

Orkuveita Reykjavíkur
Consolidated
Financial Statements 2013

Orkuveita Reykjavíkur
Bæjarháls 1
110 Reykjavík

reg no. 551298-3029

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Endorsement by the Board of Directors and the Managing Director

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

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

Profit of operations of Orkuveita Reykjavíkur during the year 2013 was ISK 3.350 million. According to the statement of financial position the Company's assets were ISK 283.107 million at year-end, book value of equity at year-end was ISK 80.969 million, resulting in equity ratio of 28.6%

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 Company's Board of Directors do not propose dividend payments to the Company's shareholders in the year 2014 due to the operating year 2013.

Changes in the Company's group January 1, 2014

On 1 January 2014 the provision of the Electricity Act that obligates companies in that market to segregate licensed from competitive operations, came to effect. At the beginning of the year 2014, Our Nature plc, began operating on the competitive electricity market as a subsidiary, wholly-owned by Reykjavik Energy, this being done to fulfil the act. The unbundling of Reykjavik Energy involved numerous tasks. Care had to be taken to maintaining lenders' trust. The company had to safeguard that the changed Group kept the benefit of its taxable loss, and that the finances of individual units were sufficiently solid after the segregation.

In connection with the unbundling, parliament passed a new comprehensive act for the company, Act no. 136/2013. It reflects decisions of the company's owners on its core operations. At the same time, decisions on the internal governance of Reykjavik Energy are more in the hands of the owners.

In order to ensure that the unbundling would surely be in accordance with governmental requirements without harming consumers, Reykjavik Energy's owners decided to segregate various aspects of the operations as clearly as possible. Mandatory services, water and sewage utilities, will be operated in a separate company, and exclusively licensed operations in another one. The competitive units in the field of electricity and fibre optics are in independent companies, owned by Reykjavik Energy. The core of Reykjavik Energy's operations is and will be utility services. They will continue to be operated under Reykjavik Energy's banner, both the mandatory municipal services, like water and sewage utilities, and the exclusively licensed services of electricity distribution and heating. In the parent company of the unbundled group, joint service divisions for the subsidiaries will be operated.

Corporate governance

The Board maintains and seeks to improve good corporate governance. In an appendix with the Financial Statements further information regarding corporate governance can be found and further information on owners' policy and the Board's procedures will be discussed in the Company's Annual Statements. The Annual Statement will be published in April 2014 and can then be found on the Company's website, www.or.is

Endorsement by the Board of Directors and the Managing Director

Statement by the Board of Directors

According to the best knowledge of the Board of Directors of Orkuveita Reykjavíkur, the company's consolidated financial statements are in accordance with IFRS's as adopted by the EU. It is the opinion of the Board of Directors that the consolidated financial statements give a fair view of the Company's assets, liabilities and financial position 31 December 2013 and the company's operating return and changes in cash and cash equivalents for the year then ended.

It is the opinion of the Board of Directors that the consolidated financial statements give a fair view of the Company's operating development and results, its standing and describe the main risk factors and uncertainties faced by the Company. Discussion on risk management and risk due to financial instruments can be found in the notes with the financial statements.

The Board of Directors and the Managing Director of Orkuveita Reykjavíkur hereby confirm the Company's consolidated financial statements for the year 2013.

Reykjavík, 21 March 2014.

The Board of Directors:

Haraldur Flosi Tryggvason

Brynhildur Davíðsdóttir

Gylfi Magnússon

Hrönn Ríkharðsdóttir

Sóley Tómasdóttir

Kjartan Magnússon

Managing Director:

Bjarni Bjarnason

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 statement of financial position as at December 31, 2013, the income statement, the statement of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of Orkuveita Reykjavíkur as at December 31, 2013, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Report on the Board of Directors report

Pursuant to the legal requirement under Article 104, Paragraph 2, of the Icelandic Financial Statement Act No. 3/2006, we confirm that, to the best of our knowledge, the report of the Board of Directors accompanying the financial statements includes the information required by the Financial Statement Act if not disclosed elsewhere in the Financial Statements.

Reykjavík, 21 March 2014.

KPMG ehf.

Auðunn Guðjónsson

Guðný Helga Guðmundsdóttir

Income Statement 2013

	Notes	2013	2012
Operating revenue		38.587.479	37.863.227
Profit from sale of assets		621.959	41.318
Operating revenues, total	5	39.209.438	37.904.545
Energy purchase .....	(	5.401.633)	(4.865.858)
Salaries and salary related expenses	7	(3.639.815)	(3.701.222)
Other operating expenses	8	(4.084.336)	(4.293.531)
Operating expenses, total		(13.125.784)	(12.860.611)
EBITDA		26.083.654	25.043.934
Depreciation and amortisation	9	(8.927.345)	(10.371.085)
Results from operating activities, EBIT		17.156.310	14.672.849
Interest income		208.723	146.916
Interest expenses .....	(	6.307.674)	(7.092.787)
Other (expenses) income on financial assets and liabilities		(133.335)	(11.547.680)
Total financial income and expenses	10	(6.232.285)	(18.493.550)
Share in loss of associated companies	15	(2.309)	(9.754)
Profit (loss) before income tax		10.921.715	(3.830.455)
Income tax	11	(7.571.959)	1.535.261
Profit (loss) for the year		3.349.756	(2.295.194)
Attributable to:			
Equity holders of the Company		3.349.756	(2.294.823)
Minority interest in subsidiaries		0	(371)
Profit (loss) for the year		3.349.756	(2.295.194)

The notes on pages 11 to 56 are an integral part of these Consolidated Financial Statements.

Statement of Comprehensive Income for the year ended 31 December 2013

	Notes	2013	2012
Profit (loss) for the year		3.349.756	(2.295.194)
Comprehensive income			
Items moved to equity that will not be moved later to the income statement			
Revaluation reserve, increase	12	14.682.883	0
Revaluation reserve, decrease	12 (	4.000.000)	0
Income tax effect of revaluation	11 (	2.183.524)	0
Effect of change in tax rate on the revaluation reserve	11	7.934.264	0
		16.433.623	0
Items moved to equity that could be moved later to the income statement			
Changes in fair value of assets available for sale	16	542.248	1.300.000
		542.248	1.300.000
Comprehensive income moved directly to equity, after taxes		16.975.870	1.300.000
Total comprehensive profit (loss) for the year		20.325.626	(995.194)
Total comprehensive income attributable to:			
Equity holders of the Company		20.325.626	(994.823)
Minority interest in subsidiaries		0	(371)
Total comprehensive profit (loss) for the year		20.325.626	(995.194)

The notes on pages 11 to 56 are an integral part of these Consolidated Financial Statements.

Consolidated Statement of Financial Position

31 December 2013

	Notes	2013	2012
Assets			
Property, plant and equipment	12	251.400.707	246.111.462
Intangible assets	14	1.242.808	1.218.980
Investments in associated companies	15	57.517	59.826
Investments in other companies	16	3.734.550	3.265.182
Embedded derivatives in electricity sales contracts	17	965.916	14.150.678
Hedge contracts	18	1.127.246	893.934
Other financial assets	18	7.502.804	9.745.440
Deferred tax assets	19	1.646.049	3.467.268
Total non-current assets		<u>267.677.597</u>	<u>278.912.770</u>
Inventories	20	367.347	402.872
Trade receivables	21	5.579.218	4.721.350
Embedded derivatives in electricity sales contracts	17	0	587.982
Hedge contracts	18	232.031	38.956
Other financial assets	18	386	5.986
Properties held for sale	13	0	5.347.856
Other receivables	21	257.409	298.181
Cash and cash equivalents	22	8.993.410	6.885.693
Total current assets		<u>15.429.801</u>	<u>18.288.875</u>
Total assets		<u><u>283.107.398</u></u>	<u><u>297.201.645</u></u>

The notes on pages 11 to 56 are an integral part of these Consolidated Financial Statements.

Consolidated Statement of Financial Position

31 December 2013

	Notes	2013	2012
Equity			
Revaluation reserve		66.354.727	51.791.161
Fair value reserve		2.302.248	1.760.000
Retained earnings		12.312.122	7.092.309
Equity attributable to equity holders of the Company		80.969.097	60.643.470
Minority interest		0	4.353
Total equity	23	80.969.097	60.647.822
Liabilities			
Loans and borrowings	24	175.319.931	201.546.363
Retirement benefit obligation	25	492.925	483.377
Hedge contracts	18	80.847	98.974
Total non-current liabilities		175.893.703	202.128.714
Accounts payable		1.988.525	1.366.254
Loans and borrowings	24	19.619.524	29.956.923
Embedded derivatives in electricity sales contracts	17	548.176	0
Hedge contracts	18	1.390.870	150.300
Other current liabilities	26	2.697.502	2.951.632
Total current liabilities		26.244.598	34.425.109
Total liabilities		202.138.301	236.553.823
Total equity and liabilities		283.107.398	297.201.645

The notes on pages 11 to 56 are an integral part of these Consolidated Financial Statements.

Statement of Changes in Equity for the year 2013

	Revaluation reserve	Fair value reserve	Retained earnings	Attributable to equity holders of the Company	Minority interest	Total equity
The year 2013						
Equity at 1 January 2013	51.791.161	1.760.000	7.092.309	60.643.470	4.353	60.647.822
Revaluation, increase	14.682.883			14.682.883		14.682.883
Revaluation, decrease	(4.000.000)			(4.000.000)		(4.000.000)
Income tax effect of revaluation	(2.183.524)			(2.183.524)		(2.183.524)
Effect of group changes 1.1.2014						
on income tax on revaluation	7.934.264			7.934.264	0	7.934.264
Changes in fair value of						
assets available for sale		542.248		542.248		542.248
Profit for the year			3.349.756	3.349.756	0	3.349.756
Total comprehensive income	16.433.623	542.248	3.349.756	20.325.627	0	20.325.627
Depreciation transferred to						
retained earnings	(1.870.057)		1.870.057	0		0
Other changes				0	(4.353)	(4.353)
Equity at 31 December 2013	66.354.726	2.302.248	12.312.122	80.969.097	0	80.969.096
The year 2012						
Equity at 1 January 2012	53.923.090	460.000	7.255.201	61.638.291	4.725	61.643.016
Changes in fair value of						
assets available for sale		1.300.000		1.300.000		1.300.000
Loss for the year			(2.294.823)	(2.294.823)	(371)	(2.295.194)
Total comprehensive income	0	1.300.000	(2.294.823)	(994.823)	(371)	(995.194)
Depreciation transferred to						
retained earnings	(2.131.929)		2.131.929	0		0
Equity at 31 December 2012	51.791.161	1.760.000	7.092.307	60.643.468	4.354	60.647.822

The notes on pages 11 to 56 are an integral part of these Consolidated Financial Statements.

Statement of Cash Flows for the year 2013

	Notes	2013	2012
Cash flows from operating activities			
Cash generated from operations before interest and taxes	33	25.120.308	24.335.571
Received interest income		210.379	137.916
Paid interest expenses .....	(	4.966.841)	(5.411.118)
Dividend received		52.124	54.475
Paid due to other financial income and expenses .....	(	383.224)	(182.318)
Net cash from operating activities		20.032.746	18.934.526
Cash flows from investing activities			
Acquisition of property, plant and equipment .....	(	3.459.378)	(3.122.147)
Acquisition of intangible assets .....	(	70.795)	(50.383)
Proceeds from sale of property, plant and equipment		5.972.782	226.200
Sale of subsidiaries .....	(	10.833)	0
Proceeds from sale of other companies		6.529	197.693
Acquisition of other financial assets		0	(28.000)
Proceeds and repayment of other financial assets		5.986	29.858
Net cash used in investing activities		2.444.291	(2.746.779)
Cash flows from financing activities			
Proceeds from new borrowings		3.080.750	1.007.996
Repayment of borrowings .....	(	23.571.061)	(12.317.428)
Proceeds from new borrowings from the owners		4.000.000	74.640
Credit facility, change .....	(	2.500.000)	(2.482.638)
Current liabilities, change .....	(	152.190)	2.357.358
Net cash from financing activities	(	19.142.500)	(11.360.072)
Increase in cash and cash equivalents		3.334.536	4.827.676
Cash and cash equivalents at year beginning		6.885.693	1.652.484
Effect of currency fluctuations on cash and cash equivalents .....	(	1.226.819)	405.534
Cash and cash equivalents at year-end		8.993.410	6.885.693
Investments and financing without payment effects:			
Acquisition of property, plant and equipment .....	(	131.085)	(195.704)
Current liabilities, change		131.085	195.704
Other information:			
Working capital from operation		19.675.015	19.880.141

The notes on pages 11 to 56 are an integral part of these Consolidated Financial Statements.

Notes to the Financial Statements

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Notes

1. Reporting entity

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

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

2. Basis of preparation

a. Statement of compliance

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

The financial statements were approved by the Board of Directors on 21 March 2014.

b. Basis of measurement

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

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

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

c. Functional and presentation currency

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

d. Use of estimates and judgements

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

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

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

- note 12 - Property, plant and equipment (revaluation of the distribution- and production system and valuation of impairment.)
- note 16 - Investments in other companies (presumptions made when calculating fair value of assets classified for sale.)
- note 17 - Embedded derivatives in electricity sales contracts (presumptions when calculating fair value.)
- note 18 - Other financial assets and other financial liabilities
- note 19 - Deferred tax assets and liabilities (valuation of future taxable profits against carry forward tax losses.)
- note 25 - Retirement benefit obligations (presumptions when calculating the obligation)
- note 28 - Market risk
- note 34 - Property leases (classification of property leases)

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. Exception from this is the effect changes evolving from implementing new accounting standards, further discussed in note 3. p.

a. Basis of consolidation

i) Subsidiaries

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

ii) Associates

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

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

iii) Transactions eliminated on consolidation

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

b. Foreign currency

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

Notes

3. Significant accounting policies, contd.

c. Financial instruments

i) Non-derivative financial assets

Loans, receivables and cash in bank are recognised when received. All other financial instruments are recognised in the financial statements when the Company becomes a party of contractual provisions of the relevant financial instruments.

Financial assets are eliminated from the financial statements if the Company's contractual right to cash flow due to the financial asset expires or if the Group transfers the assets to another party without retaining control or nearly all risk and gain inherent with their ownership. Any interest in transferred financial assets that is created or retained by the group is recognized as a separate asset or liability.

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.

Available-for sale financial assets

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

Financial assets at fair value through profit or loss

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

Loans and receivables

Loans and receivables are financial assets with certain or determinable payments and are not listed in active markets. Such assets are recognised initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition loans and receivables are measured at amortised cost using the effective interest method, less any impairment losses.

Loans and receivables comprise of receivables and other current assets.

Cash and cash equivalents comprise cash balances and call deposits.

Notes

3. Significant accounting policies, contd.

c. Financial instruments, contd.

ii) Non-derivative financial liabilities

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

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

The Company classifies non-derivative financial liabilities as other financial liabilities. Such liabilities are recognised initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition financial liabilities are measured at amortised cost using the effective interest method.

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

iii) Derivative financial instruments

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

iv) Embedded derivatives

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

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

Notes

3. Significant accounting policies, contd.

d. Property, plant and equipment

i) Recognition and measurement

Items of property, plant and equipment, except 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.

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

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

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

The fair value of these assets is determined on the basis of the depreciated replacement cost. This consists in that an assessment is made on changes in the construction cost of comparable assets and both cost and accumulated depreciations are revalued in accordance with those changes. The calculation is based on official information and actual statistics from the Company's books on value changes of cost of items and takes into account an estimate on the weight of each cost item in the total cost of construction of comparable assets. Cost items and their proportional weight were determined by experts within and outside of the Company. The impairment test of assets is also taken into consideration and revaluation is not recognised beyond the expected future cash flow of the assets. Distribution systems for hot water, cold water, sewage and electricity are licensed operations and subject to official revenue targets that are based mostly on changes in the construction cost index. This is taken into consideration when revaluating these systems.

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

ii) Subsequent costs

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

Notes

3. Significant accounting policies, contd.

d. Property, plant and equipment, contd.

iii) Depreciation

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

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

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

e. Intangible assets

i) Heating rights

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

ii) Other intangible assets

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

iii) 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.

iv) Amortisation

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

Heating rights	100 years
Software	3-7 years

f. Leased assets

All of the Company's lease agreements are considered as operating lease agreements and the leased assets are not capitalised.

i) The Company as a lessee

Payments of leases are expensed on straight-line basis in the lease term period unless another systematic method describes the usage of the leased item better. Uncertain lease payments from lease agreements are expensed in the period they occur.

ii) The Company as a lessor

Payments received from leases, both own property as well as lease-back properties, are booked on straight-line basis in the lease term period.

Notes

3. Significant accounting policies, contd.

g. Inventories

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

h. Impairment

i) Financial assets

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

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

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

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

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

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

ii) Non-financial assets

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

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

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

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

Notes

3. Significant accounting policies, contd.

i. Employee benefits

i) Defined contribution plans

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

ii) Defined benefit plans

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

j. Obligations

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

k. Revenue

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

Revenue from the sale and distribution of electricity and hot water is recognised in the income statement according to measured delivery to purchasers during the year plus a fixed fee.

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

ii) Revenues from sale of cold water and sewage

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

iii) Connection revenues

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

iv) Other revenues

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

Notes

3. Significant accounting policies, contd.

m. *Financial income and expenses*

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

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

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

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

n. *Income tax*

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

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. The income tax ratio for the parent company is 36.0% and the tax ratio for the subsidiaries is 20.0%. Cold water supply and sewage is exempt from tax.

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax was measured in accordance with the current tax rate, which is 36.0% for the parent company that is a partnership and 20.0% for the subsidiaries that are companies with limited liability. Deferred tax that comes from operations that move to recently established subsidiaries in the beginning of the year 2014 is calculated with the tax rate applicable for the subsidiaries, i.e. 20%.

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

Notes

3. Significant accounting policies, contd.

o. Segment reporting

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

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

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

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

p. New standards and interpretations

The Company has implemented all international accounting standards, their interpretation and changes on existing standards that were effective at year end 2013 and are related to the Company's operation. The effect of new standards are described here below. The Group has not beforehand implemented international accounting standards, their interpretation and changes which are effective after 31 December 2013. Adoption of these standards are not considered to have a significant effect on the preparation of the Group's financial statements.

i) IFRS 13 Fair value measurement

The Company has applied IFRS 13 for the first time in the current year. IFRS 13 establishes a single source of guidance for fair value measurements and disclosures about fair value measurements. The scope of IFRS 13 is broad; the fair value measurement requirements of IFRS 13 apply to both financial instrument items and non-financial instrument items for which other IFRSs require or permit fair value measurements and disclosures about fair value measurements, except for share-based payment transactions that are within the scope of IFRS 2 Share-based Payment, leasing transactions that are within the scope of IAS 17 Leases, and measurements that have some similarities to fair value but are not fair value (e.g. net realisable value for the purposes of measuring inventories or value in use for impairment assessment purposes).

IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions. Fair value under IFRS 13 is an exit price regardless of whether that price is directly observable or estimated using another valuation technique. Also, IFRS 13 includes extensive disclosure requirements.

IFRS 13 requires prospective application from 1 January 2013. In addition, specific transitional provisions were given to entities such that they need not apply the disclosure requirements set out in the Standard in comparative information provided for periods before the initial application of the Standard. In accordance with these transitional provisions, the Group has not made any new disclosures required by IFRS 13 for the 2012 comparative period. Other than the additional disclosures, the application of IFRS 13 has not had any material impact on the amounts recognised in the consolidated financial statements.

IAS 1 Presentation of Items of Other Comprehensive Income

The Company has applied the amendments to IAS 1 Presentation of Items of Other Comprehensive Income for the first time in the current year. The amendments to IAS 1 require items of other comprehensive income to be grouped into two categories in the other comprehensive income section: (a) items that will not be reclassified subsequently to profit or loss and (b) items that may be reclassified subsequently to profit or loss when specific conditions are met. Income tax on items of other comprehensive income is required to be allocated on the same basis – the amendments do not change the option to present items of other comprehensive income either before tax or net of tax. The amendments have been applied retrospectively, and hence the presentation of items of other comprehensive income has been modified to reflect the changes. Other than the above mentioned presentation changes, the application of the amendments to IAS 1 does not result in any impact on profit or loss, other comprehensive income and total comprehensive income.

Notes

4. Determination of fair values

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities.

The Company's CFO is responsible for overseeing all significant fair value measurements, including Level 3 fair values. Treasury- and risk management, led by the CFO, regularly reviews significant unobservable inputs and valuation adjustments. If third party information, such as broker quotes or pricing services, is used to measure fair values, then that information is used to support the conclusion that such valuations meet the requirements of IFRS, including the level in the fair value hierarchy in which such valuations should be classified.

The Company's audit committee is informed of significant valuation issues.

When measuring the fair value of an asset or a liability, the Company uses market observable data as far as possible. Fair values are categorised into different levels in a fair value hierarchy based on the inputs used in the valuation techniques as follows.

Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: inputs other than quoted prices included in 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).

If the inputs used to measure the fair value of an asset or a liability might be categorised in different levels of the fair value hierarchy, then the fair value measurement is categorised in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement.

The Company recognises transfers between levels of the fair value hierarchy at the end of the reporting period during which the change has occurred.

Further information about the assumptions made in measuring fair values can be found in relevant notes and in note nr. 31 regarding fair value.

a. *Property, plant and equipment*

The fair value of production- and fibre-optic systems that have undergone a revaluation is determined on the basis of the depreciated replacement cost, which consists in the assessment of changes in construction cost of comparable assets and both cost and accumulated depreciation are re-measured in accordance with those changes. The results of the impairment tests are also taken into consideration and revaluation is not recognised beyond the expected future cash flow of those assets.

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

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

Notes

4. Determination of fair values, contd.

b. *Investments in equity and debt securities*

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

c. *Derivatives*

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

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

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

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

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

d. *Trade and other receivables*

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

e. *Non-derivative financial liabilities*

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

Notes

5. Segment reporting

Business divisions and sectors

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

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

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

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

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

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

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

Customers that have significant effect on the Company's revenues

One customer has significant effect on the Company's revenues in the year 2013, i.e. Norðurál Grundartangi inc.

Revenues from Norðurál Grundartangi inc., a customer of the Company's Production and Sale's division, represents approximately ISK 6.589 million or 16.8% of total revenues. (2012: ISK 6.943 million, or 18.3% of total revenue.)

Notes

5. Segment reporting

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

Business segments - divisions		Production	Other	Adjust-	
The year 2013	Utilities	and sale	Operation	ments	Total
External revenue	25.893.741	12.498.245	817.452	0	39.209.438
Inter-segment revenue	239.225	11.361.307	507.128	(12.107.660)	0
Total segment revenue	26.132.966	23.859.552	1.324.580	(12.107.660)	39.209.438
Segment result	11.440.742	4.930.163	996.482	0	17.367.387
Unallocated expenses					(211.077)
Results from operating activities					17.156.310
Financial income and expenses					(6.232.285)
Share of loss of associated companies					(2.309)
Income tax					(7.571.959)
Profit for the year					3.349.757
The year 2012					
External revenue	24.536.839	12.928.173	439.533	0	37.904.545
Inter-segment revenue	239.150	11.249.187	382.497	(11.870.834)	0
Total segment revenue	24.775.989	24.177.360	822.030	(11.870.834)	37.904.545
Segment result	11.352.117	4.586.527	(7.002)	0	15.931.642
Unallocated expenses					(1.258.793)
Results from operating activities					14.672.849
Financial income and expenses					(18.493.550)
Share of loss of associated companies					(9.754)
Income tax					1.535.261
Loss for the year					(2.295.194)

Notes

5. Segment reporting, contd.

Business segments - divisions, contd.

The year 2013

Balance sheet (31.12. 2013)

	Utilities	Production and sale	Other Operation	Adjustments	Total
Property, plant and equipment and properties held for sale	144.445.946	104.928.005	9.286	2.017.471	251.400.708
Intangible assets	0	0	0	1.242.808	1.242.808
Shares in associates					57.517
Other unallocated assets					30.406.365
Total assets					283.107.398
Unallocated liabilities					202.138.301

Investments:

Property, plant and equipment	2.692.093	557.264	0	240.347	3.489.704
Intangible assets	0	0	0	70.795	70.795

Depreciation, amortization:

Property, plant and equipment	4.957.625	3.787.859	0	151.032	8.896.516
Intangible assets	0	0	0	30.829	30.829

The year 2012

Balance sheet (31.12. 2012)

Property, plant and equipment and properties held for sale	134.028.592	110.594.420	9.286	6.827.021	251.459.319
Intangible assets	0	0	0	1.218.980	1.218.980
Shares in associates					59.826
Other unallocated assets					44.463.520
Total assets					297.201.645
Unallocated liabilities					236.553.823

Investments:

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

Depreciation, amortization:

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

Notes

5. Segment reporting, contd.

Business segments - sectors

The year 2013

	Electricity	Hot water	Cold water	Sewer	Fibre-optic cable system	Adjustments	Total
Income							
External revenue	19.290.486	10.396.708	3.323.183	4.612.210	1.586.851	0	39.209.438
Inter-segment revenue	858.014	172.948	44.794	62.170	0	(1.137.926)	0
Total segment revenue	20.148.500	10.569.656	3.367.977	4.674.380	1.586.851	(1.137.926)	39.209.438
Balance sheet (31.12. 2013)							
Properties, current and non-current	104.406.924	75.577.277	20.087.937	40.115.146	11.213.423	0	251.400.707
Intangible assets	569.205	367.872	99.425	206.306	0	0	1.242.808
Unallocated assets	0	0	0	0	0	0	30.463.883
Total assets	104.976.129	75.945.149	20.187.362	40.321.452	11.213.423	0	283.107.398
Investments							
Property, plant and equipments	811.148	803.083	330.742	633.050	911.682	0	3.489.705
Intangible assets	32.778	20.814	5.593	11.610	0	0	70.795
Depreciation, amortization							
Property, plant and equipments	3.887.686	2.689.835	528.424	1.252.309	538.261	0	8.896.515
Intangible assets	11.715	9.557	3.083	6.474	0	0	30.829

Notes

5. Segment reporting, contd.

Business segments - sectors, contd.

The year 2012

	Electricity	Hot water	Cold water	Sewer	Fibre-optic cable system	Adjustments	Total
Income							
External revenue	19.252.841	9.904.780	3.176.966	4.184.368	1.385.590	0	37.904.545
Inter-segment revenue	824.308	137.839	33.275	43.827	0	(1.039.249)	0
Total segment revenue	20.077.149	10.042.619	3.210.241	4.228.195	1.385.590	(1.039.249)	37.904.545
Balance sheet (31.12. 2012)							
Properties	112.712.357	70.343.547	18.699.324	38.864.090	10.840.001	0	251.459.319
Intangible assets	570.483	355.942	96.299	196.256	0	0	1.218.980
Unallocated assets	0	0	0	0	0	0	44.523.346
Total assets	113.282.840	70.699.489	18.795.623	39.060.346	10.840.001	0	297.201.645
Investments							
Property, plant and equipments	984.378	573.471	216.723	302.763	937.599	0	3.014.934
Intangible assets	23.579	14.813	3.930	8.061	0	0	50.383
Depreciation, amortization							
Property, plant and equipments	4.563.001	3.379.335	536.353	1.281.570	522.485	0	10.282.744
Intangible assets	33.750	27.525	8.479	18.586	0	0	88.340

Notes

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 2013	Hot water 2013	Electricity 2012	Hot water 2012
Power plant at Nesjavellir				
Revenue	8.139.505	2.700.000	8.663.959	1.915.000
Operating expenses	(1.322.543)	(662.894)	(1.262.653)	(682.717)
Depreciation	(2.525.250)	(808.745)	(3.109.676)	(843.802)
Profit before financial expenses	<u>4.291.712</u>	<u>1.228.360</u>	<u>4.291.630</u>	<u>388.481</u>
Return on investment	5.1%	5.5%	4.7%	2.1%

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

The Company has changed its basis for cost allocation between heat and electricity in its geothermal power plants. The cost allocation is now based on installed capacity for both electricity and heat. Previously the Company used guidelines from the National Energy Authority, which according to Orkuveita Reykjavíkur, do not represent a fair allocation. Cost allocation was based on actual production figures. The Company's methodology for cost allocation has been sent to National Energy Authority for approval, without confirmation so far.

7. Salaries and salary related expenses

	2013	2012
Salaries and salary related expenses are specified as follows:		
Salaries	3.179.776	2.988.203
Defined contribution pension expenses	419.024	395.860
Defined benefit pension expenses	28.748	55.547
Other salary related expenses	331.935	313.216
Expensed salaries and salary related expenses due to early retirement plan and laid-off employees 1)	<u>54.887</u>	<u>314.271</u>
Total salaries and salary related expenses	<u>4.014.369</u>	<u>4.067.097</u>

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

Expensed in the income statement	3.639.815	3.701.222
Capitalised on projects	374.554	365.875
Total salaries and salary related expenses	<u>4.014.369</u>	<u>4.067.097</u>

Number of employees:

Number of annual working units	445	476
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Management's salaries and benefits for the parent company and subsidiaries are specified as follows:

Salaries to the Board of Directors of the Parent Company	20.137	16.695
Salaries to the Director and five Managing Directors of the Parent Company	102.638	94.037
Salaries to the Board of Directors and Managing Directors of subsidiaries	19.861	21.931
Defined contribution pension expenses	17.905	17.075
Termination expenses, pension expenses included	0	9.071
	<u>160.541</u>	<u>158.808</u>

Included in salaries are vehicle subsidy.

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

Notes

8. Other operating expenses

	2013	2012
Other operating expenses is specified as follows:		
Operational cost of utilities and power plants	1.329.494	1.570.857
Collection cost and other office cost	704.139	625.924
Operation cost of properties	585.571	566.098
Public levies and insurance cost	444.087	447.369
Various cost	1.021.046	1.083.283
Other operating expenses, total	<u>4.084.337</u>	<u>4.293.531</u>

Among other operating expenses is one-time cost due to unbundling of the Company at the beginning of the year 2014. Most of the cost results from changes in computer systems, legal advisement and consultation regarding capital structure and tax issues.

9. Depreciation and amortisation

	2013	2012
Depreciation and amortisation is specified as follows:		
Depreciation of property, plant and equipment	8.496.515	9.052.618
Amortisation of assets in construction	400.000	743.431
Amortisation of properties held for sale	0	486.696
Depreciation and amortisation, total, cf. note 12	<u>8.896.515</u>	<u>10.282.745</u>
Amortisation of intangible assets, cf. note 14	<u>30.829</u>	<u>88.340</u>
Depreciation and amortisation recognised in the income statement	<u>8.927.345</u>	<u>10.371.085</u>

10. Financial income and expenses

	2013	2012
Financial income and expenses are specified as follows:		
Interest income	208.723	146.916
Interest expense	(5.489.263)	(6.232.254)
Guarantee fee to owners 1)	(818.411)	(860.534)
Total interest expenses	<u>(6.307.674)</u>	<u>(7.092.787)</u>
Fair value changes of embedded derivatives in electricity sales contracts	(14.320.921)	(2.944.310)
Fair value changes of assets available for sale	(74.900)	0
Fair value changes of financial assets and financial liabilities through P/L	(2.102.704)	1.847.840
Change in valuation of derivatives in default, cf. note 37	0	(558.759)
Hedge contracts	(1.355.128)	417.832
Foreign exchange difference	17.666.647	(10.364.758)
Dividends	53.671	54.475
Total of other income (expenses) on financial assets and liabilities	<u>(133.335)</u>	<u>(11.547.680)</u>
Total financial income and expenses	<u>(6.232.285)</u>	<u>(18.493.550)</u>

1) Orkuveita Reykjavíkur paid a guarantee fee to current and former owners of the company for guarantees they have made on the Groups loans and borrowings according to a decision made on the annual meeting of Orkuveita Reykjavíkur in 2005. The fee on yearly basis for its licenced operations is 0.375% and 0.49% 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 818 million in the year 2013 (2012: ISK 861 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. Change in fair value that is expensed in the income statement amounts ISK 16.499 million. (2012: expense ISK 1.096 million).

Notes

11. Income tax

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

Income tax recognised in the income statement is specified as follows:	2013	2012
Change in deferred income tax	7.571.959	(1.535.261)
Income tax recognised in the income statement	7.571.959	(1.535.261)

Reconciliation of effective tax rate:	2013		2012	
Profit (loss) before income tax		10.921.715		(3.830.455)
Income tax according to current tax ratio	36.0%	3.931.817	36.0%	(1.378.964)
Effect of various tax rates in the Group	(1.6%)	(172.496)	(0.9%)	33.817
Effect of valuation of exploitation of deferred tax losses	(2.7%)	(290.000)	2.6%	(100.000)
Non-taxable operation of water supply and sewer	(23.4%)	(2.555.631)	2.4%	(93.706)
Effect of unbundling on deferred income tax	60.3%	6.586.925	0.0%	0
Other items	0.7%	71.344	(0.1%)	3.592
Effective income tax	69.3%	7.571.959	40.0%	(1.535.261)

Income tax moved directly to equity

Deferred tax

Due to income and expenses moved directly to equity	2013	2012
Tax effect of revaluation	2.183.524	0
Effect of unbundling on tax on revaluation	(7.934.264)	0
Deferred tax, total	(5.750.740)	0

See further discussion about the effect of the unbundling on deferred taxes in note 3. n.

Notes

12. Property, plant and equipment

Property, plant and equipment is specified as follows:

The year 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 year	808.728	2.394.477	870	235.945	3.440.021
Additions of assets					
in construction	4.940	44.744	0	0	49.684
Sold or disposed of	0	0	0	16.054	16.054
Revaluation, increase	9.044.863	12.793.442	0	0	21.838.305
Revaluation, decrease	(4.073.811)	0	0	0	(4.073.811)
Balance at year end	204.016.107	239.007.474	2.084.402	1.496.289	446.604.272
Depreciation					
Balance at year beginning	64.424.583	113.110.231	881.295	806.447	179.222.557
Reclassification of assets	0	0	17.836	0	17.836
Depreciated during the year	4.904.854	3.842.117	16.288	133.257	8.896.515
Sold or disposed of	0	0	0	(14.954)	(14.954)
Revaluation, increase	877.981	6.277.442	0	0	7.155.423
Revaluation, decrease	(73.811)	0	0	0	(73.811)
Balance at year end	70.133.607	123.229.790	915.419	924.750	195.203.566
Carrying amounts					
At 1.1. 2013.....	133.806.804	110.664.579	1.202.237	437.842	246.111.462
At 31.12. 2013.....	133.882.500	115.777.684	1.168.983	571.538	251.400.706
Thereof assets in construction at year end.....	6.949.212	1.599.762	0	0	8.548.975
The year 2012					
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

Notes

12. Property, plant and equipment, contd.

Revaluation

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

Revaluation was carried out for the distribution system except for the fibre-optic system at year-end as a part of the regular revaluation of the Company's assets. The revaluation led to an increase of book value of those assets, amounting to ISK 12.683 million. Revaluation was also done for hot water in the production system at year end 2013. The revaluation led to an increase of book value of production assets in hot water amounting to ISK 2.000. The revaluation led to a decrease in the production assets for electricity amounting to ISK 4.000 million, that decrease was recognised in June 2013.

	Date of Revaluation
Revaluation was last executed as specified in the following table:	
Production systems	
Hot water	31.12.2013
Cold water	31.12.2013
Electricity	30.6.2013
Distribution systems	
Hot water	31.12.2013
Cold water	31.12.2013
Sewage	31.12.2013
Electricity	31.12.2013
Fibre-optic cable system	30.9.2010

The fair value of these assets is determined on the basis of the depreciated replacement cost. This consists in that an assessment is made on changes in the construction cost of comparable assets and both cost and accumulated depreciations are revaluated in accordance with those changes. The calculation is based on official information and actual statistics from the Company's books on value changes of cost of items and takes into account an estimate on the weight of each cost item in the total cost of construction of comparable assets. Cost items and their proportional weight were determined by experts within the Company. The impairment test of assets is also taken into consideration and revaluation is not recognised beyond the expected future cash flow of the assets. Distribution systems for hot water, cold water, sewage and electricity are licensed operations and subject to official revenue targets that are based mostly on changes in the construction cost index. This is taken into consideration when revaluating these systems. Revaluation is classified as level 3 of the hierarchy of fair value, further explained in note 31.

Information on revalued assets at year end

	Production system	Distribution system	Total
31.12. 2013			
Revalued carrying amount	133.882.500	115.777.684	249.660.184
Thereof effect of revaluation	(30.401.658)	(45.941.014)	(76.342.672)
Carrying amount before effect of revaluation	<u>103.480.842</u>	<u>69.836.670</u>	<u>173.317.512</u>
31.12. 2012			
Revalued carrying amount	133.806.804	110.664.579	244.471.382
Thereof effect of revaluation	(27.206.629)	(40.048.340)	(67.254.969)
Carrying amount before effect of revaluation	<u>106.600.175</u>	<u>70.616.238</u>	<u>177.216.413</u>

Notes

12. Property, plant and equipment, contd.

Impairment tests

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

i) Weighted average cost of capital (WACC) is 4.67% to 7.93%, (2012: 3.64% to 6.31%) Increase in WACC is mostly explained by changes in tax rates in new subsidiaries.

ii) The future growth is between 0% to 2.5%. (2012: 0% to 2.5%)

Further explanation on impairment test is in note 3. h.

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

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. At year end impairment tests did not indicate further impairment. The assumptions that have had the most effect since year-end 2012 in the impairment tests 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 year.

Rateable value and insurance value

The rateable value of the Company's assets measured in the rateable value assessment amounted to ISK 24.309 million at year end 2013 (2012: ISK 31.390 million). The fire insurance value of the company's assets amounted to ISK 28.182 million at the same time (2012: ISK 38.499 million). Among those assets are real estates capitalised among production and distribution systems.

Obligations

In May 2008 the Company entered into a contract concerning purchase of five, 45 MW turbines for power plants, two of them put to use in the year 2011. In the year 2013 the Company negotiated to delay confirming the deliverance of two of the turbines until 1 June 2016, being delivered in the year 2019. A settlement was also made to cancel the fifth turbine.

The Company received parts for the three turbines in the beginning of the year 2014. These are parts that the producers have received from their subcontractors. The Company has already made payments for these parts according to the contract. Due to the cancellation, but taking into account the value of the delivered parts, a write-off amounting to ISK 400 million in the year 2013 of investment stock.

The remainder of the contract for the two turbines on hold amounts to approximately ISK 7.0 billion as per exchange rate at year end (2012: ISK 12.3 billion). More information regarding these contracts can be found in note 37.

Furthermore, the Company has entered into contracts and placed purchase orders with suppliers and developers concerning work on production and distribution systems. The balance of these contracts and purchase orders at year end is estimated at ISK 1.2 billion (2012: ISK 1.2 billion).

Notes

13. Properties held for sale

Properties held for sale are specified as follows:

	2013	2012
Orkuveita Reykjavíkur, headquarters at Bæjar- and Réttarháls, 110 Reykjavík	0	4.397.856
Perlan, Öskjuhlíð, 105 Reykjavík	0	950.000
Properties held for sale, total	0	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 made a sale contract 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 with a profit of ISK 613,8 million recognised in the income statement. From the same time the Company leases back the headquarters from the new owner, but then subleases a part of the assets to lessees from outside the Company. Further information regarding the lease is in note 34.

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.

14. Intangible assets

Intangible assets are specified as follows:

	Heating rights	Software	Total
The year 2013			
Cost			
Balance at year beginning	1.427.031	1.371.816	2.798.847
Additions during the year	0	70.795	70.795
Sold or disposed of	0	(33.974)	(33.974)
Balance at end of the year	1.427.031	1.408.638	2.835.669
Amortisation			
Balance at year beginning	503.524	1.076.343	1.579.867
Reclassification of assets	0	(17.836)	(17.836)
Amortisation during the year	(55.243)	86.073	30.829
Balance at end of the year	448.281	1.144.579	1.592.860
Carrying amounts			
At 1.1. 2013	923.507	295.474	1.218.980
At 31.12. 2013	978.750	264.058	1.242.808
The year 2012			
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

Notes

15. Investments in associated companies

Investments in associated companies are specified as follows:

	2013		2012	
	Share	Carrying amount	Share	Carrying amount
Iceland American Energy Inc.	83.7%	0	83.7%	0
Íslensk Njorka ehf.	27.6%	29.341	27.6%	29.339
Netorka hf.	23.5%	21.856	23.5%	29.207
Reykjavik Energy Grad. School hf.	45.0%	6.320	45.0%	1.281
Total		<u>57.517</u>		<u>59.827</u>

The Company's share in the loss of its associated companies amounted to ISK 2,3 million in the year 2013 (2012: loss of ISK 10 million).

16. Investments in other companies

Investments in other companies are specified as follows:

	Share	2013	2012
HS Veitur hf.	16.6%	1.499.248	957.000
Landsnet hf. 1)	6.8%	2.160.000	2.160.000
Other shares in companies		<u>75.303</u>	<u>148.182</u>
Other shares in companies, total		<u>3.734.551</u>	<u>3.265.182</u>

The value of financial assets at fair value through profit or loss is based on market value. Fair value of financial assets available for sale is based on generally accepted valuation methods performed by independent experts, unless where it is possible to base it on recent commercial transactions. See further discussion in note 31.

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

17. Embedded derivatives in electricity sales contracts

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

	2013	2012
Fair value of embedded derivatives at the beginning of the year	14.738.660	17.682.970
Fair value changes during the year	(14.320.921)	(2.944.310)
Fair value of embedded derivatives at year-end	<u>417.739</u>	<u>14.738.660</u>

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

Non-current embedded derivatives	965.916	14.150.678
Current embedded derivatives	(548.176)	587.982
Total embedded derivatives at year-end	<u>417.740</u>	<u>14.738.660</u>

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

Notes

18. Other financial assets and financial liabilities

Non-current assets	2013	2012
Financial assets at fair value through profit or loss:		
Bonds	7.502.611	9.744.861
Hedge contracts	1.127.246	893.934
	<u>8.629.857</u>	<u>10.638.795</u>
Bonds and other receivables:		
Bonds	193	579
	<u>193</u>	<u>579</u>
Total among non-current assets	<u>8.630.050</u>	<u>10.639.373</u>
Current assets		
Financial assets at fair value through profit or loss:		
Hedge contracts	232.031	38.956
	<u>232.031</u>	<u>38.956</u>
Bonds and other receivables:		
Bonds	386	5.986
	<u>386</u>	<u>5.986</u>
Total among current assets	<u>232.417</u>	<u>44.942</u>
Non current liabilities		
Financial liabilities at fair value through profit or loss:		
Hedge contracts	(80.847)	(98.974)
	<u>(80.847)</u>	<u>(98.974)</u>
Current liabilities		
Financial liabilities at fair value through profit or loss:		
Hedge contracts	(1.390.870)	(150.300)
	<u>(1.390.870)</u>	<u>(150.300)</u>

The bond among non-current assets is issued in USD and carries 1.5% interest. It has one due date in the year 2016. The bond is linked to aluminium prices to certain extent and is pledged with shares in HS Orka hf. The bond is stated at fair value through P/L and derivatives are not separated from the bond. The fair value of the bond is measured from future prices of aluminium, discounted by the interest rate of the relevant currency, plus premium due to counter-party risk. All of the Company's bonds are determined to be third level in the fair value hierarchy as further is explained in note 31.

Hedge contracts are measured by discounted future cash flow and market observable data is used in the price determination.

19. Deferred tax assets and liabilities

Deferred tax assets and liabilities is specified as follows:

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 year	(7.571.959)	0	(7.571.959)
Tax effect due to unbundling of the Company	7.934.264	0	7.934.264
Tax effect on the revaluation account	(2.183.524)	0	(2.183.524)
Deferred tax assets/liabilities at end of the year	<u>1.646.048</u>	<u>0</u>	<u>1.646.048</u>
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	<u>3.467.267</u>	<u>0</u>	<u>3.467.268</u>

Notes

19. Deferred tax assets and liabilities, contd.,

Deferred tax assets and liabilities are attributable to the following:

	31.12. 2013		31.12. 2012	
	Tax assets	Tax liabilities	Tax assets	Tax liabilities
Property, plant and equipment	(8.896.046)	0	(15.063.674)	0
Embedded derivatives	(83.548)	0	(5.305.918)	0
Other items	(1.487.660)	0	2.599.893	0
Effect of carry forward taxable loss	12.113.303	0	21.236.966	0
Deferred tax assets/liabilities at year end	1.646.049	0	3.467.268	0

Carry forward taxable loss

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

	2013	2012
Unadjusted taxable loss for the year 2008, usable until year 2018	45.857.516	56.383.614
Unadjusted taxable loss for the year 2009, usable until year 2019	4.953.017	4.953.017
Carry forwards taxable loss at year end	50.810.533	61.336.631

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

20. Inventories

Inventories are specified as follows at year end:

	2013	2012
Inventory of materials	367.347	402.872

The Company's material inventories consist of material for maintenance, renewal and construction of the Company's production and distribution systems. A part of the inventories is defined as safety inventories, i.e. inventories that are necessary to have on hand in case of malfunction or maintenance even though their turnover is low. The value of inventories is estimated regularly. Inventories for renewal and new constructions are accounted for among property, plant and equipment as part of building cost of assets under construction.

21. Receivables

Trade receivables is specified as follows at year end:

	2013	2012
Trade receivables, industrial consumers	1.786.124	1.100.917
Trade receivables, retail	4.010.494	3.938.933
Trade receivables, total	5.796.618	5.039.850
Allowance for doubtful accounts	(217.400)	(318.500)
	5.579.218	4.721.350

Other current receivables are specified as follows at year end:

Pre-paid expenses	146.420	199.480
Capital income tax	43.800	34.832
Accrued interest income	31.035	32.035
Receivables from employees	5.756	6.529
Other receivables	30.397	25.305
	257.409	298.181

Notes

22. Cash and cash equivalents

Cash and cash equivalents at year end are specified as follows:	2013	2012
Bank balances	<u>8.993.410</u>	<u>6.885.693</u>

23. Equity

Equity ratio of the Company at year end 2013 is 28.6% (2012: 20.4%). Return on equity was positive by 4.8% in the year (2012: negative by 3.7%).

Revaluation reserve

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

Fair value reserve

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

Retained earnings

Dividend was not paid to the owners of the parent Company in the year 2013. (2012: No payment of dividend). The Company's Board of Directors do not propose dividend to be paid to the owners of the parent company in the year 2014 due to the operating year 2013. The owners of the parent company decide on dividend payments.

24. Loans and borrowings

This note provides information about the contractual terms of the Group's interest-bearing loans and borrowings, that are measured at amortised cost. For more information about the Group's exposure to interest rate, foreign currency and liquidity risk, see note 28. Loans and borrowings are as follows:

Non-current liabilities	2013	2012
Bank loans	157.253.461	195.721.276
Subordinated loan from owners of the Company	13.306.266	8.849.752
Bond issuance	<u>22.614.727</u>	<u>22.515.068</u>
	193.174.454	227.086.096
Current portion on non-current liabilities	(17.854.524)	(25.539.733)
	<u>175.319.930</u>	<u>201.546.363</u>
Current liabilities		
Current portion on non-current liabilities	17.854.524	25.539.733
Short-term bank loans	<u>1.765.000</u>	<u>4.417.190</u>
	19.619.524	29.956.923
Total interest bearing loans and borrowings	<u>194.939.454</u>	<u>231.503.286</u>

Notes

24. Loans and borrowings, contd.,

Terms of interest-bearing loans and borrowings

Liabilities in foreign currencies:

	Date of maturity	2013		2012	
		Average interest rate	Carrying amount	Average interest rate	Carrying amount
Liabilities in CHF	5.10.2027	0.37%	21.201.702	0.56%	33.989.877
Liabilities in EUR	6.12.2032	1.04%	64.419.375	0.98%	84.800.019
Liabilities in USD	8.11.2030	1.83%	44.580.565	1.81%	41.956.344
Liabilities in JPY	5.10.2027	0.35%	10.657.589	0.47%	16.304.551
Liabilities in GBP	26.2.2024	1.55%	4.573.439	1.85%	5.084.266
Liabilities in SEK	5.10.2027	1.26%	7.343.913	2.06%	8.891.712
			152.776.583		191.026.769
Liabilities in Icelandic kronas:					
Indexed	10.1.2037	4.51%	40.397.871	4.67%	36.059.327
Non-indexed	31.1.2014	8.10%	1.765.000	7.53%	4.417.190
			42.162.871		40.476.517
Total interest-bearing loans and borrowings			194.939.454		231.503.286

Repayment on non-current liabilities are specified as follows on the next years:	2013	2012
The year 2013.....	0	25.539.733
The year 2014.....	17.854.524	16.747.099
The year 2015.....	17.920.187	19.625.714
The year 2016.....	18.474.237	19.697.595
The year 2017.....	14.298.158	15.625.559
The year 2018.....	14.161.483	15.145.311
Later	110.465.865	114.705.085
Total non-current liabilities, including next year's repayment	193.174.454	227.086.096

Next years repayment

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

Guarantees and pledges

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

Covenants

Loans for the amount of ISK 18.138 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. (2012: ISK 16.856 million). Management regularly evaluate the covenants and in their view there is not danger of them being breached.

Notes

25. Retirement benefit obligation

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

The Company's accrued retirement benefit obligation amounted to ISK 518 million at year end 2013, discounted based on 2% interests and taken into account the share in the net asset of the pension fund (2012: ISK 508 million). The Company updates the obligation according to an assessment from an actuary each year when that assessment is available. Premises for life expectancy are in accordance with provisions of Regulation no. 391/1998 on obligatory insurance of pension benefits and operation of pension funds. The estimated increase in the obligation in the year is based on general increase in salaries taken into account interests. The increase of the obligation during the year is expensed in the income statement among salaries and salary related expenses. The part of the obligation that is estimated to be payable in the year 2014 is recognised among current liabilities.

Retirement benefit obligation is specified as follows:	2013	2012
Retirement benefit obligation at the beginning of the year	508.377	476.694
Contribution due to pension payments during the year ..... (	19.200) (	23.864)
Increase in the pension fund obligation during the year	28.748	55.547
Retirement benefit obligation at year end	<u>517.925</u>	<u>508.377</u>
Non-current component of retirement benefit obligation	492.925	483.377
Current component of retirement benefit obligation	25.000	25.000
Retirement benefit obligation at year end	<u>517.925</u>	<u>508.377</u>

26. Current liabilities

Other current liabilities is specified as follows:	2013	2012
Unpaid taxes	757.353	860.745
Unpaid salaries and salary related items	410.765	463.324
Accrued interest expenses	718.379	799.631
Current component of retirement benefit obligation	25.000	25.000
Derivative contracts in default, cf. note 36	740.000	740.000
Other liabilities	46.006	62.933
	<u>2.697.502</u>	<u>2.951.632</u>

27. Risk management and financial instruments

Overview

The risk policy was updated and approved by the Board of Directors of Orkuveita Reykjavík at the end of the year 2013. The Board's policy is that in all of the Company's operations, risks are to be considered and thereby the policy implements a mindset of responsible and efficient decisions as well as good corporate governance. The risk policy explains the overview and main targets of the Board in this matter. The risk policy also defines the main risk factors, measurement indicators, objectives and risk limits in the daily risk management. One of the main foundations in the risk policy is to define the risk factors which are of relevance, measure their impact and define acceptable limits when controlling them.

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

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

Notes

27. Risk management and financial instruments, contd.,

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

Financial risk is divided into:

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

28. Market risk

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

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

a. Currency risk

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

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

Approx. 79.1% of the Company's interest bearing 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 123.563 million (2012: ISK 160.383 million). That amount is based on the future price of aluminium on LME (London Metal Exchange) on the accounting date and expectations of price development of aluminium for the next 25 years according to the assessment of CRU, an independent evaluation party, as available on the accounting date.

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

	2013	2012	31.12. 2013	31.12. 2012
	Average exchange rate		Exchange rate at year end	
CHF	131,907	133,352	129,190	140,640
EUR	162,381	160,733	158,500	169,800
USD	122,231	125,052	115,030	128,740
JPY	1,256	1,570	1,096	1,495
GBP	191,225	198,155	190,210	208,150
SEK	18,776	18,4684	17,950	19,758
CAD	118,715	125,110	108,070	129,360
TWI	218,955	221,796	210,108	232,686

Notes

28. Market risk, contd.

a. Currency risk, contd.

Exposure to currency risk

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

31.12. 2013	CHF	EUR	USD	JPY	GBP	CAD	SEK	DKK	Total
Loans and borrowings	(21.201.702)	(64.419.375)	(44.580.565)	(10.657.589)	(4.573.439)		(7.343.913)		(152.776.583)
Accounts payables		(39.028)	(254.558)					(64)	(293.650)
Trade receivables			526.950						526.950
Bank deposits	393.442	2.996.807	438.207	280.217	40.738	36	34.301		4.183.748
Embedded derivatives			417.740						417.740
Hedge contracts	(53.233)	18.857.773	439.925	(78.818)	(11.505)		(9.640)		19.144.502
Other financial assets			7.502.611						7.502.611
Balance sheet risk	(20.861.494)	(42.603.823)	(35.509.691)	(10.456.189)	(4.544.206)	36	(7.319.252)	(64)	(121.294.683)
Estimated sale 2014	0	0	6.252.705	0	0	0	0	0	6.252.705
Estim. purchase 2014	0	(431.843)	(222.910)	(85.543)	0	0	0	0	(740.296)
Balance sheet risk	0	(431.843)	6.029.795	(85.543)	0	0	0	0	5.512.409
Net risk	(20.861.494)	(43.035.666)	(29.479.896)	(10.541.733)	(4.544.206)	36	(7.319.252)	(64)	(115.782.274)

Notes

28. 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 2013	0	0	8.116.661	0	0	0	0	0	8.116.661
Estim. purch. in 2013	0	(155.915)	(25.849)	(290.034)	(154)	0	0	0	(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
The year 2013	1.335.136	2.726.645	2.272.620	669.196	290.829	(2)	468.432	4	7.762.860
The year 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.

Notes

28. Market risk, contd.

b. Interest rate risk

Interest rate risk is the risk of changes in interest rates having a negative effect on the Company's income. The Company is exposed to interest rate risk due to interest bearing assets, liabilities and financial instruments measured at fair value. The Company's liabilities both have fixed and variable interest rates, majority being subject to variable interest rates. The department of treasury and risk monitors that interest rate risk is within preset limits and has permission to control interest rate risk with derivatives. On the accounting date hedges covered 94% of loans with variable interest rates 1 year ahead minimum and proportionally less the next years after that.

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

Fixed rate instruments	2013	2012
Financial assets	579	6.564
Financial liabilities	(44.026.345)	(42.553.480)
	<u>(44.025.766)</u>	<u>(42.546.915)</u>
Variable rate instruments		
Financial liabilities	(150.913.110)	(188.949.806)
	<u>(150.913.110)</u>	<u>(188.949.806)</u>
Financial instruments at fair value		
Other financial assets	7.502.611	9.744.861
Hedge contracts	(112.441)	683.616
	<u>7.390.170</u>	<u>10.428.477</u>

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	
	100 p increase	100 p decrease	100 p increase	100 p decrease
31.12. 2013				
Embedded derivatives	0	0 (	116.682)	134.238
Other financial assets	0	0 (	127.896)	132.677
Hedge contracts	477.658 (	477.658)	2.055.498 (	2.148.257)
Interest bearing loans	(508.768)	508.768	0	0
	<u>(31.110)</u>	<u>31.110</u>	<u>1.810.920 (</u>	<u>1.881.342)</u>
31.12. 2012				
Embedded derivatives	0	0 (	725.573)	811.329
Other financial assets	0	0 (	226.081)	237.008
Hedge contracts	284.502 (	284.502)	699.815 (	717.916)
Interest bearing loans	(633.244)	633.244	0	0
	<u>(348.742)</u>	<u>348.742 (</u>	<u>251.839)</u>	<u>330.420</u>

Notes

28. Market risk, contd.

c. Aluminium risk

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

Four electricity sales contracts have been made, originally to the next 20 years. One with Landsvirkjun in regards of Norðurál and three with Norðurál in regards of the aluminium plant at Grundartangi, in addition contracts have been done with Landsnet hf. on distribution of electricity. Orkuveita Reykjavíkur and Norðurál have also made an electricity sales contract due to sale of electricity to a pending aluminium plant in Helguvík, where delivery of electricity has begun, but the contract is for the next 25 years. These electricity sales contracts are denominated in USD and the price of the electricity is connected to the world market price of aluminium. Income of electricity contracts that are effected by price of aluminium is 18.3% of total revenue for the year 2013 (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 44% of expected income effected by aluminium until the year end 2014 (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 0.1 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.

Notes

28. Market risk, contd.

c. Aluminium risk, contd.

In the following table shows the calculated effect on financial instruments due to change in aluminium price booked at fair value, taking tax effect into account.

Sensitivity analysis on the price of aluminium

31.12. 2013	Sensitivity of Fair value	
	10% decrease	10% increase
Embedded derivatives	(4.587.241)	4.587.241
Aluminium hedges	174.885 (	174.885)
Financial assets at fair value through P/L	(252.702)	252.702
Total	(4.665.058)	4.665.058

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.

29. Liquidity risk

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

The Company's cash and cash equivalents at year end amounted to ISK 9.0 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 year end to the amount of approx. ISK 18.4 billion. The corresponding amount at year end 2012 amounted to ISK 13.7 billion.

Notes

29. Liquidity risk, contd.

c. Liquidity risk, contd.

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

31.12. 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	194.939.455	(219.728.601)	(22.670.612)	(20.702.238)	(54.330.444)	(122.025.307)
Accounts payable	1.988.525	(1.988.525)	(1.988.525)	0	0	0
Other liabilities ...	2.697.502	(2.697.502)	(2.697.502)	0	0	0

Derivative financial instruments

Hedge contracts	1.471.718	(1.653.811)	(1.318.783)	(987.468)	652.440	0
	<u>201.097.200</u>	<u>(226.068.440)</u>	<u>(28.675.422)</u>	<u>(21.689.706)</u>	<u>(53.678.004)</u>	<u>(122.025.307)</u>

31.12. 2012

Non-derivative financial instruments

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	(2.951.632)	(2.951.632)	0	0	0

Derivative financial instruments

Hedge contracts	249.274	(1.233.289)	(631.390)	(553.736)	(103.455)	55.292
	<u>236.066.969</u>	<u>(265.608.890)</u>	<u>(38.301.596)</u>	<u>(19.835.638)</u>	<u>(62.171.585)</u>	<u>(145.300.070)</u>

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

Notes

30. Credit risk

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

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

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

	2013	2012
Trade receivable	5.579.218	4.721.350
Other current receivables	257.409	298.181
Other financial assets	7.503.190	9.751.425
Hedge contracts	1.359.277	932.890
Cash and cash equivalents	8.993.410	6.885.693
Total	23.692.504	22.589.539

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

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

Trade receivable, industrial consumers	1.786.124	1.262.927
Trade receivable, retail	3.793.094	3.458.423
	5.579.218	4.721.350

Impairment

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

	2013		2012	
	Gross balance	Allowance	Gross balance	Allowance
Not past due receivables	3.503.568	84.878	4.081.898	102.884
Past due, 1 to 30 days	803.634	25.869	316.652	12.263
Past due, 31 to 90 days	163.001	24.951	108.612	24.581
Past due, 91 days and older	1.326.415	81.702	532.688	178.772
Total	5.796.618	217.400	5.039.850	318.500

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

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

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

Notes

31. Fair value

Fair values versus carrying amounts

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

	2013		2012	
	Carrying amount	Fair value	Carrying amount	Fair value
Interest-bearing liabilities	(194.939.455)	(165.716.726)	(231.503.285)	(185.860.652)

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:

	2013	2012
Embedded derivatives in electr. sales contr.	2.22% to 12.91%	2.37% to 11.56%
Other financial assets	6.85% to 7.21%	3.99% to 4.39%
Interest bearing loans	2.59% to 9.44%	1.90% to 8.13%

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).

2013	Level 2	Level 3	Total
Shares in companies	0	3.734.550	3.734.550
Embedded derivatives in sales contracts	0	417.740	417.740
Other financial assets	1.359.277	7.503.190	8.862.467
Other financial liabilities	(1.471.718)	0	(1.471.718)
	(112.441)	11.655.479	11.543.039
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	932.890	9.751.425	10.684.315
Other financial liabilities	(249.274)	0	(249.274)
	683.616	27.755.267	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.

Notes

32. Overview of financial instruments

A part of the Company's financial assets and financial liabilities are measured at fair value. Fair value of these assets and liabilities are determined by market data or price in recent transactions if that is available. Otherwise, accepted valuation methods are used. Further information on fair value calculations can be found in the discussion of the relevant assets and liabilities.

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

	2013			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			3.734.550			3.265.182
Embedd. electr. sales contracts ..		417.740			14.738.660	
Other financial assets	386	8.862.081		5.986	10.678.330	
Trade receivabl. .	5.579.218			4.721.350		
Other receivabl. ..	257.409			298.181		
Cash	8.993.410			6.885.693		
Interest-bearing .. liabilities	(194.939.455)		(231.503.285)			
Other financial liabilities		(1.471.718)			(249.274)	
Account payabl. . (	1.988.525)		(1.366.254)			
Other current liabilities	(2.697.502)		(2.951.632)			
	(184.795.059)	7.808.103	3.734.550	(223.909.962)	25.167.716	3.265.182

Notes

33. Statement of cash flows, details

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

	2013	2012
Profit (loss) for the year	3.349.756 (	2.295.194)
Adjusted for:		
Financial income and expenses	6.232.285	18.493.550
Share of loss of associated companies	2.309	9.754
Income tax	7.571.959 (	1.535.261)
Depreciation and amortisation	8.927.345	10.371.085
Profit from sale of assets and other changes	(621.959) (	41.318)
Retirement benefit obligation, change	9.548	31.683
Working capital from operation before interest and taxes	25.471.243	25.034.299
Inventories, decrease	35.525	28.688
Trade and other receivables, change	(1.213.943) (	702.520)
Payables and other current liabilities, change	827.483 (	24.897)
Cash generated from operations before interests and taxes	25.120.308	24.335.571

34. Property leases

The Company as a lessee

Factors of the lease agreement

Following the sale of the Company's headquarters that was finalised in the end of October 2013, a lease agreement was signed, to lease back the entire headquarters the next 20 years from Foss fasteignafélag inc. In the agreement there is a purchase option that the Company can exercised after 10 and 20 years. The lease minimum payments the first 10 years is ISK 223,9 million pr year, indexed. If the purchase option is not exercised after 10 years the lease payments the next 10 years thereafter are ISK 290,2 million pr. year, indexed.

Lease payments and income	2013	2012
Minimum lease payments, expensed	37.315	0
Income from subleases	(4.630)	0
	32.685	0

Commitment in unresignable lease agreements	2013	2012
Within a year	223.890	0
After 1 to 5 years	895.560	0
After 5 years	3.984.035	0
	5.103.485	0

Expected future income from subleases	219.725	0
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The Company as a lessor

The Company has made lease agreements on part of the leased properties of the headquarters with five year terms and possible extension to ten years.

Expected future income from leases due to unresignable lease contracts	2013	2012
Within a year	47.203	0
After 1 to 5 years	172.522	0
	219.725	0

Notes

35. Related parties

Definition of related parties

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

Transactions with related parties

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

The following gives an overview of the transactions with related parties during the last two years as well as a statement of receivables and payables. Transactions and positions with subsidiaries are eliminated in the financial statements but that information is provided here. This information does not include sale of conventional household supplies to the related parties.

	2013	2012
Sale to related parties:		
Reykjavik City	1.214.691	1.235.886
Institutions and companies controlled by Reykjavik City	462.980	431.868
Subsidiaries	301.400	367.253
	1.979.072	2.035.007
Purchases from related parties:		
Reykjavik City	11.527	5.246
Institutions and companies controlled by Reykjavik City	14.069	6.841
Subsidiaries	15.917	15.028
Associates	47.468	42.949
	88.981	70.064
Receivables for related parties:		
Reykjavik City	215.251	284.843
Institutions and companies controlled by Reykjavik City	44.070	39.505
Subsidiaries	242.025	90.636
Subsidiaries, interest bearing loans	6.204.347	6.988.862
	6.705.693	7.403.846
Payables for related parties:		
Reykjavik City	180.253	77.141
Institutions and companies controlled by Reykjavik City	3.158	305
Board members and key employees	413.855	408.313
	597.266	485.758
Interest bearing loans from owners of the parent Company:		
Reykjavik City	12.446.548	8.277.970
Akranes town	735.570	489.214
Borgarbyggð, municipality	124.147	82.568
	13.306.265	8.849.752
Interest expense on loans from owners of the parent Company:		
Reykjavik City	1.310.449	1.262.297
Akranes town	75.558	72.281
Borgarbyggð, municipality	12.753	10.738
	1.398.759	1.345.316

Guarantee fee to owners

Orkuveita Reykjavíkur paid a guarantee fee to Reykjavík City and other present and former owners of the company for guarantees they have granted on the Groups loans and borrowings. For further information regarding amounts and the guarantee fee, see note 10.

Notes

36. Group entities

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

Subsidiaries	Main operation	Share	
		31.12. 2013	31.12. 2012
Gagnaveita Reykjavíkur ehf.	Data transfer	100.0%	100.0%
OR Eignir ohf.	Holding company	100.0%	0.0%
OR Veitur ohf.	Distribution of electricity and hot water	100.0%	0.0%
Orka náttúrunnar ohf.	Sale of electricity	100.0%	0.0%
OR Vatns- og fráveita sf.	Cold water and sewage	100.0%	0.0%
Reykjavík Energy Invest ehf.	Investments	100.0%	100.0%
Úlfjótuvatn 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 Hrafnabjargavirkjun hf.

At year end 2013 new companies were established in the group to prepare for the unbundling of the Company. The unbundling took place 1 January 2014. OR Veitur., Orka náttúrunnar, OR Vatns- og fráveita and OR Eignir were established. OR Eignir ohf. and OR Vatns- og fráveita sf. are owned directly by the parent company and OR Veitur ohf. and Orka náttúrunnar ohf. are owned by OR Eignir. The unbundling is discussed in the endorsement of the board and the managing director in the financial statements.

37. Other issues

Reduced payments from Norðurál

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

Energy sale contracts with Norðurál Helguvík ehf.

Considerable delays have been in waiving the conditions precedence in the power purchase agreement with Norðurál Helguvík ehf. (NH) for second and third phase of potential the aluminium smelter in Helguvík. There is therefore uncertainty whether the construction of the smelter will commence or not. Discussions are ongoing with NH on a revised power purchase agreement. OR questions the validity of a part of the power purchase agreement and is in dispute with NH on this matter. As a result negotiations have been concluded with Mitsubishi Heavy Industries (MHI) and Balcke Dürr (BD) on the purchase of turbine units, further discussed in note 12. Uncertainty still persists regarding commencement of the construction of the Hverahlíð power plant, but the agreement with MHI and BD has dissolved the uncertainty more or less. Management of the Company is of the opinion that there is no reason to make provisions in the financial statements regarding the matter at this point.

Notes

37. Other issues, contd.

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 Reykjavíkur 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 Reykjavíkur's behalf and the amount can either increase or decrease when the contracts are settled. The contracts are accounted for among other current liabilities.

36. Events after the reporting date

Orkuveita Reykjavíkur's investment in HS Veitur

Orkuveita Reykjavíkur sold its investment in HS Veitur in the beginning of 2014. The contract was 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 municipality, Grindavíkurbær municipality, Sandgerðisbær municipality, Garður municipality and Vogar municipality. The book value was valued at year end as sales price, less sales cost and amounted to ISK 1.499 million.

Corporate governance statement (unaudited)

Corporate governance

Orkuveita Reykjavíkur's (OR) main operations were governed by the provisions of Act No.139/2001 in the year 2013 but 1 January 2014 a new act took effect, Act no. 136/2013. The owners of OR have outlined an 'Ownership Policy', where 'Board Operation Procedures' are further outlisted. The Ownership Policy can be accessed via the OR website: www.or.is.

Orkuveita Reykjavíkur values

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

Board of Directors

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

Sixteen Board meetings were held in 2013 and the majority of the Members of the Board were present on all of the meetings.

Audit Committee

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

The Auditing Committee acts as a consultant to the Board of Directors and acts on its behalf. The Committee does not have executive powers. There are three members of the Audit Committee. Gylfi Magnússon is the only Board Member. Also in the committee is Sigríður Ármannsdóttir, Chairman of the Committee, she is a state authorised accountant and Per Matts Henje, cand. oecon, a trust manager at Stefmir hf. Twelve meetings were held in the year 2013.

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

The CEO and Executive Directors

The Board of Directors appoints the CEO; Bjarni Bjarnason is OR's CEO. The Board and the CEO are responsible for the operations of OR. In the year 2013, before the unbundling of the Company, five Executive Directors at OR and the CEO, formed the Executive Board, meeting approximately every two weeks. The following description applied to the unbundled Company, changes in the Group took place year end 2013 as discussed in the endorsement by the Board and the CEO in the financial statements.

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

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

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

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

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

Also, the Company wholly owns the subsidiary Gagnaveita Reykjavíkur ehf. The Director of the subsidiary is Birgir Rafn Þráinsson. Gagnaveita Reykjavíkur runs a fibre-optic cable system.

Corporate governance statement (unaudited)

Corporate governance statement, contd.,

Orkuveita Reykjavíkur - Risk management

OR operates after a risk management policy that has been approved by the Board of Directors. It is the policy of the Company board that all of the Company's operations are low risk by promoting responsible and effective decision making and management. The risk management policy provides an overview of the Board's strategy in this regard. It also defines the main types of risk, a risk measurement scale, basic strategies, objectives and goals regarding daily risk management within the Company. Main types of risk in the Company's operations are core risk, financial risk and operational risk.

Internal monitoring and risk management

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

Further discussion of corporate governance can be found in the Annual Report, released in April, 2014 and available on the website: www.or.is.