.903.487	2.233.299
Institutions and companies controlled by Reykjavík City	440.737	452.281
Subsidiaries	702.414	399.399
Associates	386	982
Board members and key employees	1.318	772
	4.048.342	3.086.733

Purchases from related parties

Reykjavík City	304.238	63.762
Institutions and companies controlled by Reykjavík City	86.174	74.654
Subsidiaries	224.937	260.057
Associates	45.477	147.390
Board members and key employees	20.440	1.606
	681.266	547.469

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27. Related parties, contd.

Receivables for related parties

Reykjavík City	239.218	44.934
Institutions and companies controlled by Reykjavík City	85.065	51.992
Subsidiaries	111.776	226.335
Associates	16.033	15.280
Board members and key employees	929	772
	453.021	339.313

Payables for related parties

Reykjavík City	17.016	16.850
Institutions and companies controlled by Reykjavík City	17.761	54.073
Subsidiaries	569.692	166.241
Associates	332	62
Board members and key employees	22	0
	604.823	237.226

Guarantee fee to owners

Orkuveita Reykjavíkur paid a guarantee fee to Reykjavík City, other existing and former owners of the company for guarantees they made on the Groups loans and borrowings according to a decision made on the annual meeting of Orkuveitu Reykjavíkur in 2005. At that meeting it was agreed upon that the guarantee fee should be 0.0625% of the quarterly balance of loans at the repoting date. The guarantee fee amounted to ISK 300 million in 2008 (2007: ISK 154 million) and is accounted for amongst interest expenses, see note 9.

28. Group entities

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

			Share	
	Main operation	Nominal value	2008	2007
Gagnaveita Reykjavíkur ehf.	Data transfer	4.736.841	100.0%	100.0%
Hitaveita Akraness og Borgarfj	Heating supplier		79.3%	79.3%
Reykjavík Energy Invest ehf.	Investment company	3.004.723	100.0%	100.0%
Reykjavík Energy Grad. school hf.	Graduate school	10.500	99.99%	
Úlfljótsvatn frítímabyggð ehf.	Preparation company	225.000	100.0%	100.0%
Hrafnabjargavirkjun	Preparation company	6.000	60.0%	60.0%
NCI fjarskipti og orka ehf.	Without operations			100.0%

Main changes in the Group during the year

In february 2008 Orkuveita Reykjavíkur, University of Iceland and Reykjavik University founded REYST hf. The purpose is to bring to the society an expertise knowledge in the field of sustainable energy through education and research worldwide.

NCI fjarskipti og orka ehf. was dissolved in the year 2008

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29. Other issues

Hitaveita Suðurnesja (now HS Orka hf. and HS Veitur hf.)

Orkuveita Reykjavíkur purchased in the year 2007 a 16.58% share in Hitaveita Suðurnesja hf. According to an agreement between Orkuveita Reykjavíkur and Hafnarfjarðarbær, the Company entered into an obligation to purchase, in addition, all of the shares of Hafnarfjarðarbær in Hitaveita Suðurnesja amounting to the total of ISK 1.133.356.000 nominal value at the price 7. The town council of Hafnarfjarðarbær agreed on a meeting on 18 December 2007 to sell 95% of the municipality's share in Hitaveita Suðurnesja to Orkuveita Reykjavíkur. In a decision by the Competitive Authority No. 23/2008 it was stated that according to Article 16 of the Competition Act No. 44/2005, the Competitive Authority instructs that Orkuveita Reykjavíkur is not allowed to own more than 3% of Hitaveita Suðurnesja hf. The Board of Directors of Orkuveita Reykjavíkur appealed this decision the Competition Appeals Committee which decided on 2 July 2008 that the Company was not allowed to own 10% or more of Hittaveita Suðurnesja.

With reference to the decision of the Competition Appeals Committee, the Board of Directors of Orkuveita Reykjavíkur is of the opinion that Orkuveita Reykjavíkur can not fulfill its obligation under the contract with Hafnarfjarðarbær to buy 95% of the municipality's shares in Hitaveita Suðurnesja hf. Hafnarfjarðarbær has subpoenaed Orkuveita Reykjavíkur for the amount payable under the contract. The case was registered with the District Court of Reykjavík on 28 April 2008 and the case will be argued before the Court on 9 March 2009.

The Board of Directors of Orkuveita Reykjavíkur has applied for an extension with the Competitive Authority to decrease its share in Hitaveita Suðurnesja. The Company's shares in HS Veitur hf. and HS Orka hf. are available for sale.

General uncertainties in the Icelandic economy

Considerable changes have taken place in the Icelandic economy after the collapse of the Icelandic banks in the beginning of October. This has lead to a more limited access for Icelandic companies to capital in the financial markets. In spite of this the Group's situation concerning cash generated from operations is strong.

Effect of fluctations in foreign exchange rates on the Company's standing

Expectations for the currency index (TWI) in the budget for Orkuveita Reykjavík were 155 at year end 2008. This conclusion was drawn from findings from economic research departments of the banks and public institutions in Iceland.

The TWI at year end was 216,3 but on the 26 February 2009 the TWI was 187,0 If interest-bearing loans and borrowings would be accounted for according to the TWI on 26 February 2009 they would have amounted to ISK 178.7 billion i.e. ISK 27.1 billion lower then accounted for at year end 2008. Accordingly embedded derivatives in electricity sales contracts would have amounted to ISK 8.4 billion or ISK 0.7 billion lower then accounted for at year end 2008.

Defaulted derivative financial instruments

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. In the financial statements at year end 2008 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. TWI 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.