Orkuveita Reykjavíkur

Condensed consolidated
Interim Financial Statements
1 January to 30 September 2013

Orkuveita Reykjavíkur
Bæjarháls 1
110 Reykjavík

reg no. 551298-3029

Contents

Endorsement by the Board of Directors and the Managing Director

Orkuveita Reykjavíkur is a partnership that complies with the Icelandic law no.139/2001 on the founding of the partnership Orkuveita Reykjavíkur. The Company is an independent service company operating its own power plants, producing and selling electricity and hot water. It provides local distribution of electricity, hot water and cold water, operates the sewage systems in its service area as well as a telecom network based on IP and fiber optic technology.

The condensed consolidated interim financial statements for the period 1 January to 30 September 2013 are prepared in accordance with the International Financial Reporting Standard IAS 34 Interim financial reporting. The financial statements comprise the consolidated interim financial statements of Orkuveita Reykjavíkur and subsidiaries. The financial statements have been reviewed by the independent auditor of the company.

Profit of operations of Orkuveita Reykjavíkur during the period 1 January to 30 September 2013 ISK 5.972 million. According to the statement of financial position the Company´s assets were ISK 280.446 million at the end of the period, book value of equity at the end of period was ISK 64.420 million, resulting in equity ratio of 23.0%

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

	Share
Reykjavíkurborg	93.539%
Akraneskaupstaður	5.528%
Borgarbyggð	0.933%

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

A bill is expected to be proposed regarding changes to law governing Reykjavik Energy. The motion is, among other things, intended to ensure that the Company's unbundling will not, by itself, confer taxing that otherwise would not fall on the Company. The unbundling will be presented in more detail when formal decisions have been made by the Board.

Reykjavik Energy‘s Board of Directors has commissioned the CEO to prepare motions regarding the unbundling of RE‘s operations, as instructed by amendments to law 65/2003 that come to effect January 1st 2014. The motions are based on unanimous conclusions reached by the Company's owners; The City of Reykjavik and the municipalities of Akranes and Borgarbyggd.

These entail that the current partnership of Reykjavik Energy (Orkuveita Reykjavikur) will be a holding company for subsidiaries, each of which will be responsible for its sector of operations; municipalities' obligatory operations, licensed operations and competitive operations. The holding company's type of entity remains the same, thus the unbundling does not affect its rights, obligations nor owners' liabilities.

Statement by the Board of Directors

According to the best knowledge of the Board of Directors of Orkuveita Reykjavíkur, the company´s consolidated financial statements are in accordance with IFRS´s as adopted by the EU. It is the opinion of the Board of Directors that the consolidated financial statements give a fair view of the Company's assets, liabilities and financial position 30 September 2013 and the company´s operating return and changes in cash and cash equivalents for the period then ended.

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

The Board of Directors and the Managing Director of Orkuveita Reykjavíkur hereby confirm the Company´s consolidated financial statements for the period 1 January to 30 September 2013.

Reykjavík, 15 November 2013.

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

Managing Director:
Bjarni Bjarnason

Independent Auditor´s Review Report

To the Board of Directors and owners of Orkuveita Reykjavikur.

We have reviewed the accompanying condensed financial statements of Orkuveita Reykjavíkur, which comprise the interim statement of financial position as at 30 September 2013 and the interim statement of income, interim statement of comprehensive income, interim statement of changes in equity and interim cash flow statement for the nine-month period then ended, and a summary of significant accounting policies and other explanatory notes. Management is responsible for the preparation and fair presentation of this interim financial information in accordance with International Financial Reporting Standards as adopted by the EU. Our responsibility is to express a conclusion on this interim financial information based on our review.

Scope of Review

We conducted our review in accordance with International Standard on Review Engagements 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and others review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we could become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to belive that the accompanying interim financial information does not give a true and fair view of the financial position of the Company as at 30 September 2013, and of its financial performance and its cash flows for the nine-month period then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Reykjavík, 15 November 2013.

KPMG ehf.
Auðunn Guðjónsson
Guðný Helga Guðmundsdóttir

Income Statement
1 January to 30 September 2013

	Notes	2013 1.7.-30.9.	2012 1.7.-30.9.	2013 1.1.-30.9.	2012 1.1.-30.9.
Operating revenue		8.695.196	7.999.003	28.806.221	27.286.177
Energy purchase		(1.233.158)	(1.113.292)	(3.901.654)	(3.490.176)
Salaries and salary related expenses	4	(791.776)	(843.605)	(2.713.092)	(2.812.087)
Other operating expenses		(1.089.552)	(931.514)	(3.179.030)	(3.146.382)
Operating expenses, total		(3.114.485)	(2.888.412)	(9.793.775)	(9.448.646)
EBITDA		5.580.711	5.110.591	19.012.446	17.837.531
Depreciation and amortisation	5	(1.754.510)	(2.277.092)	(6.250.525)	(6.861.757)
Results from operating activities		3.826.201	2.833.499	12.761.921	10.975.775
Interest income		39.799	57.054	128.911	113.609
Interest expenses		(1.432.832)	(1.171.690)	(4.724.662)	(5.122.599)
Other income (expenses) on financial assets and liabilities		749.914	3.617.419	(1.571.834)	(2.572.070)
Total financial income and expenses	6	(643.118)	2.502.783	(6.167.585)	(7.581.060)
Profit before income tax		3.180.773	5.336.282	6.592.027	3.394.714
Income tax	7	(945.055)	(1.831.633)	(619.949)	(814.367)
Profit for the period		2.235.718	3.504.648	5.972.079	2.580.347
Attributable to:					
Equity holders of the Company		2.235.718	3.504.648	5.972.079	2.580.347
Minority interest in subsidiaries		0	0	0	0
Profit for the period		2.235.718	3.504.648	5.972.079	2.580.347

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Interim Statement of Comprehensive Income
1 January to 30 September

	Notes	2013 1.1.-30.9.	2012 1.1.-30.9.
Profit for the period		5.972.079	2.580.347
Comprehensive income			
Revaluation reserve, decrease	8	(4.000.000)	0
Income tax effect of revaluation		1.440.000	0
Changes in fair value of assets available for sale		364.000	0
Total comprehensive profit for the period		3.776.079	2.580.347
Total comprehensive income attributable to:			
Equity holders of the Company		3.776.079	2.580.347
Minority interest in subsidiaries		0	0
Total comprehensive profit for the period		3.776.079	2.580.347

Interim Financial Statements of Orkuveita Reykjavikur 30 September 2013 6 Amounts are in ISK thousands

Consolidated Statement of Financial Position
30 September 2013

	Notes	30.9. 2013	31.12. 2012
Assets			
Property, plant and equipment	8	237.851.835	246.111.462
Intangible assets	10	1.309.855	1.218.980
Investments in associated companies		57.517	59.826
Investments in other companies		3.629.182	3.265.182
Embedded derivaties in electricity sales contracts	11	4.937.106	14.150.678
Hedge contracts		1.438.154	893.934
Other financial assets		8.123.221	9.745.440
Deferred tax assets	12	4.287.319	3.467.268
Total non-current assets		261.634.190	278.912.770
Inventories		407.752	402.872
Trade receivables	13	5.332.134	4.721.350
Embedded derivatives in electricity sales contracts	11	0	587.982
Hedge contracts		227.520	38.956
Other financial assets		386	5.986
Properties held for sale	9	4.397.856	5.347.856
Other receivables		353.554	298.181
Cash and cash equivalents		8.092.919	6.885.693
Total current assets		18.812.121	18.288.875
Total assets		280.446.310	297.201.645

Interim Financial Statements of Orkuveita Reykjavikur 30 September 2013 7 Amounts are in ISK thousand

Consolidated Statement of Financial Position
30 September 2013

	Notes	30.9. 2013	31.12. 2012
Equity			
Revaluation reserve		47.867.728	51.791.161
Fair value reserve		2.124.000	1.760.000
Retained earnings		14.427.820	7.092.309
Equity attributable to equity holders of the Company		64.419.549	60.643.470
Minority interest		0	4.353
Total equity	14	64.419.549	60.647.822
Liabilities			
Loans and borrowings	15	188.566.063	201.546.363
Retirement benefit obligation		493.197	483.377
Hedge contracts		101.083	98.974
Total non-current liabilities		189.160.343	202.128.714
Accounts payable		1.166.969	1.366.254
Loans and borrowings	15	18.795.690	29.956.923
Embedded derivaties in electricity sales contracts	11	354.430	0
Hedge contracts		1.306.658	150.300
Deferred revenue	13	1.738.792	3.477
Other current liabilities		3.503.879	2.948.155
Total current liabilities		26.866.419	34.425.109
Total liabilities		216.026.762	236.553.823
Total equity and liabilities		280.446.310	297.201.645

Interim Financial Statements of Orkuveita Reykjavikur 30 September 2013 8 Amounts are in ISK thousand

Interim Statement of Changes in Equity
1 January to 30 September 2013

	Revaluation reserve	Fair value reserve	Retained earnings	Attributable to equity holders of the Company	Minority interest	Total equity
1.1.-30.9. 2013						
Equity at 1 January 2013	51.791.161	1.760.000	7.092.309	60.643.470	4.353	60.647.822
Revaluation, decrease	(4.000.000)			(4.000.000)		(4.000.000)
Income tax effect of revaluation	1.440.000			1.440.000		1.440.000
Changes in fair value of assets available for sale		364.000		364.000		364.000
Profit for the period			5.972.079	5.972.079	0	5.972.079
Total comprehensive income	(2.560.000)	364.000	5.972.079	3.776.079	0	3.776.079
Depreciation transferred to retained earnings	(1.363.433)		1.363.433	0		0
Other changes				0	(4.353)	(4.353)
Equity at 30 September 2013	47.867.728	2.124.000	14.427.821	64.419.549	(0)	64.419.548

	Revaluation reserve	Fair value reserve	Retained earnings	Attributable to equity holders of the Company	Minority interest	Total equity
1.1.-30.9. 2012						
Equity at 1 January 2012	53.923.090	460.000	7.255.201	61.638.291	4.725	61.643.016
Profit for the period			2.580.347	2.580.347	0	2.580.347
Total comprehensive income	0	0	2.580.347	2.580.347	0	2.580.347
Depreciation transferred to retained earnings	(1.596.252)		1.596.252	0		0
Equity at 30 September 2012	52.326.838	460.000	11.431.800	64.218.638	4.725	64.223.363

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Interim Statement of Cash Flows
1 January to 30 September 2013

	2013 1.1.-30.9.	2012 1.1.-30.9.
Cash flows from operating activities		
Profit for the period	5.972.079	2.580.347
Financial income and expenses	6.167.585	7.581.060
Other items not affecting the cash flow	6.876.039	7.671.750
Changes in operating assets and liabilities	1.361.449	1.535.079
Working capital from operation before interest and taxes	20.377.151	19.368.236
Received interest income	176.182	86.547
Paid interest expenses	(3.448.219)	(3.868.585)
Dividend received	53.659	54.475
Paid due to other financial income and expenses	(224.425)	(68.706)
Net cash from operating activities	16.934.348	15.571.968
Cash flows from investing activities		
Acquisition of property, plant and equipment	(2.158.152)	(2.304.874)
Acquisition of intangible assets	(37.853)	(36.360)
Proceeds from sale of property, plant and equipment	958.867	223.700
Sale of subsidiaries	(10.833)	0
Proceeds from sale of other companies	6.529	212.968
Acquisition of other financial assets	0	(28.000)
Proceeds and repayment of other financial assets	5.986	24.258
Net cash used in investing activities	(1.235.456)	(1.908.308)
Cash flows from financing activities		
Proceeds from new borrowings	3.080.750	1.007.996
Repayment of borrowings	(17.894.244)	(10.025.220)
Proceeds from new borrowings from the owners	4.000.000	74.640
Credit facility, change	(2.500.000)	(2.482.638)
Current liabilities, change	(167.190)	(407.024)
Net cash from financing activities	(13.480.684)	(11.832.246)
Increase in cash and cash equivalents	2.218.208	1.831.414
Cash and cash equivalents at year beginning	6.885.693	1.652.484
Effect of currency fluctuations on cash and cash equivalents	(1.010.982)	130.513
Cash and cash equivalents at end of the period	8.092.919	3.614.411
Investments and financing without payment effects:		
Acquisition of property, plant and equipment	(83.775)	(67.173)
Current liabilities, change	83.775	67.173
Other information:		
Working capital from operation	14.972.918	13.086.003

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Notes to the Interim Financial Statements

Notes

1. Reporting entity

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

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

2. Basis of preparation

a. *Statement of compliance*

These condensed consolidated interim financial statements have been prepared in accordance with International Financial Reporting Standard IAS 34 *Interim Financial Reporting*. They do not include all of the information required for a complete set of consolidated annual financial statements and should be read in conjunction with the consolidated financial statements of the Company the year ended 31 December 2012.

In the beginning of the year the accounting standards IFRS 13 *Fair Value Measurement* was implemented. IFRS 13 establishes a single framework for measuring fair value and making disclosures about fair value measurements, when such measurements are required or permitted by other IFRSs. In particular, it unifies the definition of fair value as the price at which an orderly transaction to sell an asset or to transfer a liability would take place between market participants at the measurement date. It also replaces and expands the disclosure requirements about fair value measurements in other IFRSs, including IFRS 7 *Financial Instruments: Disclosures*. The implementation of the new standard has insignificant effect on valuation methods or notes in the Company´s interim financial statements.

The annual financial statements can be found at the company´s web site; www.or.is and at the web site of the Icelandic Stock exchange market; www.nasdaqomxnordic.com.

The interim financial statements were approved by the Board of Directors on 15 November 2013.

b. *Basis of measurement*

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

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

c. *Functional and presentation currency*

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

d. *Use of estimates and judgements*

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

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

In particular, information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements is included in the following notes:

- note 8 - Property, plant and equipment
- note 12 - Deferred tax assets and liabilities
- note 17 - Market risk

3. Segment reporting

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

Business segments - divisions

1.1.-30.9. 2013	**Utilities**	**Production and sale**	**Other Operation**	**Adjust-ments**	**Total**
External revenue	19.050.819	9.387.170	368.232	0	28.806.221
Inter-segment revenue	175.720	1.892.520	121.214	(2.189.454)	0
Total segment revenue	19.226.539	11.279.690	489.446	(2.189.454)	28.806.221
Segment result	10.312.505	4.335.879	(2.496)	0	14.645.888
Unallocated expenses					(1.883.967)
Results from operating activities					12.761.921
Financial income and expenses					(6.167.584)
Share of loss of associated companies					(2.309)
Income tax					(619.949)
Profit for the period					5.972.079

1.1.-30.9. 2012	**Utilities**	**Production and sale**	**Other Operation**	**Adjust-ments**	**Total**
External revenue	17.556.087	9.389.950	340.140	0	27.286.177
Inter-segment revenue	179.644	1.862.231	286.460	(2.328.335)	0
Total segment revenue	17.735.731	11.252.181	626.600	(2.328.335)	27.286.177
Segment result	8.635.845	4.440.372	(4.378)	0	13.071.839
Unallocated expenses					(2.096.064)
Results from operating activities					10.975.775
Financial income and expenses					(7.581.061)
Income tax					(814.367)
Loss for the period					2.580.347

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3. Segment reporting, contd.

Business segments - divisions, contd. 1.1.-30.9. 2013	Utilities	Production and sale	Other Operation	Adjust- ments	Total
Balance sheet (30.9. 2013)					
Property, plant and equipment and properties held for sale	131.962.859	102.534.571	9.286	7.742.976	242.249.692
Intangible assets	0	0	0	1.309.855	1.309.855
Shares in associates					57.517
Other unallocated assets					36.829.247
Total assets					280.446.311
Unallocated liabilities					216.026.762
Investsments:					
Property, plant and equipment	1.665.773	65.800	0	314.650	2.046.223
Intangible assets	0	0	0	37.853	37.853
Depreciation, amortization:					
Property, plant and equipment	3.731.512	2.457.376	0	114.660	6.303.548
Intangible assets	0	0	0	(53.022)	(53.022)
1.1.-30.9. 2012					
Balance sheet (31.12. 2012)					
Property, plant and equipment	134.028.592	110.594.420	9.286	6.827.021	251.459.319
Intangible assets	0	0	0	1.218.980	1.218.980
Shares in associates					59.826
Other unallocated assets					44.463.520
Total assets					297.201.645
Unallocated liabilities					236.553.823
Investsments:					
Property, plant and equipment	1.443.655	469.791	0	155.685	2.069.131
Intangible assets	0	0	0	36.360	36.360
Depreciation, amortization:					
Property, plant and equipment	3.768.471	2.773.754	0	250.578	6.792.803
Intangible assets	0	0	0	68.954	68.954

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3. Segment reporting, contd.

Business segments - sectors

1.1.-30.9. 2013	Electricity	Hot water	Cold water	Sewer	Fibre-optic cable system	Adjust-ments	Total
Income							
External revenue	14.283.191	7.452.758	2.476.329	3.413.889	1.180.054	0	28.806.221
Inter-segment revenue	505.714	58.353	10.865	14.979	0	(589.911)	0
Total segment revenue	14.788.905	7.511.111	2.487.194	3.428.868	1.180.054	(589.911)	28.806.221
Balance sheet (30.9. 2013)							
Properties, current and non-current	105.961.489	68.403.829	18.503.199	38.281.636	11.099.538	0	242.249.691
Intangible assets	599.914	387.717	104.788	217.436	0	0	1.309.855
Unallocated assets	0	0	0	0	0	0	36.886.764
Total assets	106.561.403	68.791.546	18.607.987	38.499.072	11.099.538	0	280.446.310
Investments							
Property, plant and equipments	566.614	396.638	157.906	250.951	674.114	0	2.046.223
Intangible assets	17.602	11.091	2.990	6.170	0	0	37.853
Depreciation, amortization							
Property, plant and equipments	2.537.870	2.015.830	396.427	938.842	414.578	0	6.303.547
Intangible assets	(20.148)	(16.435)	(5.304)	(11.135)	0	0	(53.022)

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3. Segment reporting, contd.

Business segments - sectors, contd.

1.1.-30.9. 2012	Electricity	Hot water	Cold water	Sewer	Fibre-optic cable system	Adjust-ments	Total
Income							
External revenue	14.018.830	6.750.105	2.377.923	3.122.959	1.016.360	0	27.286.177
Inter-segment revenue	618.772	100.712	25.930	34.054	0	(779.468)	0
Total segment revenue	14.637.602	6.850.817	2.403.853	3.157.013	1.016.360	(779.468)	27.286.177
Balance sheet (31.12. 2012)							
Properties	112.712.357	70.343.547	18.699.324	38.864.090	10.840.001	0	251.459.319
Intangible assets	570.483	355.942	96.299	196.256	0	0	1.218.980
Unallocated assets	0	0	0	0	0	0	44.523.346
Total assets	113.282.840	70.699.489	18.795.623	39.060.346	10.840.001	0	297.201.645
Investments							
Property, plant and equipments	728.940	313.650	126.318	190.731	709.492	0	2.069.131
Intangible assets	18.725	8.981	2.800	5.854	0	0	36.360
Depreciation, amortization							
Property, plant and equipments	3.250.587	1.794.655	400.529	955.167	391.864	0	6.792.802
Intangible assets	26.344	21.485	6.618	14.507	0	0	68.954

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Notes

4. Salaries and salary related expenses

	2013 1.1.-30.9.	2012 1.1.-30.9.
Salaries and salary related expenses are specified as follows:		
Salaries	2.338.423	2.206.581
Defined contribution pension expenses	312.247	296.159
Defined benefit pension expenses	23.868	53.481
Other salary related expenses	247.731	234.180
Expensed salaries and salary related expenses due to early retirement plan and laid-off employees 1)	53.947	279.435
Total salaries and salary related expenses	2.976.216	3.069.836

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

	2013 1.1.-30.9.	2012 1.1.-30.9.
Expensed in the income statement	2.713.092	2.812.087
Capitalised on projects	263.124	257.749
Total salaries and salary related expenses	2.976.216	3.069.836

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

5. Depreciation and amortisation

	2013 1.1.-30.9.	2012 1.1.-30.9.
Depreciation and amortisation is specified as follows:		
Depreciation and amortisation, total, cf. note 8	6.303.547	6.792.802
Amortisation of intangible assets, cf. note 10	(53.022)	68.954
Depreciation and amortisation recognised in the income statement	6.250.525	6.861.756

Interim Financial Statements of Orkuveita Reykjavikur 30 September 2013 17 Amounts are in ISK thousand

6. Financial income and expenses

Financial income and expenses are specified as follows:

	2013 1.1.-30.9.	2012 1.1.-30.9.
Interest income	128.911	113.609
Interest expense	(4.072.273)	(4.528.120)
Guarantee fee to owners 1)	(652.385)	(594.479)
Total interest expenses	(4.724.658)	(5.122.599)
Fair value changes of embedded derivatives in electricity sales contracts	(10.155.984)	(412.794)
Fair value changes of financial assets and financial liabilities through P/L	(1.621.833)	1.269.333
Hedge contracts	(684.020)	(713.234)
Foreign exchange difference	10.836.333	(2.769.850)
Dividends	53.671	54.475
Total of other income (expenses) on financial assets and liabilities	(1.571.834)	(2.572.070)
Total financial income and expenses	(6.167.580)	(7.581.060)

1) Orkuveita Reykjavíkur paid a guarantee fee to current and former owners of the company for guarantees they have made on the Groups loans and borrowings according to a decision made on the annual meeting of Orkuveita Reykjavikur in 2005. The fee on yearly basis for its licenced operations is 0.375% and 0.48% regarding loans due for operations in the open market. The calculation of the fee is done at the end of each quarter. The guarantee fee amounted to ISK 652 million in the period 1 January to 30 September 2013 (1.1.-30.9 2012: ISK 594 million) and is accounted for among interest expenses.

Fair value changes through P/L

Generally accepted valuation methods are used to determine the fair value of certain financial assets and financial liabilities, further discussed in note 4 in the Company´s financial statements for the year 2012. Change in fair value that is expensed in the income statement amounts ISK 11.778 million. (1.1.-30.9 2012: income ISK 857 million).

7. Income tax

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

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

	2013 1.1.-30.9.	2012 1.1.-30.9.
Change in deferred income tax	619.949	814.367
Income tax recognised in the income statement	619.949	814.367

Reconciliation of effective tax rate:

		2013 1.1.-30.9.		2012 1.1.-30.9.
Profit before income tax		6.592.027		3.394.714
Income tax according to current tax ratio	36.0%	2.373.130	36.0%	1.222.097
Non-taxable operation of water supply and sewer	(25.5%)	(1.682.419)	(12.0%)	(405.925)
Effect of various tax rates in the Group	(1.6%)	(105.111)	0.0%	(1.099)
Other items	0.5%	34.348	0.0%	(706)
Effective income tax	9.4%	619.948	24.0%	814.367

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Notes

8. Property, plant and equipment

Property, plant and equipment is specified as follows:

1.1.-30.9. 2013	Production system	Utility system	Other real estates	Other equipment	Total
Cost or deemed cost					
Balance at year beginning	198.231.387	223.774.810	2.083.533	1.244.289	425.334.019
Additions during the period	349.432	1.549.617	870	146.305	2.046.223
Sold or disposed of	0	0	0	(14.132)	(14.132)
Revaluation, decrease	(4.073.811)	0	0	0	(4.073.811)
Balance at end of period	194.507.008	225.324.427	2.084.402	1.376.462	423.292.299
Depreciation					
Balance at year beginning	64.424.583	113.110.231	881.295	806.447	179.222.557
Depreciated during the period	3.299.303	2.893.192	12.272	98.780	6.303.547
Sold or disposed of	0	0	0	(11.828)	(11.828)
Revaluation, decrease	(73.811)	0	0	0	(73.811)
Balance at end of period	67.650.075	116.003.424	893.567	893.399	185.440.465
Carrying amounts					
At 1.1. 2013................................	133.806.804	110.664.579	1.202.237	437.842	246.111.462
At 30.9. 2013..............................	126.856.933	109.321.003	1.190.835	483.063	237.851.834
Thereof assets in construction at end of period....	7.396.559	1.597.774	0	0	8.994.332

1.1.-31.12. 2012	Production system	Utility system	Other real estates	Other equipment	Total
Cost or deemed cost					
Balance at year beginning	195.996.921	222.894.519	8.140.245	5.596.352	432.628.037
Reclassification of assets	1.301.287	(884.548)	1.383.128	(3.528.887)	(1.729.019)
Additions during the year	993.880	1.856.200	19.769	145.086	3.014.935
Transferred to properties held for sale	(60.701)	0	(7.390.556)	(869.043)	(8.320.300)
Sold or disposed of	0	(91.361)	(69.054)	(99.219)	(259.634)
Balance at year end	198.231.387	223.774.810	2.083.533	1.244.289	425.334.019
Depreciation					
Balance at year beginning	58.379.184	111.034.725	1.825.401	2.586.718	173.826.027
Reclassification of assets	491.232	(1.693.391)	580.320	(1.107.180)	(1.729.019)
Depreciated during the year	5.611.392	3.858.468	644.176	168.709	10.282.745
Transferred to properties held for sale	(57.224)	0	(2.156.978)	(758.241)	(2.972.444)
Sold or disposed of	0	(89.570)	(11.624)	(83.559)	(184.752)
Balance at year end	64.424.583	113.110.231	881.295	806.447	179.222.557
Carrying amounts					
At 1.1. 2012................................	137.617.737	111.859.794	6.314.845	3.009.634	258.802.010
At 31.12. 2012............................	133.806.804	110.664.579	1.202.237	437.842	246.111.462
Thereof assets in construction at year end...........	7.209.960	1.555.018	0	0	8.764.979

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8. Property, plant and equipment, contd.

Obligations

In May 2008 the Company entered into a contract concerning purchase of equipment for power plants. The equipment will be delivered in the year 2016. The contract and other contracts regarding developments at Hellisheiði amount to ISK 11.0 billion as per exchange rate at end of the period (31.12. 2012: ISK 12.4 billion). More information regarding these contracts can be found in note 23. Furthermore, the Company has entered into contracts and placed purchase orders with suppliers and developers concerning work on production and distribution systems. The balance of these contracts and purchase orders at the end of the period is estimated at ISK 1.2 billion (31.12. 2012: ISK 1.2 billion).

Revaluation

The fair value of these assets is valuated regularly and a transaction is made when it has changed significantly from stated cost, both increase and decrease.

When revaluating, the relevant asset groups are measured at fair value. The aforementioned revaluation is recognised in a revaluation reserve among equity taken into account effects of deferred income tax as further explained in note 3. d in the Company´s financial statements for the year 2012.

Impairment tests are performed yearly, but indications of impairment are looked into at each reporting date looking at changes in main assumptions since tests were last performed. At the end of June 2013 the review showed impairment on non-current assets of production systems in electricity, therefore former revaluation of these assets was reversed, the reversal amounting to ISK 4.000 million. The assumptions that have changed since year-end 2012 in the impairment tests and have the most effect are increase of the rate of risk-free interests, decrease in the price of aluminium and the strengthening of the ISK against the USD in the period.

There were no signs of impairment in segment sectors or divisions at the end of September 2013. Further discussion regarding impairment tests can be found in notes 3. h and 12. to the Company´s financial statements for the year 2012.

Transactions due to revaluation are specified in the following table:

Production systems	
Hot water	31.12.2011
Cold water	31.12.2011
Electricity	30.6.2013
Distribution systems	
Hot water	31.12.2011
Cold water	30.9.2011
Sewage	30.9.2011
Electricity	31.12.2011
Fibre-optic cable system	30.9.2010

9. Properties held for sale

Properties held for sale are specified as follows:	**30.9. 2013**	**31.12. 2012**
Orkuveita Reykjavíkur, headquarters at Bæjar- and Réttarháls, 110 Reykjavík	4.397.856	4.397.856
Perlan, Öskjuhlíð, 105 Reykjavík	0	950.000
Properties held for sale, total	4.397.856	5.347.856

At year-end 2012 Reykjavík City purchased Perlan from the Company for ISK 950 million. The sale was finalised in March 2013. In the beginning of 2013 the Company a sale contract was made regarding the sale of its headquarters at Bæjar- and Réttarháls for ISK 5.100 million. The contract was finalised at the end of October 2013 and at that time entered into the financial statements. From this same time point the Company leases back all of the headquarters from the new owner, but then re leases a part of the assets to leasees from outside the Company. Further information regarding the lease is in note 23.
Properties held for sale are classified among current assets since completion of sale is expected within a year. These assets are not depreciated from the time they are reclassified from non-current assets.

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10. Intangible assets

Intangible assets are specified as follows:

1.1.-30.9. 2013	Heating rights	Software	Total
Cost			
Balance at year beginning	1.427.031	1.371.816	2.798.847
Additions during the period	0	37.853	37.853
Balance at end of the period	1.427.031	1.409.669	2.836.700
Amortisation			
Balance at year beginning	503.524	1.076.343	1.579.867
Amortisation during the period	(126.018)	72.996	(53.022)
Balance at end of the period	377.506	1.149.339	1.526.845
Carrying amounts			
At 1.1. 2013	923.507	295.474	1.218.980
At 30.9. 2013	1.049.525	260.331	1.309.855

1.1.-31.12. 2012	Heating rights	Software	Total
Cost			
Balance at year beginning	1.427.031	3.045.194	4.472.225
Reclassification of assets	0	(1.723.761)	(1.723.761)
Additions during the year	0	50.383	50.383
Balance at year end	1.427.031	1.371.816	2.798.847
Amortisation			
Balance at year beginning	491.550	2.723.738	3.215.288
Reclassification of assets	0	(1.723.761)	(1.723.761)
Amortisation during the year	11.974	76.366	88.340
Balance at year end	503.524	1.076.343	1.579.867
Carrying amounts			
At 1.1. 2012	935.481	321.456	1.256.937
At 31.12. 2012	923.507	295.474	1.218.979

11. Embedded derivatives in electricity sales contracts

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

	30.9. 2013	31.12. 2012
Fair value of embedded derivatives at the beginning of the year	14.738.660	17.682.970
Fair value changes during the period	(10.155.984)	(2.944.310)
Fair value of embedded derivatives at end of period	4.582.676	14.738.660

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

	30.9. 2013	31.12. 2012
Non-current embedded derivatives	4.937.106	14.150.678
Current embedded derivatives	(354.430)	587.982
Total embedded derivatives at end of period	4.582.676	14.738.660

Further discussion regarding embedded derivatives can be found in note 17 c.

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12. Deferred tax assets and liabilities

Deferred tax assets and liabilities is specified as follows:

1.1.-30.9. 2013	**Tax assets**	**Tax liabilities**	**Net amount**
Deferred tax assets/liabilities at the beginning of the year	3.467.267	0	3.467.267
Calculated income tax for the period	(619.949)	0	(619.949)
Effect of change in income tax on revaluation account	1.440.000	0	1.440.000
Deferred tax assets/liabilities at end of the period	4.287.319	0	4.287.319
1.1.-31.12. 2012			
Deferred tax assets/liabilities at the beginning of the year	1.932.006	0	1.932.006
Calculated income tax for the year	1.535.261	0	1.535.261
Deferred tax assets/liabilities at year end	3.467.267	0	3.467.268

Deferred tax assets and liabilities are attributable to the flollowing:

	30.9. 2013		**31.12. 2012**	
	Tax assets	**Tax liabilities**	**Tax assets**	**Tax liabilities**
Property, plant and equipment	(12.763.185)	0	(15.063.674)	0
Embedded derivatives	(1.649.763)	0	(5.305.918)	0
Other items	(189.514)	0	2.599.893	0
Effect of carry forward taxable loss	18.889.781	0	21.236.966	0
Deferred tax assets/liabilities at period end	4.287.319	0	3.467.268	0

13. Receivables

The balance of trade receivables changes considerably between periods since income is collected evenly but actual usage fluctuates significantly between periods. Also, billing for cold water and sewage is done in the first nine months of the year but income disbursed evenly over the year. Recognition of income is subject to usage and deliverance of the service in accordance with accounting standards.

14. Equity

Equity ratio of the Company at the end of the period is 23.0% (31.12. 2012: 20.4%). Return on equity was positive by 13.6% in the period 1 January to 30 September 2013 (1.1.-30.9 2012: positive by 5.6%).

Revaluation reserve

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

Fair value reserve

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

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15. 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 17.

Non-current liabilities	30.9. 2013	31.12. 2012
Bank loans	169.656.193	195.721.276
Subordinated loan from owners of the Company	13.213.662	8.849.752
Bond issuance	22.741.898	22.515.068
	205.611.753	227.086.096
Current portion on non-current liabilities	(17.045.690)	(25.539.733)
	188.566.063	201.546.363

Current liabilities		
Current portion on non-current liabilities	17.045.690	25.539.733
Short-term bank loans	1.750.000	4.417.190
	18.795.690	29.956.923
Total interest bearing loans and borrowings	207.361.753	231.503.286

Terms of interest-bearing loans and borrowings

Liabilities in foreign currencies:

		30.9. 2013		31.12. 2012	
	Date of maturity	Average interest rate	Carrying amount	Average interest rate	Carrying amount
Liabilities in CHF	5.10.2027	0.53%	27.954.350	0.56%	33.989.877
Liabilities in EUR	6.12.2032	1.00%	67.650.254	0.98%	84.800.019
Liabilities in USD	8.11.2030	1.85%	44.366.710	1.81%	41.956.344
Liabilities in JPY	5.10.2027	0.36%	12.469.328	0.47%	16.304.551
Liabilities in GBP	26.2.2024	1.55%	4.702.075	1.85%	5.084.266
Liabilities in SEK	5.10.2027	1.29%	8.067.755	2.06%	8.891.712
			165.210.472		191.026.769

Liabilities in Icelandic kronas:

Indexed	10.1.2037	4.51%	40.401.281	4.67%	36.059.327
Non-indexed	31.10.2013	8.10%	1.750.000	7.53%	4.417.190
			42.151.281		40.476.517
Total interest-bearing loans and borrowings			207.361.753		231.503.286

Interim Financial Statements of Orkuveita Reykjavikur 30 September 2013 23 Amounts are in ISK thousand

15. Loans and borrowings, contd.,

Repayment on non-current liabilities are specified as follows on the next periods:	30.9. 2013	31.12. 2012
1.10. 2013 to 30.9. 2014 / 1.1. to 31.12 2013	17.045.690	25.539.733
1.10. 2014 to 30.9. 2015 / 1.1. to 31.12 2014	16.272.652	16.747.099
1.10. 2015 to 30.9. 2016 / 1.1. to 31.12 2015	19.575.693	19.625.714
1.10. 2016 to 30.9. 2017 / 1.1. to 31.12 2016	19.121.263	19.697.595
1.10. 2017 to 30.9. 2018 / 1.1. to 31.12 2017	14.747.792	15.625.559
Later	118.848.663	129.850.396
Total non-current liabilities, including next year's repayment	205.611.753	227.086.096

Guarantees and pledges

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

Covenants

Loans for the amount of ISK 18.983 million have certain covenants that regard repayment time as a proportion of EBITDA and as interests as a proportion of EBITDA as well as reviewing that budgets are within set limits. (31.12. 2012: ISK 16.856 million). Management regularly evaluate the covenants and in their view there is not danger of them being breached.

16. Risk management and financial instruments

Overview

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

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

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

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

Financial risk is divided into:
- Market risk, further discussed in note 17
- Liquidity risk, further discussed in note 18
- Credit risk, further discussed in note 19

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17. Market risk

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

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

a. *Currency risk*

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

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

Approx. 80.4% of the Company's non-current loans are in foreign currencies. The Company has entered into long term electricity sales contracts in foreign currency (USD). The expected future revenues from these contracts on the accounting date amount to approx. ISK 132.369 million. That amount is based on the future price of aluminium on LME (London Metal Exchange) on the accounting date and expectations of price development of aluminium for the next 25 years according to the assessment of CRU, an independent evaluation party, as available on the accounting date.

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

	1.1.-30.9. 2013	1.1.-31.12. 2012	30.9. 2013	31.12. 2012
	Average exchange rate		Exchange rate at year end	
CHF	131,592	133,352	133,720	140,640
EUR	162,057	160,733	163,390	169,800
USD	122,980	125,052	121,070	128,740
JPY	1,276	1,570	1,237	1,495
GBP	190,194	198,155	195,560	208,150
SEK	18,886	18,4684	18,879	19,758
CAD	120,157	125,110	117,410	129,360
TWI	219,422	221,796	218,837	232,686

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17. Market risk, contd.

a. *Currency risk, contd.*

Exposure to currency risk

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

30.9. 2013	CHF	EUR	USD	JPY	GBP	CAD	SEK	DKK	Total
Loans and borrowings	(27.954.350)	(67.650.254)	(44.366.710)	(12.469.328)	(4.702.075)		(8.067.755)		(165.210.472)
Accounts payables			(121.992)		(1.526)		(1.544)	(2.611)	(127.673)
Trade receivables		9.741	534.415						544.157
Bank deposits	1.971.617	3.324.779	1.671.386	459.035	2	36	15.928		7.442.784
Embedded derivatives			4.582.676						4.582.676
Hedge contracts	(50.175)	19.154.317	390.414	(85.793)	(11.407)		(7.546)		19.389.810
Other financial assets			8.123.028						8.123.028
Balance sheet risk	(26.032.908)	(45.161.417)	(29.186.783)	(12.096.086)	(4.715.006)	36	(8.060.917)	(2.611)	(125.255.691)
Estimated sale									
1.10 to 30.9. 2014			6.818.437						6.818.437
Estimated purchase									
1.10 to 30.9. 2014		(44.445)	(2.179)	(24.003)	(5.532)				(76.159)
Balance sheet risk	0	(44.445)	6.816.258	(24.003)	(5.532)	0	0	0	6.742.278
Net risk	(26.032.908)	(45.205.862)	(22.370.526)	(12.120.088)	(4.720.537)	36	(8.060.917)	(2.611)	(118.513.414)

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17. Market risk, contd.

a. *Currency risk, contd.*

Exposure to currency risk, contd.

31.12. 2012	**CHF**	**EUR**	**USD**	**JPY**	**GBP**	**CAD**	**SEK**	**DKK**	**Total**
Loans and borrowings	(33.989.877)	(84.800.019)	(41.956.344)	(16.304.551)	(5.084.266)	0	(8.891.712)	0	(191.026.769)
Accounts payables		(37.253)	(299.766)						(337.019)
Trade receivables			658.285		47				658.332
Bank deposits	1.709	6.226.479	492.598	135	131	2.530	1.263	90	6.724.936
Embedded derivatives			14.738.660						14.738.660
Hedge contracts	(217.681)	14.874.347	2.754	156.497	(10.985)		(18.706)		14.786.226
Other financial assets			9.744.861						9.744.861
Balance sheet risk	(34.205.849)	(63.736.446)	(16.618.951)	(16.147.919)	(5.095.073)	2.530	(8.909.154)	90	(144.710.772)
Estimated sale in 2012			8.116.661						8.116.661
Estim. purch. in 2012		(155.915)	(25.849)	(290.034)	(154)				(471.952)
Balance sheet risk	0	(155.915)	8.090.812	(290.034)	(154)	0	0	0	7.644.709
Net risk	(34.205.849)	(63.892.361)	(8.528.139)	(16.437.953)	(5.095.227)	2.530	(8.909.154)	90	(137.066.063)

Sensitivity analysis

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

	Profit or (loss)								
	CHF	EUR	USD	JPY	GBP	CAD	SEK	DKK	Total
1.1.-30.9. 2013	1.666.106	2.890.331	1.867.954	774.149	301.760	(2)	515.899	167	8.016.364
1.1.-31.12. 2012	2.189.174	4.079.133	1.063.613	1.033.467	326.085	(162)	570.186	(6)	9.261.489

This analysis assumes that all other variables, in particular interest rates, remain constant. The analysis was performed on the same basis for the year 2012. Weakening by 10% of the Icelandic krona against the above currencies would have had the equivalent, but opposite effect on the above currencies to the amounts shown above, on the basis that all other variables remain constant.

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17. Market risk, contd.

b. *Interest rate risk*

Interest rate risk is the risk of changes in interest rates having a negative effect on the Company's income. The Company is exposed to interest rate risk due to interest bearing assets, liabilities and financial instruments measured at fair value. The Company´s liabilities both have fixed and variable interest rates, majority being subject to variable interest rates. The department of treasury and risk monitors that interest rate risk is within preset limits and has permission to control interest rate risk with derivatives. On the accounting date hedges covered 100% of loans with variable interest rates 1 year ahead.

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

Fixed rate instruments	**30.9. 2013**	**31.12. 2012**
Financial assets	579	6.564
Financial liabilities	(46.156.741)	(42.553.480)
	(46.156.162)	(42.546.915)
Variable rate instruments		
Financial liabilities	(161.205.013)	(188.949.806)
	(161.205.013)	(188.949.806)
Financial instruments at fair value		
Other financial assets	8.123.028	9.744.861
Hedge contracts	257.932	683.616
	8.380.960	10.428.477

In the following table, effect of changes on financial instruments at fair value is set forth, taken into account the effect of taxes. The analysis was done in the same way for the year 2012.

	Cash flow sensitivity analysis		**Fair value sensitivity analysis**	
30.9. 2013	**100 p increase**	**100 p decrease**	**100 p increase**	**100 p decrease**
Embedded derivatives	0	0	(420.480)	478.720
Other financial assets	0	0	(147.814)	153.690
Hedge contracts	507.198	(507.198)	2.436.361	(2.562.851)
Interest bearing loans	(538.404)	538.404	0	0
	(31.206)	31.206	1.868.067	(1.930.441)
31.12. 2012	**100 p increase**	**100 p decrease**	**100 p increase**	**100 p decrease**
Embedded derivatives	0	0	(725.573)	811.329
Other financial assets	0	0	(226.081)	237.008
Hedge contracts	284.502	(284.502)	699.815	(717.916)
Interest bearing loans	(633.244)	633.244	0	0
	(348.742)	348.742	(251.839)	330.420

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17. Market risk, contd.

c. *Aluminium risk*

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

Four electricity sales contracts have been made, originally to the next 20 years. One with Landsvirkjun in regards of Norðurál and three with Norðurál in regards of the aluminium plant at Grundartangi, in addition contracts have been done with Landsnet hf. on distribution of electricity. Orkuveita Reykjavíkur and Norðurál have also made an electricity sales contract due to sale of electricity to a pending aluminium plant in Helguvík, where delivery of electricity has begun, but the contract is for the next 25 years. These electricity sales contracts are denominated in USD and the price of the electricity is connected to the world market price of aluminium. Income of electricity contracts that are effected by price of aluminium is 19.3% of total revenue for the period 1 January to 30 September 2013 (31.12. 2012: 20.0%)

To reduce risk due to aluminium prices the Company has entered into derivative contracts to reduce the fluctuation of income effected by aluminium prices. The department of treasury and risk has permission to hedge 100% of the aluminium risk of next year and proportionally less in the next two years. At the accounting date hedges amounted to 47% of expected income effected by aluminium until the year end 2014 (31.12. 2012: 22.2%).

Embedded derivatives in electricity sales contracts

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

As the market value of the embedded derivatives is not available their fair value has been measured with generally accepted evaluation methods. The expected net present value of the cash flow of a contract on the accounting date has been measured, based on the future price of aluminium on LME (London Metal Exchange) on the accounting date and expectations of price development of aluminium for the next 25 years according to the assessment of CRU, an independent evaluation party, as available on the accounting date. From the expected net present value of cash flow of the contract on the accounting date the expected net present value based on premises on aluminium price on the initial date of the contract is deducted. The difference is the fair value change of the derivative. The valuation is based on the premises that the derivative has no value at the initial date of the contract.

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

Among embedded electricity sales contracts is a contract with Norðurál Helguvík ehf. (NH), stated at the book value of ISK 0.5 billion (31.12.2012: ISK 1.9 billion). The constructions of the aluminium plant at Helguvík have been delayed and there is uncertainty regarding continuance of the project. It was scheduled to begin delivery of power to the aluminium plant 1 September 2011 and NH was obliged to begin payments from that date. NH has used a option in the contract that allows NH to use the power at the aluminium plant at Grundartangi. Counter party risk is valued by the management as considerable and the risk is reflected in the stated book value of the derivative. If the contract will be terminated or renegotiated on other terms, the book value of the embedded derivative would be fully expensed through the income statement.

17. Market risk, contd.

c. *Aluminium risk, contd.*

Sensitivity analysis on the price of aluminium

30.9. 2013	**Sensitivity of Fair value**	
	10% decrease	**10% increase**
Embedded derivatives	(7.468.160)	7.468.160
Aluminium hedges	259.511	(259.511)
Financial assets at fair value through P/L	(276.717)	276.717
Total	(7.485.366)	7.485.366

31.12. 2012	**Sensitivity of Fair value**	
	10% decrease	**10% increase**
Embedded derivatives	(6.483.469)	6.471.310
Aluminium hedges	275.762	(197.940)
Financial assets at fair value through P/L	(353.902)	353.902
Total	(6.561.609)	6.627.272

d. *Other market risk*

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

18. Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due.

The Company's cash and cash equivalents at the end of the period amounted to ISK 8.1 billion. Furthermore, the Company had unused loan authorisations and a open credit line to the total amount of approx. ISK 9.4 billion. The Company had thus in total ensured capital at the end of the period to the amount of approx. ISK 17.5 billion. The corresponding amount at year end 2012 amounted to ISK 13.7 billion.

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18. Liquidity risk, contd.

c. *Liquidity risk, contd.*

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

30.9. 2013

Non-derivative financial instruments

	Carrying amount	Contractual cash flows	Less than 1 year	1 - 2 years	2 - 5 years	More than 5 years
Interest-bearing liabilities	207.361.753	(233.144.199)	(21.965.284)	(19.170.597)	(61.187.748)	(130.820.570)
Accounts payable	1.166.969	(1.166.969)	(1.166.969)	0	0	0
Other liabilities ...	3.503.879	(3.503.879)	(3.503.879)	0	0	0
Derivative financial instruments						
Hedge contracts	1.407.741	(1.320.877)	(1.231.751)	(833.271)	576.380	167.766
	213.440.343	(239.135.924)	(27.867.883)	(20.003.869)	(60.611.368)	(130.652.804)

31.12. 2012

Non-derivative financial instruments

	Carrying amount	Contractual cash flows	Less than 1 year	1 - 2 years	2 - 5 years	More than 5 years
Interest-bearing liabilities	231.503.285	(260.057.715)	(33.352.320)	(19.281.902)	(62.068.130)	(145.355.362)
Accounts payable	1.366.254	(1.366.254)	(1.366.254)	0	0	0
Other liabilities ...	2.948.155	(2.948.155)	(2.948.155)	0	0	0
Derivative financial instruments						
Hedge contracts	249.274	(1.233.289)	(631.390)	(553.736)	(103.455)	55.292
	236.066.969	(265.605.413)	(38.298.119)	(19.835.638)	(62.171.585)	(145.300.070)

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

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19. Credit risk

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

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

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

	30.9. 2013	31.12. 2012
Trade receivable	5.332.134	4.721.350
Other current receivables	353.554	298.181
Other financial assets	8.123.606	9.751.425
Hedge contracts	1.665.674	932.890
Cash and cash equivalents	8.092.919	6.885.693
Total	23.567.888	22.589.539

Financial assets as stated above are categorised as *loans and receivables* exept for a part of *other financial assets* and *hedge contracts*. Their categorisation can be seen in note 21.

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

Trade receivable, industrial consumers	1.253.277	917.120
Trade receivable, retail	4.078.857	3.804.230
	5.332.134	4.721.350

Impairment

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

	30.9. 2013		31.12. 2012	
	Gross balance	Allowance	Gross balance	Allowance
Not past due receivables	3.995.876	108.248	4.081.898	102.884
Past due, 1 to 30 days	206.279	8.435	316.652	12.263
Past due, 31 to 90 days	178.739	28.701	108.612	24.581
Past due, 91 days and older	1.213.240	116.616	532.688	178.772
Total	5.594.134	262.000	5.039.850	318.500

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

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

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

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20. *Fair value*

Fair values versus carrying amounts

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

	30.9. 2013		31.12. 2012	
	Carrying amount	Fair value	Carrying amount	Fair value
Interest-bearing liabilities	(207.361.753)	(183.620.814)	(231.503.285)	(223.412.705)

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

Interest rates used for determining fair value

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

	30.9. 2013	31.12. 2012
Embedded derivatives in electr. sales contr.	1.69% to 12.58%	2.37% to 11.56%
Other financial assets	6.59% to 7.23%	3.99% to 4.39%
Interest bearing loans	1.60% to 5.28%	1.05% to 4.76%

Fair value hierarchy

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

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

30.9. 2013	Level 2	Level 3	Total
Shares in companies	0	3.629.182	3.629.182
Embedded derivatives in sales contracts	0	4.582.676	4.582.676
Other financial assets	0	9.789.280	9.789.280
Other financial liabilities	(1.407.741)	0	(1.407.741)
	(1.407.741)	18.001.138	16.593.396
31.12. 2012			
Shares in companies	0	3.265.182	3.265.182
Embedded derivatives in sales contracts	0	14.738.660	14.738.660
Other financial assets	0	10.684.315	10.684.315
Other financial liabilities	(249.274)	0	(249.274)
	(249.274)	28.688.157	28.438.883

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

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Notes

21. Overview of financial instruments

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

	30.9. 2013			31.12. 2012		
	Loans and receivables	Financial asset/ financial liability at fair value through P/L	Available for sale	Loans and receivables	Financial asset/ financial liability at fair value through P/L	Available for sale
Shares in other companies			3.629.182			3.265.182
Embedd. electr. sales contracts ..		4.582.676			14.738.660	
Other financial assets	579	9.788.701		6.564	10.677.751	
Trade receivabl. .	5.332.134			4.721.350		
Other receivabl. ..	353.554			298.181		
Cash	8.092.919			6.885.693		
Interest-bearing .. liabilities	(207.361.753)			(231.503.285)		
Other financial liabilities		(1.407.741)			(249.274)	
Account payabl. .	(1.166.969)			(1.366.254)		
Prepaid income ..	(1.738.792)			(3.477)		
Other current liabilities	(3.503.879)			(2.948.155)		
	(199.992.207)	12.963.636	3.629.182	(223.909.384)	25.167.137	3.265.182

22. Group entities

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

		Share	
Subsidiaries	**Main operation**	**30.9. 2013**	**31.12. 2012**
Gagnaveita Reykjavíkur ehf.	Data transfer	100.0%	100.0%
Reykjavík Energy Invest ehf.	Investments	100.0%	100.0%
Úlfljótsvatn frítímabyggð ehf.	Preperation company	100.0%	100.0%
Hrafnabjargavirkjun hf.	Preperation company	0.0%	60.0%

Main changes in the Group during the year

In June 2013 Orkuveita Reykjavíkur sold all its shares in Hrafnabjargarvirkjun hf.

23. Events after the reporting date

Finalisation of the sale of the Company´s headquarters and leaseback

The sale of the Company´s headquarters was finalised at the end of October 2013. The properties were all leased back from the same time from the new owner, Foss fasteignafélag ehf. The lease period is 20 years. Lease payments are netto ISK 223.9 million for the first 10 years and increase after that for the next 10 years to ISK 290.2 million, amounts subject to changes in the CPI of Iceland. In the contracts there are articles regarding purchase options the Company can use in 10 years and 20 years.

Orkuveita Reykjavikur´s investment in HS Veitur

Orkuveita Reykjavikur has entered into an agreement regarding the main disclaimers and private negotioation regarding the sale of it´s investment in HS Veitur. The contract is between the buyer, Ursus I slhf. and Orkuveita Reykjavíkur as the seller as well as other sellers of their part in HS Veitur. Those sellers are Reykjanesbær, Grindavíkurbær, Sandgerðisbær, Garður municipality and municipality Vogar. According to the agreement Orkuveita Reykjavikur will sell all its shares in HS Veitur, book value ISK 1.321 million and projected sale price is ISK 1.514 million.

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24. Other issues

Reducted payments from Norðurál

A conclusion was reached in an arbitration, where HS Orka was the claimant against Norðurál on the grounds of the reduction af contractual payments. OR was also a party to the trilateral contract and was therefore also a respondant to the arbitration.The result was that Norðurál did not have the right to reduce contractual payments. OR´s claim amounted to ISK 760 million. OR had not fully realised this claim in revenues due to uncertainty in the matter, that allowance has now been reversed.

Sale of financial assets

Among other financial assets in the balance sheet is a bond issued by Magma Energy Sweden A.B. Orkuveita Reykjavikur received an offer in the bond at the end of June that the Board of Directors and the owners approved. The offer had disclaimers that the buyer could not fulfill within time limits so the offer is no longer valid. The Company is still open to interesting bids in the bond. The fair value of the bond is valued with the same method as before, taking into account presumptions in the void offer.
The bond is classified as a financial asset through P/L and its book value 30 September 2013 is ISK 8.1 billion.

Delays of power plant constructions

The continuation of energy production projects has been called into question due to delays in meeting contractual conditions of energy sales contracts between Orkuveita Reykjavíkur and Norðurál Helguvik ehf. (NH). A review of energy sales contracts is ongoing with NH. It is OR´s opinion that some of the contractual conditions have been breached and OR is in dispute with NH on this matter. As a result, there have also been delays in the fulfilling of contracts with other parties such as machine producers and contractors. Negotiations have been conducted concerning compensation due to these delays. The largest contracts are with Mitsubishi Heavy Industries (MHI) and Balcke Dürr (BD) regarding the delivery of machinery, Orkuveita Reykjavíkur´s obligation regarding those contracts is discussed in note 8. Settlement has been reached with MHI and BD regarding delay of delivery of this machinery. Uncertainty still remains regarding investments of Hverahlíðarvirkjun, the amount of compensation to MHI and BD is unknown, but could be considerable if realised. It is the view of the management that there is no reason to make provisions in the financial statements regarding the matter at this point. The management is confident that solutions which should lower these costs considerably will be realised.

Effect of fluctations in foreign exchange rates and aluminium prices on the Company´s standing

15 November 2013, the day Orkuveita Reykjavíkur´s interim financial statements for the period 1 January to 30 September 2013 were authorised for issue, the TWI is 220,0757 but was 218,8366 at the reporting date 30 September 2013. If interest bearing loans and borrowings would be accounted for according to the foreign exchange rates on the reporting date they would have amounted to ISK 206.9 billion or ISK 1.3 billion higher than accounted for at the end of the accounting period. Embedded derivatives in sales contracts, when taken into consideration changes in aluminium price and currency exchange rates, would have amounted to ISK 2.5 billion on the reporting date or 2.1 billion lower than on the accounting date. Further information about the effect of changes in the exchange rates and aluminium prices can be found in note 17.

Derivative contracts in default

After the collapse of the Icelandic banks in 2008 trading in the foreign exchange market in Iceland has been little and it can hardly be stated that the foreign exchange market is active. Due to the collapse, the Central Bank of Iceland issued rules on foreign exchange based on authority contained in the Act amending the Foreign Exchange Act No. 87/1992, which imposed restrictions on investment and transactions in foreign exchange.

Among other current liabilities are derivative contracts accounted for that are in default. The contracts have not been settled and Orkuveita Reykjavíkur has recently been sued regarding the claims. Great uncertainties, both with Orkuveita Reykjavikur and the Receivership Committees of the fallen banks, is on how to settle them. In previous periods ISK 740 million have been expensed. This action is in no way an admittance of the debt on Orkuveita Reykjavikur´s behalf and the amount can either increase or decrease when the contracts are settled. The contracts are accounted for among other current liabilities.