

Risk management

ISS continuously seeks to identify and evaluate risk factors that may have an adverse effect on the ISS Group's activities, financial position, results and future growth. For a detailed, non-exhaustive list of the risk factors to which the Group is subject, reference is made to the High Yield Offering Memorandum (pages 33-52) available from the Group's website www.issworld.com.

Overall, operational and financial risks are managed in accordance with policies adopted by the Board. In addition, detailed plans and business procedures for a number of functions are described in manuals and guidelines. The policies for operational and financial risk management and the ISS Group's standards are documented and distributed to the operating companies. ISS's Group Risk Management and Group Treasury departments supervise compliance with these standards. Monthly reporting to the Board contains an overview of the status in these areas.

OPERATIONAL RISK MANAGEMENT

Operational risk management focuses principally on procedures for claims management, entering into contracts, occupational safety, environmental aspects and safeguarding of physical assets. Operational risk is assessed based on the activities of each operating company, historic and current claims events, and the markets in which the companies operate. Operational risk is monitored and mitigated in accordance with ISS Group standards for risk management, risk financing and good operational practice. Operational risk financing is based on insurance and own funding, primarily through local and global insurance programmes including a captive (Global Insurance A/S), all managed centrally in ISS.

ISS considers that the Group is not subject to material operational risks except for risks common in the ordinary course of business in the service industry.

Operational responsibility is delegated to the operating companies under the supervision of regional management.

FINANCIAL RISK MANAGEMENT

Financial risk management focuses primarily on interest rate risk, currency risk and credit risk. The ISS Group's financial risk management is described in note 32 to the consolidated financial statements.

MAIN ELEMENTS OF THE GROUPS INTERNAL

CONTROL ENVIRONMENT

The Board and the EGM have overall responsibility for the Groups internal control and risk management systems related to preparation of the consolidated financial statements. The Audit Committee reviews and monitors the EGM in the assessment of material risks and the internal controls and risk management systems that manage the identified risks.

A material risk is considered to be a risk that may cause a material error in the consolidated financial statements of the Group. Internal control procedures at group level have been established to assess the Group's internal control environment and to manage identified risks.

ISS considers strong controls to be an essential management tool. Accordingly, care is taken to ensure that a sound framework of controls is in place for safeguarding the business, the company's assets and the shareholder investments. However, such controls are designed to manage rather than eliminate the risks and can provide only reasonable and not absolute assurance against material misstatements or losses. The policies and procedures set out below reflect the principal features of the ISS Group's internal control environment.

ISS aims at establishing a control environment that provides the Board and the EGM with reasonable assurance that:

- > management reporting is reliable and in compliance with applicable laws, regulations, internal policies and procedures and gives a true and fair view of the financial results
- > risks are identified and minimised
- > internal controls are in place to support the quality and efficiency of the business processes and to safeguard the Group's assets
- > ISS's business is conducted in compliance with legislation and ISS policies

The country management teams are responsible for ensuring that the control environment in each operating unit is sufficient to meet the objectives above. The regional management teams provide governance of the country operations. In order to ensure that adequate internal control procedures are maintained locally, the Group Business Controlling department visits the subsidiaries regularly. Controller visits

take place according to a plan for the year approved by the Audit Committee and in accordance with the control procedures and standards defined in ISS's control manual. The findings and conclusions of the visits, which include recommendations on how to improve the control environment, are presented in reports addressed to country and regional managements and the external auditor. The controllers perform follow-up reviews to ensure that the recommendations are implemented. The results of the control visits are presented to the Audit Committee and the Audit Committee assesses the results reported and uses this assessment to review the Control Plan for the coming year.

Other key elements of ISS's control environment are:

- > strategy reviews – annual meetings with country managers at which the strategy is discussed, and priorities and plans for the coming year are agreed
- > business reviews – monthly meetings between regional management and country management with a focus on the current performance and state of the business
- > budgets and financial plans – all countries must prepare budgets and plans for the following financial year in a pre-defined procedure and format. Regional managements review the proposed budgets and plans with the countries
- > IT solutions – all countries must use a standardised IT reporting tool and the number of different ERP platforms within the Group is continuously being reduced
- > acquisitions – all acquisition proposals must be presented in a predefined acquisition report and valuation model for approval. Board approval is required for large or strategic acquisitions
- > reporting of cash flow forecasts – countries must report the daily cash flow forecast for the coming month on the third working day of each month. Subsequently, actual figures are continuously monitored by ISS's Group Treasury department for deviations from the forecasted figures
- > reporting of financial results – all countries must report a full income statement, balance sheet, cash flow statement, portfolio analysis etc. on a monthly basis. Any significant variance from budgets must be explained
- > full-year forecasts – all countries must update and report their year-end estimates twice a year

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

32. FINANCIAL RISK MANAGEMENT

The Group is exposed to a number of financial risks as a result of its operating activities, investing activities and financing activities, mainly related to fluctuations in exchange rates and interest rates as well as availability of funding. The Group has not identified any additional financial risk exposures in 2008. However, the individual risks associated with the exposures identified have changed following the current financial crisis.

The Group's financial risks are managed centrally in Group Treasury based on policies approved by the Board of Directors. The Group's financial risk management is focused on managing risks arising from the Group's operating and financing activities, mainly by use of interest rate instruments and currency instruments. It is not the Group's policy to take positions in the financial markets.

Currency risk

The service industry is characterised by a relatively low level of transaction risk, since the services are produced and delivered in the same local currency with minimal exposure from imported components.

However, as an international business with the majority of revenue and operating profit stemming from foreign entities, the Group is exposed to risk relating to translation into Danish kroner of income statements and net assets of foreign subsidiaries, including intercompany items such as loans, royalties, service fees and interest payments between entities with different functional currencies.

Additionally, the Group has a currency risk to the extent that its interest payments with respect to borrowings are not denominated in the same currencies as the Group's revenue.

The Group hedges the exposure on the intercompany loans to foreign subsidiaries by entering into currency swaps. Foreign exchange gains and losses arising from both the intercompany loans and currency swaps are recognised in the income statement. It is not Group policy to hedge the currency exposure on foreign investments. Consequently, no hedging transactions of net investments in foreign subsidiaries were entered into in 2008 and 2007. However, the Group may choose to hedge the currency exposure on foreign investments by funding such investments in local currencies.

In 2008, the currencies in which the Group's revenue was denominated decreased with an average of 2.6% (2007: decreased with 0.3%) relative to Danish kroner, decreasing the Group's revenue by DKK 1,624 million (2007: a decrease of DKK 160 million). Currency movements decreased the Group's operating profit before other items by DKK 107 million (2007: a decrease of DKK 10 million). The effect of the translation of net assets in foreign subsidiaries decreased equity by DKK 791 million (2007: a decrease of DKK 263 million).

A 5% change in foreign exchange rates of the Group's main currencies would have impacted revenue, operating profit before other items and equity by the amounts shown below. The analysis is based on the assumption that all other variables remain constant.

	2008			2007		
	Revenue	Operating profit before other items	Net assets in foreign subsidiaries	Revenue	Operating profit before other items	Net assets in foreign subsidiaries
<i>Effect in DKK million</i>						
EUR	1,523	90	448	1,476	93	517
CHF	123	10	59	111	9	51
GBP	378	26	90	390	26	114
NOK	284	20	29	266	19	39
SEK	196	13	27	193	13	30
USD	211	13	65	138	8	47
Other	536	34	101	432	29	103
Total	3,251	206	819	3,006	197	901

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

32. FINANCIAL RISK MANAGEMENT (CONTINUED)

Interest rate risk

The Group's most significant interest rate risk relates to interest-bearing debt.

The Group's loan portfolio primarily consists of bank loans (senior facilities and second lien facility) and listed bonds (EMTN's and subordinated notes). To manage the interest rate risk the Group uses fixed-rate bonds and derivatives, such as interest rate swaps. A part of the Group's interest payments on the bank loans and second lien facility have been swapped from floating into fixed rates, see note 27, Borrowings, where a breakdown of the Group's long-term debt and applied interest rate swaps is provided.

The interest rate risk is measured by the duration of the net debt (fixed-rate period). As at 31 December 2008, the duration of net debt was approximately 2.0 years (31 December 2007: 2.8 years). A decrease in interest rates will increase the fair value of the debt with a fixed interest rate, but only part of this increase will be reflected in the income statement and equity as long-term borrowings are stated at amortised cost and therefore not adjusted to fair value. It is estimated that a general increase in relevant interest rates of 1%-point would increase the annual interest expenses, net by DKK 60 million (2007: DKK 54 million), all other things being equal. The estimate is based on net debt adjusted for the effect of hedging instruments as at 31 December 2008.

Liquidity risk

Liquidity risk is the risk of the Group failing to honour its contractual obligations due to insufficient liquidity. The Group's liquid reserves mainly consist of liquid funds and unused credit facilities. As at 31 December 2008, the Group's liquid reserves consisted of liquid funds of DKK 2,900 million (2007: DKK 2,531 million), unused revolving credit facilities of DKK 817 million (2007: DKK 738 million) available for drawing until 30 June 2012 and unused acquisition facilities of DKK 2,033 million (2007: DKK 3,135 million) available for drawing until 11 May 2009. It is the Group's policy to maintain an appropriate level of liquid reserve.

The bank loans and subordinated notes are subject to customary undertakings, covenants (including financial covenants) and other restrictions. Financial covenants comprise the following: i) Debt cover ii) Senior debt cover, iii) Cash flow cover, iv) Interest cover and v) Limitation on Capex spending. The financial covenants are calculated on a last-twelve-months basis and reported quarterly, except for ii) and v), which are only reported at year-end. In the event of a default under those agreements, the debt incurred including accrued interest could be declared immediately due and payable. In 2008 and 2007, all covenants have been complied with.

For a breakdown of the maturity of the Group's long-term debt, see note 27, Borrowings. In 2010, EUR 850 million of the EMTN's will mature. The Group intends to repay the principal amount of the notes at maturity using funds obtained from other financing sources, rather than with cash from operations. In accordance with the provisions of the Group's Intercreditor Agreement, the Group is obliged to publicly announce that it is in negotiations to refinance these EMTN's at least 6 months prior to maturity date.

Capital management

The Group monitors the capital structure and evaluates the need for adjustments on an ongoing basis. The dividend policy and payment of dividends is made subject to the necessary consolidation of equity and the Group's continuing expansion. The Group seeks to reduce the financial leverage on a multiple basis in terms of net debt to pro forma adjusted EBITDA¹⁾. At 31 December 2008, the Group's net debt to pro forma adjusted EBITDA was 5.92x (2007: 6.16x).

ISS Holding A/S (the Group's parent) is a holding company, and its primary assets consist of shares in ISS A/S and cash in its bank accounts. ISS Holding A/S has no revenue generating operations of its own, and therefore ISS Holding A/S's cash flow and ability to service its indebtedness, will depend primarily on the operating performance and financial condition of ISS A/S and its operating subsidiaries, and the receipt by ISS Holding A/S of funds from ISS A/S and its subsidiaries in the form of dividends or otherwise.

Credit risk

Credit risk is the risk of a counterparty failing to meet its contractual obligations and so inflicting a loss on the Group. The Group's credit risk is mainly related to transactions with financial institutions (liquid funds and derivatives with positive fair value) and service deliveries to customers (trade receivables). It is the Group's policy that financial transactions may be entered into only with financial institutions with a high credit rating.

The Group is not exposed to significant risks relating to individual customers. The Group performs ongoing credit evaluations of the financial condition of the Group's counterparties in order to reduce the credit risk exposure. Losses on bad debt relating to individual customers have historically been relatively low. It is estimated that the provisions made are sufficient to cover expected losses (see note 20, Trade receivables).

¹⁾ Pro forma information is unaudited and for informational purposes only. For further information, see Capital structure on page 134.