Confidential Presentation to: The Team

Information, Controls and Issues

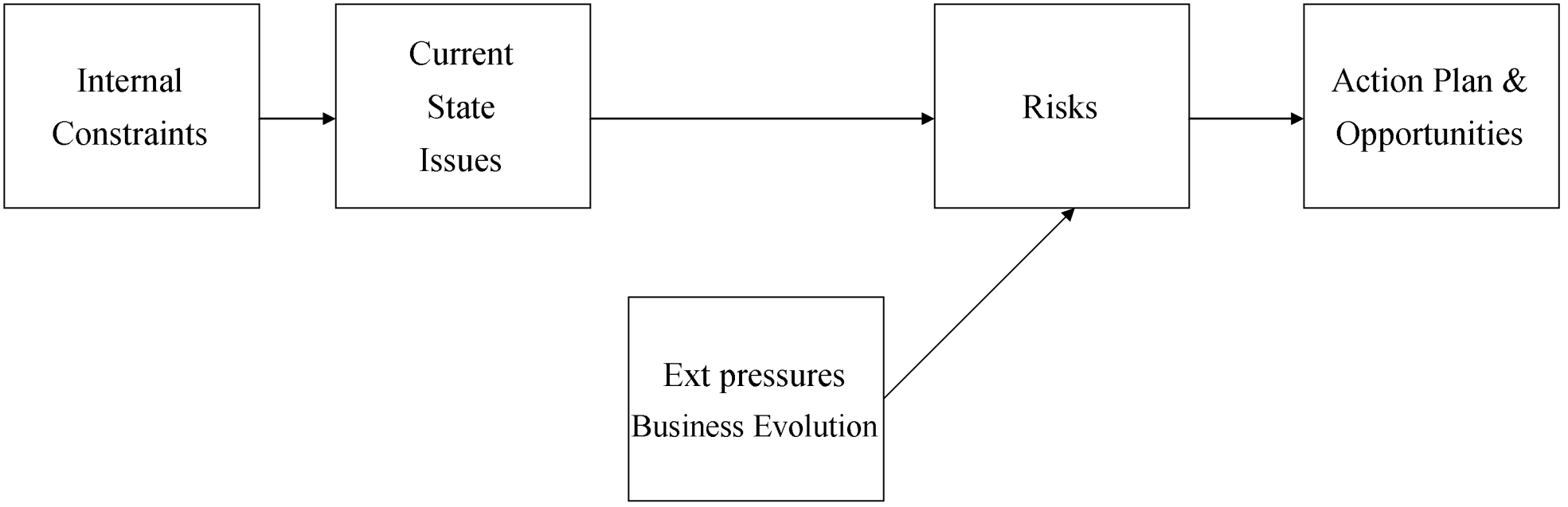
Martin Kelly

Presentation Date: May 2008

LEHMAN BROTHERS

FOIA CONFIDENTIAL TREATMENT REQUESTED BY
LEHMAN BROTHERS HOLDINGS, INC.

Financial Control Issues

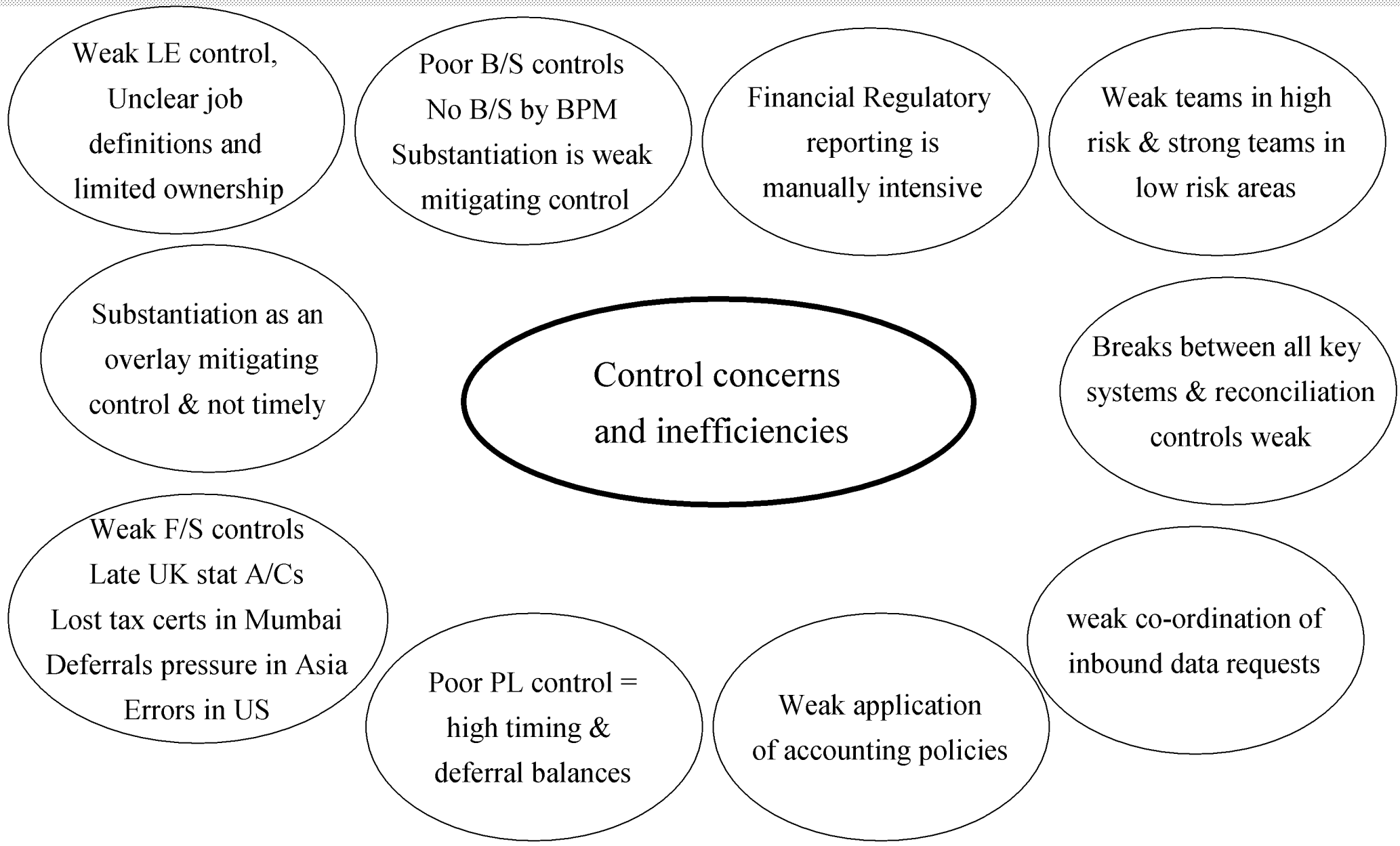


•Technology •Data Quality •People	•Control framework •BS & PL breaks •Info quality & dependencies	•Reg developments •Media/Invest scrutiny •Localization (Asia / LatAM)	•Reporting Integrity	•Upgrade controls & process •Upgrade people

FOIA CONFIDENTIAL TREATMENT REQUESTED BY LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

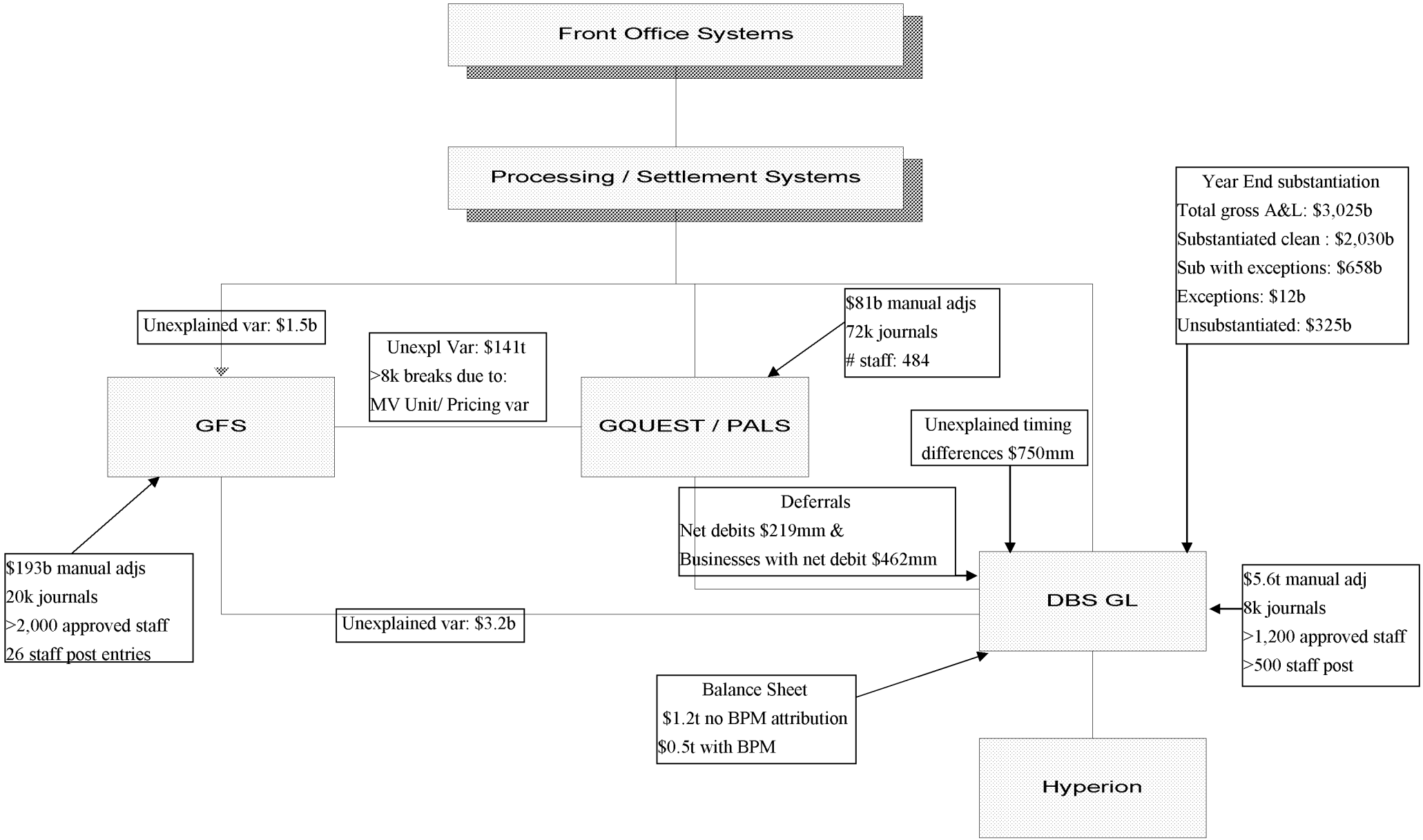
Current State Issues



FOIA CONFIDENTIAL TREATMENT REQUESTED BY LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

Information flows (Feb 08 balances)



FOIA CONFIDENTIAL TREATMENT REQUESTED BY
LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

Substantiation

- LEC-lead activity. PC assist but are not fully engaged
- Performed quarterly, completed 2-3 months after quarter end
  - → considered substantiated if agreed to underlying systems or manual support

- Review is performed by LECs and then Mumbai team (of 4) for >1,000 LEs
  - No standard format, guidance given but not universally adopted by LECs or PC
  - Many $ billions of 'substantiated' balances rejected by Mumbai for poor support

- Limited awareness and buy-in around finance – considered a low priority

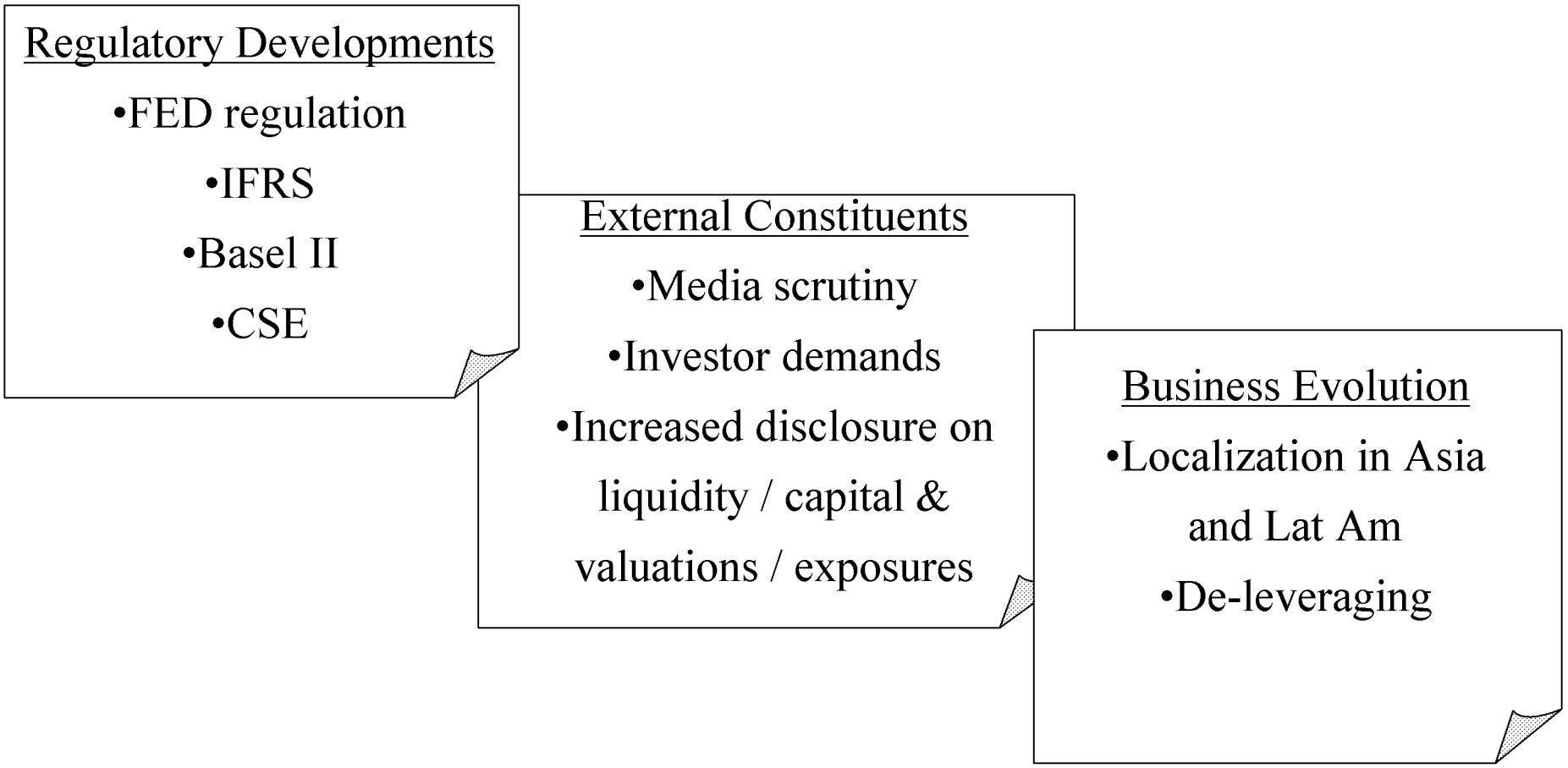
REGION	SUBSTANTIATED			EXCEPTION			NOT SUBSTANTIATED			TOTAL	
	# of A/Cs	ABS $ BN	%	# of A/Cs	ABS $ BN	%	# of A/Cs	ABS $ BN	%	# of A/Cs	ABS $ BN
AMERICAS	3,305	1,307	98%	847	8	1%	792	15	1%	4,944	1,330
EUROPE	1,149	1,256	80%	818	3	0%	1,573	305	19%	3,540	1,563
ASIA	2,052	126	95%	577	1	1%	410	5	4%	3,039	132
TOTAL	**6,506**	**$ 2,688**	**89%**	**2,242**	**$ 12**	**0%**	**2,775**	**$ 325**	**11%**	**11,523**	**$ 3,025**

- In Nov 07: 89% of the B/S is substantiated by system & manual inputs to the G/L
  - 11% of B/S is not looked at & only a small % is 'economically' substantiated
  - ~100% of tier 1 & 2 LEs certified in Nov 07

FOIA CONFIDENTIAL TREATMENT REQUESTED BY
LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

External Pressures & Business Evolution



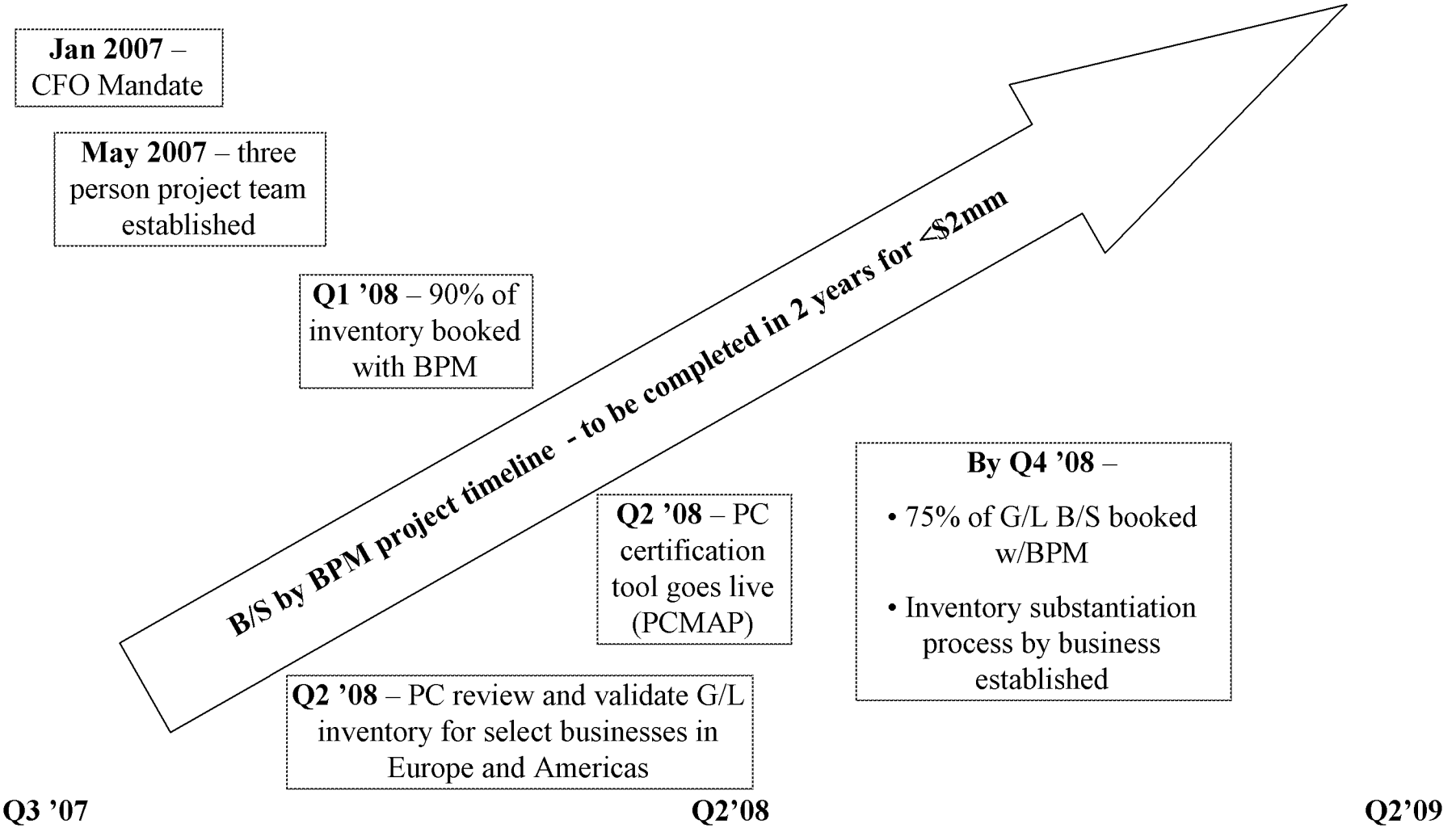
With a backdrop of tighter budgets & IA control points doubling in the last year

FOIA CONFIDENTIAL TREATMENT REQUESTED BY
LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

Foundation for Progress: B/S by BPM

Creating environment capable of economic substantiation of business' balance sheets



FOIA CONFIDENTIAL TREATMENT REQUESTED BY LEHMAN BROTHERS HOLDINGS, INC.
LBEX-DOCID 1999716

Opportunities

- Staff development, increase mobility and embrace succession planning
- Global improvement and standardization of controls
- Increase responsiveness to external demands
- Revisit the role of Finance across Lehman Brothers
  - FC / PC / Risk / Treasury / Operations / Audit
- Decrease remedial processing time and direct resources to valuable analytics
- Improve budget efficiencies by decreasing maintenance and re-investing in longer term solutions

FOIA CONFIDENTIAL TREATMENT REQUESTED BY
LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

Financial Control - Strategy

Project	Objectives	Inter-Dependencies
◆ Control Validation, Assessment & Oversight	◆ Improve information integrity ◆ Focus on key controls over books and records systems	◆ Finance-wide ◆ Operations ◆ Risk Management
◆ Balance Sheet Substantiation	◆ Identify info flows & strengthen overall & related controls ◆ Drive urgency and timeliness ◆ Align with BS & capital utilization	◆ Product Control ◆ Treasury ◆ Ops & Technology
◆ Re-define LEC Function	◆ Globally define roles & responsibilities of LECs ◆ Implement consistent reviews	◆ Product Control ◆ Treasury
◆ Fin Systems Architecture Roadmap	◆ Develop roadmap to improve financial systems architecture consistent with – Focus on controls, efficiency needs & current economic environment	◆ Finance-wide

FOIA CONFIDENTIAL TREATMENT REQUESTED BY
LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

Financial Control - Strategy

Project	Objectives	Inter-Dependencies
◆ Regulatory Capital/Risk Management	◆ Implement data flow controls for regulatory capital ◆ Prepare for possible Fed oversight	◆ Risk Management ◆ Product Control
◆ Global Booking Matrix	◆ Develop matrix of all products & related booking entities ◆ Strengthen LEC ownership of all business booked into each LE	◆ Product Control ◆ Tax ◆ Treasury ◆ Operations
◆ Streamline MIS	◆ Valuable, not redundant info ◆ Validate need for existing allocations system ◆ Align with shareholder metrics	◆ Product Control
◆ People Development	◆ Succession planning ◆ Career development ◆ Rotations, lateral moves	◆ Finance-wide

FOIA CONFIDENTIAL TREATMENT REQUESTED BY
LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

Financial Reporting Update

Current Quarter Items

- Marubeni valuation/insurance recoverable
- Real estate held for sale – depreciation
- RIF 2
- Europe SPML exit
- Compensation accrual
- Deferrals
- Other secured borrowings
- Secondary trading interests in QSPE's (deals > $500mm)

Next Quarter Items

- Repo 105/108
- Contra revenues
- Secondary trading interests in QSPE's (deals < 500mm)

FOIA CONFIDENTIAL TREATMENT REQUESTED BY
LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

High manual intervention, low system integrity

- **Manual intervention increasing**
  - Total G/L transactions increased 55% (Dec 05 – Feb 08)
  - Manual G/L journals increased 60% to 7,800 (Dec 05 – Feb 08)
  - $5.6 trillion of manual adjustments to G/L in Feb 08
  - $193 billion of manual adjustments to GFS in Feb 08
  - $81 billion of manual adjustments to GQUEST in Feb 08
- **Many entities and people involved**
  - >1,200 staff have access to make G/L entries
  - >1,000 legal entities with >100 LECs and incomplete links to PCs
  - Recent staff turnover and limited procedures in place
- **Progress:** 90% of long inventory in G/L by BPM so FC & PC can communicate

FOIA CONFIDENTIAL TREATMENT REQUESTED BY
LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

Financial Control – Quality/Risk Assessment

Area	Strength of Team	Inherent Risk	Team Headcount	Comments/Changes
Legal Entity & Balance Sheet Control	Weak	High	30	Replacing Matthew Lee and Brian Nicholson Separating day to day function (Kristie Wong) from project team (Liliana Chiu)
Financial (External) Reporting	Weak	High	10	Removed Steve Rossi and Fred Steinberg Ryan Traversari is key man Need to add an SVP and a VP under Ryan
Regulatory Reporting	Mixed	High	23	Weak team led by Stucchio (moderate strength) and Anna Yu (very strong) Highest risk is LBHI/CSE implementation under Anna Yu. Will reallocate additional resources from management reporting team
Management (Internal) Reporting	Strong	Low	15	Scicutella to replace Azerad Looking to streamline workload/free capacity to relocate elsewhere

FOIA CONFIDENTIAL TREATMENT REQUESTED BY LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

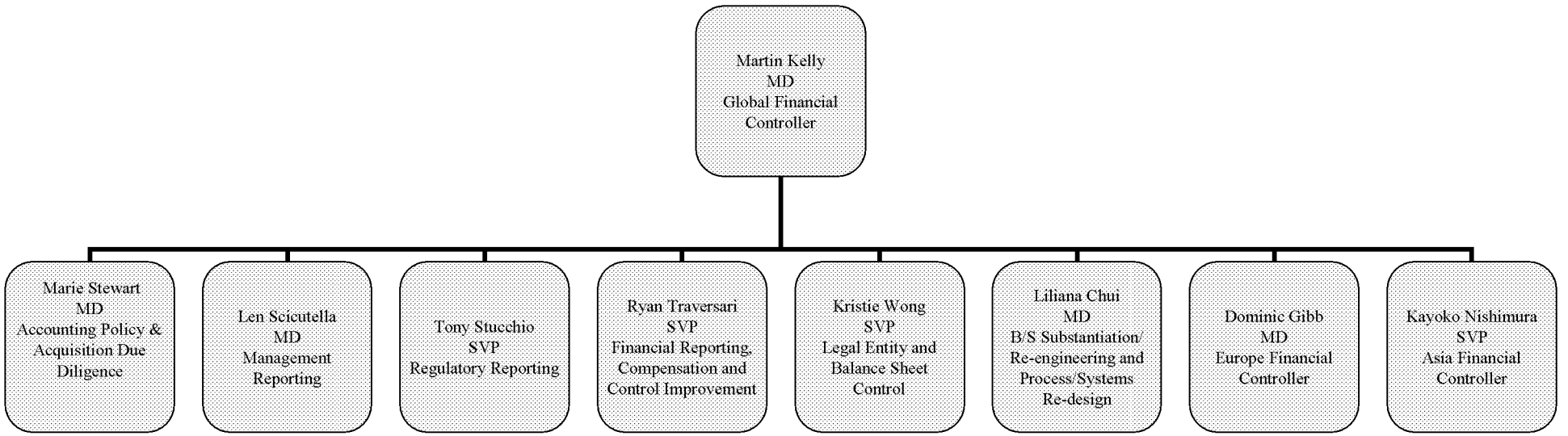
Financial Control – Quality/Risk Assessment

Area	Strength of Team	Inherent Risk	Team Headcount	Comments/Changes
Accounting Policy & Acquisition Due Diligence	Strong	High	6	Strong individuals at global, US and Europe level Asia weak and considering options
Compensation Control	Mixed	Moderate	6	Traversari to replace Emmert and reorganize process Sharyn Angley needs to move Will reallocate additional resource from management reporting team
Europe	Mixed	High	74	Replaced Marcus Jackson with Dominic Gibb
Asia	Mixed	High	75	Team stretched/stressed May need to add to headcount depending on localization plans

FOIA CONFIDENTIAL TREATMENT REQUESTED BY LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

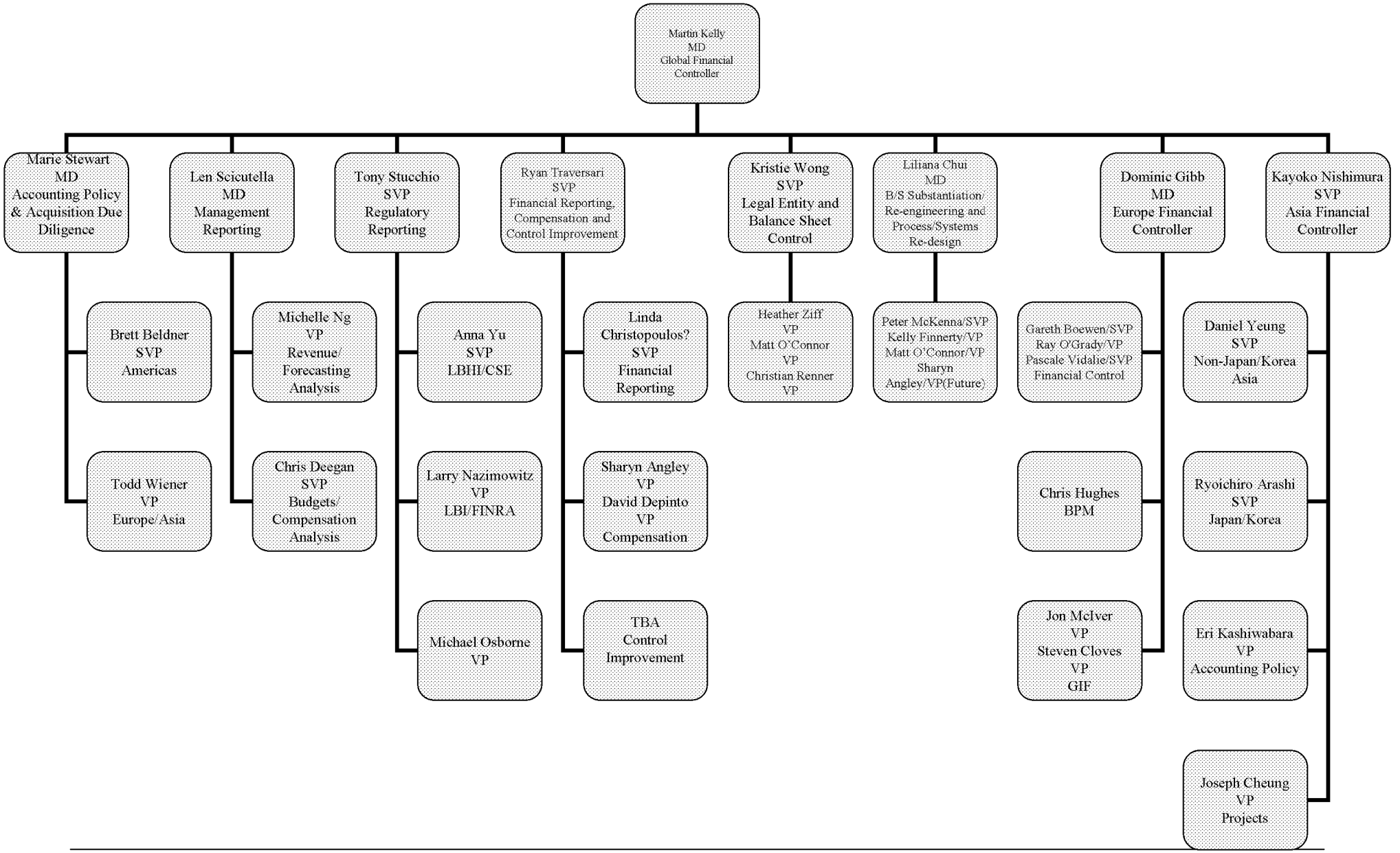
New Financial Control Structure
Direct Reports



FOIA CONFIDENTIAL TREATMENT REQUESTED BY
LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

New Financial Control Structure Senior Team



FOIA CONFIDENTIAL TREATMENT REQUESTED BY LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

$5.6 trillion of manual adjustments to G/L

Group	Amount $b	%
Controllers - US	2,172	39%
Controllers - London	1,103	20%
Treasury London	279	5%
Equity PC - London	186	3%
	3,740	
Others	*1,896*	*34%*
Total	**5,636**	**100%**

Majority of postings relate to:

- Secured Funding booking/reclass
  - Intercompany
  - Intracompany
  - Borrow/Loan
- Netting of T/D pay/receive
- Derivatives Netting

Risk: High dollar volume of low-risk mature activity reduces scrutiny of higher risk manual entries.

Actions: BS by BPM Secured Funding automation in progress, increase management attention to manual activity in FC

FOIA CONFIDENTIAL TREATMENT REQUESTED BY
LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

$193 billion of manual adjustments to GFS

Majority of postings relate to:

- >50% due to derivatives not being posted directly to GFS
  - Currently derivatives post directly from PALS/GEDS to the DBS general ledger system but have not been posted directly to the GFS system.

- Gross Ups (e.g. FAS 140, FIN 46 etc)
  - There are no automated feeds to bring the grossed up values of financing trades and special purpose vehicles into GFS. Due to the subjective nature of some gross ups, it is not possible automate all these processes

Risk: Incomplete and incorrect postings causing breaks in the reconciliation between GFS and settlement systems

Actions: GFS Derivatives project should ensure full direct postings into GFS and straight through processing of gross and net balances to DBS by the end of the year. Automation and straight through processing of GFS adjustments.

FOIA CONFIDENTIAL TREATMENT REQUESTED BY
LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

$81 billion of manual adjustments to GQUEST

Region	SYS	Division	All Adjs No. of adjustments	All Adjs USD(S) Net mm Manual Adj	All Adjs USD(S) ABS mm
Americas	Quest/PALS	FID	5,991	(4,158)	9,906
	Quest	EQUITY / Prime Services	4,921	(402)	1,825
			10,912	**(4,561)**	**11,731**
Europe	Quest/PALS	FID	11,497	(343)	19,862
	Quest	EQUITY / Prime Services	3,385	13,370	24,039
			14,882	**13,027**	**43,901**
Asia	Quest/PALS	FID	984	(211)	1,437
	Quest	EQUITY / Prime Services	2,117	(4,300)	8,813
			3,101	**(4,511)**	**10,250**
Manual Total			**28,895**	**3,955**	**65,882**
				Systematic Adj	
Americas	Quest	FID	24,339	(81)	971
	Quest	EQUITY / Prime Services	17,333	44	218
			41,672	**(37)**	**1,190**
Europe	Quest	FID	1,306	(9)	54
	Quest	EQUITY / Prime Services	21,656	(7,282)	13,620
			22,962	**(7,292)**	**13,673**
Asia	Quest	FID	21	(9)	10
	Quest	EQUITY / Prime Services	2,480	(245)	504
			2,501	**(254)**	**515**
Systematic Total			**67,135**	**(7,583)**	**15,378**
Grand Total			**96,030**	**(3,628)**	**81,259**

Key postings relate to:

- Delays in front end booking, books close after 5pm deadline
- Front end processing errors being corrected late in the day by PC
- System limitations with mainframe producing difference product/price multipliers than ITS

FOIA CONFIDENTIAL TREATMENT REQUESTED BY LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

Reporting teams use different sources for data

- **CSE reporting (Anna Yu)**
  - 174 separate spreadsheets to filter into 'trading vs banking book'
    - initially from GQUEST system as a G/L proxy. ***20% of time spent on validation / 30% processing***

- **B/S team (Matthew Lee)**
  - GFS to DBS month end reconciliation ends $1b-$8b variance after 6 days. ***50% of time spent on validation/processing***

- **External Reporting (Ryan Traversari)**
  - 100% manual checks using reconciliations of Hyperion, GFS, CWS and source material. Inventory data from Hyperion, CWS & GFS. ***80% of time spent on validation***

- **Risk CWS to DBS rec (Brian Nicholson)**
  - CWS to DBS month end rec $90m-$2b asset variance with full month review

- **Revenue Reporting (Chris Deegan)**
  - Manual topsides for all segment reporting and 'double counting' for banking

FOIA CONFIDENTIAL TREATMENT REQUESTED BY
LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

THE END

FOIA CONFIDENTIAL TREATMENT REQUESTED BY
LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

Problem Statement

• **Rapid growth without system & process investment has resulted in sub-optimal financial data…… strong enough for future demands?**

• Process and system breaks throughout the organization have resulted in:
  • knowledge and data silos
  • significant off-line processing
  • heavy reliance on compensating controls
  • budget being used up on tactical fixes
  • published financial data cannot be fully substantiated

• **It is an issue that relates to the entire firm from the initial trade entry, to operations, processing, settlement, risk and financial systems.**
→It is related to both system and process deficiencies

• As the firm increases in size and complexity the amount of resource and the risk of material misstatement will increase exponentially

FOIA CONFIDENTIAL TREATMENT REQUESTED BY
LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

Pressure to change: external and internal

We need to increase the proportion of information we extract directly from systems and reduce our dependence on non-systemic information to ensure completeness and accuracy

External

- Market conditions have deteriorated, information demands have escalated
- Requirement to de-leverage the B/S
- Disclosures are tougher: FAS157 & B/S classifications
- Basel II
- CSE

Internal

- Data continues to be stored in function-specific systems + Excel
- Finance teams with different perceived objectives?
- Technical/CMT resource is being used up for tactical fixes
- Headcount is being used up in manual processing
- Internal Audit aged Control Concerns increased from 38 to 102 May 2007 to 2008

FOIA CONFIDENTIAL TREATMENT REQUESTED BY
LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

Current State Issues

- Highly manually intensive environment:
  - Multiple sources, spreadsheets, manual data capture
- Data quality & consistency
  - System breaks, inputs not fixed but outputs reconciled, unclear control owners
- Balance sheet controls
  - G/L not have B/S by business (except Inventory), substantiation as an overlay and mitigating control, not timely closing
- Profit & Loss controls
  - Material deferrals and timing balances
- People Quality
  - Weaker teams in high risk areas, stronger teams in low risk areas
- Weak Legal Entity controls
  - Unclear job definition, ownership and interaction with PC
- Weak F/S controls
  - Errors in several F/S, late UK stat a/cs, lost tax certificates in Mumbai, pressure re allocation of deferrals
- Co-ordination of inbound data requests and consistency of information

FOIA CONFIDENTIAL TREATMENT REQUESTED BY
LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

Fundamental problems in systems and process

Control environment has not evolved commensurate with Firm growth

Systems

- Insufficient efforts to identify issues at source and resolve permanently
- Controls degraded/risks increased by non systemic data aggregation
- Incomplete system feeds – neither full population (completeness) or relevant fields
- Data out of date and not automatically updated in systems
- Reference data spread throughout many systems
- Huge reliance on Excel rather than fixing underlying systems

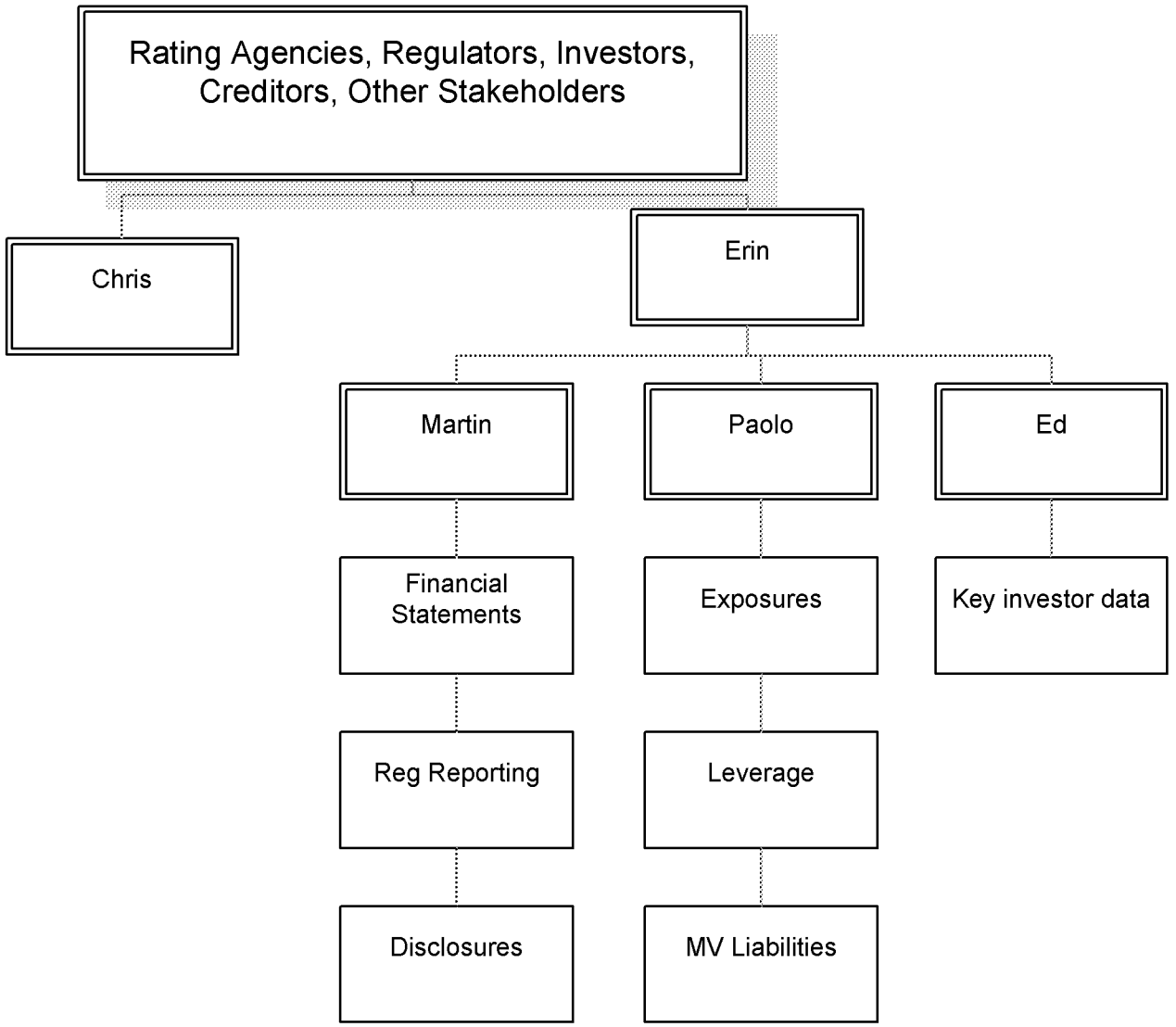
Process

- Controls are not a primary goal, reactively put in place (Reg or problem-specific)
- Effective controls are assumed to exist without adequate proof
- Routine Risk and Finance Control indicators not established and integrated
- Poorly defined roles and responsibilities regionally and functionally
- No common focus on the financial impact on B/S and P/L
- No overview or full ownership due to silo approach
- Lack of understanding of upstream and downstream implications of actions

FOIA CONFIDENTIAL TREATMENT REQUESTED BY
LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

Consistent sources for external information?

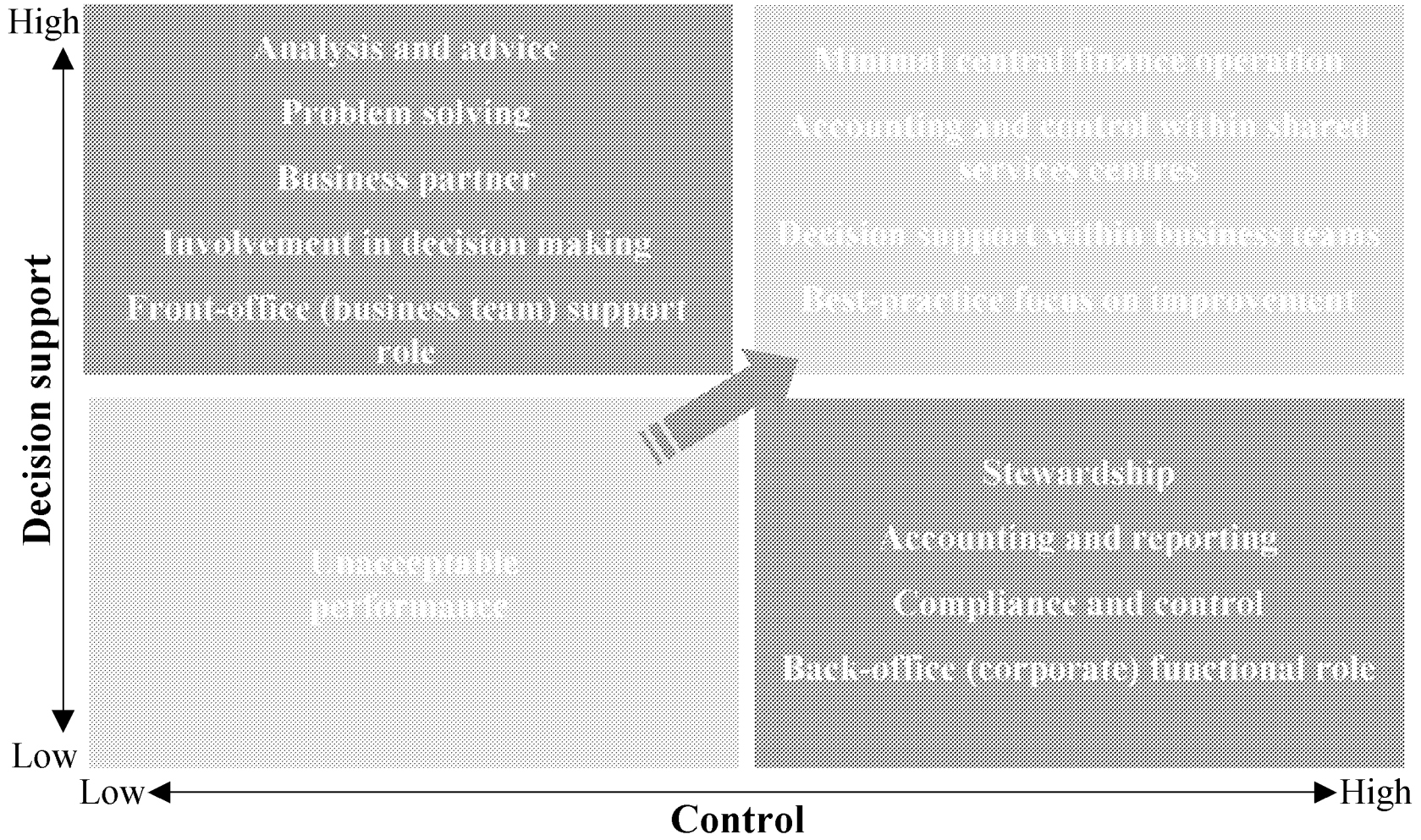


FOIA CONFIDENTIAL TREATMENT REQUESTED BY
LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

Finance Target Operating Model

Finance to define its future role with a major transformation required to move from the current to a future state



FOIA CONFIDENTIAL TREATMENT REQUESTED BY LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

How will we move forward?

Leadership

•Senior management to actively sponsor the change required to update the Finance Function

•Advocacy of a control mindset that supports the mission statement of Lehman Brothers

•Creation of a culture of change with resources empowered to own and solve issues

Organization

•Develop a target state for the organization and staff accordingly to establish continuous improvement, full accountability in every department at every level

•Empower individuals to identify root cause of problems, assign ownership and accountability

•Establish business unit controllers owning front to back controls through B/S substantiation.

•Hold businesses accountable for economic consequences of control failures

•Pay for performance – publicly reward people for continuous improvements

•Job requirements to reflect full B/S and P/L involvement for FC, PC and Risk

Process

•Key reference data readily attainable

•Have firm-wide agreed processing timetables and cut-offs

FOIA CONFIDENTIAL TREATMENT REQUESTED BY
LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716

Target Audience and Objectives

First audience: Erin Callan DRs

- **Americas, Europe & Asia**

Other stakeholders:

- **Front office**
- **Middle office / Operations**
- **Treasury**
- **CAO**
- **Risk**
- **Technology**
- **CMT**

Objective of the presentation

- **Tell: educate around the problem**
- **Sell: short-term actions and solutions**
- **Tell: long-term potential pathway**

FOIA CONFIDENTIAL TREATMENT REQUESTED BY
LEHMAN BROTHERS HOLDINGS, INC.

LBEX-DOCID 1999716