

# Walkthrough Template

Entity	Lehman Brothers Holdings Inc.	Workpaper Ref.	<b>B21b</b>
Subsidiary or Division	LBHI / LBI	Prepared by	Garron Lewis
Financial Statement Date	11/30/07	Reviewed by	Thomas Smith Ryutaro Iwanami

**Significant Class of Transactions/Process name:** Balance Sheet Close Process

This template assists in our documentation of walkthroughs under S04 Perform Walkthroughs of the *EY Global Audit Methodology (EY GAM)*.

S03 Understand Flows of Transactions, WCGWs, and Controls of *EY GAM* requires us to gain an understanding of the flow of transactions within significant processes and the sources and preparation of information in sufficient detail for the purpose of:

- Identifying the types of errors that have the potential to materially affect relevant financial statement assertions related to significant accounts and disclosures
- When appropriate, identifying controls that are effective and sufficiently sensitive to prevent or detect and correct material misstatements in the related relevant financial statement assertion

S04 Perform Walkthroughs of *EY GAM* requires that we perform a walkthrough for each significant class of transactions within significant processes, including the sub-processes of the Financial Statement Close Process (“FSCP”) and sources and preparation of information resulting in significant disclosures. The nature and extent of our walkthrough procedures will vary depending on our strategy relating to reliance on controls and the complexity of the process.

We obtain an understanding of and document the significant flows of transactions and sources and preparation of information prior to completing our walkthrough procedures. This documentation may exist in our current year or permanent files and is typically carried forward from year to year and updated as appropriate. If the client has sufficient documentation of the flow of transactions or sources and preparation of information, we examine and, as appropriate, retain copies of the client’s documentation in our current year or permanent files rather than preparing our own documentation.

For all audits regardless of our strategy (Controls Strategy or Substantive Strategy), we perform walkthroughs to achieve the following objectives:

- Confirm our understanding, as identified in our process documentation, of the flow of significant classes of transactions within significant processes or sources and preparation of information resulting in significant disclosures, including how these transactions are initiated, authorized, recorded, processed and reported: and
- Verify that we have identified the appropriate “what could go wrongs” (WCGWs) that have the potential to materially affect relevant financial statement assertions related to significant accounts and disclosures within each significant class of transactions.

Additionally, when we plan to assess control risk below maximum (Controls Strategy), or for significant risks or risks for which substantive procedures alone do not provide sufficient evidence, we perform walkthroughs to achieve each of the objectives noted above, as well as the following objective with respect to the design and implementation of controls:

- Confirm our understanding of:
  - The accuracy of information we have obtained about identified controls over the flow of significant classes of transactions,
  - Whether the controls are effectively designed to prevent, or detect and correct material misstatements on a timely basis, and
  - Whether the controls have been placed into operation.

When performing our walkthrough procedures we focus on the critical path in the process where transactions are initiated, authorized, recorded, processed and ultimately reported in the general ledger (or serve as the basis for disclosures). In particular, we focus attention on the points where data is, or should be captured, transferred, or modified as these are the points where misstatements might be most likely to occur. Our walkthrough includes both the manual and automated steps of the process and we use the same source documents and information technology that client personnel typically would use. When the client’s IT environment is complex, we work with TSRS (IT professionals) to the extent necessary to walk through the automated aspects of the flow of transactions or sources and preparation of information and if applicable, related controls.

This template assists in our documentation of walkthroughs and its use is highly encouraged. It is divided into three sections.

Section 1: Walkthrough Procedures

Section 2: Other Matters—Segregation of Incompatible Duties and Management Override of Controls

Section 3: Conclusion

## Section 1: Walkthrough Procedures

### *Performance Guidance*

S04\_Perform Walkthroughs of *EY GAM* provides detailed guidance on performing walkthroughs. Teams may find S04\_Exhibit 1 Perform Walkthroughs of *EY GAM* particularly helpful when executing our walkthrough procedures.

When we have decided to use the Substantive Strategy (i.e., assess control risk at the maximum), we limit our walkthrough to the relevant processing procedures needed to confirm our understanding of the flow of transactions or the sources and preparation of information resulting in significant disclosures.

For each walkthrough, we are required to document the following items:

- The transaction selected for walkthrough (Substantive and Controls Strategy);
- Individual(s) with whom we confirmed our understanding (Substantive and Controls Strategy);
- Description of the walkthrough procedures performed (Substantive and Controls Strategy); and
- Description of the walkthrough procedures performed to confirm our understanding of the design of the manual, IT-dependent manual and application controls on which we plan to test and rely upon and that such controls have been placed into operation (Controls Strategy only).

*Documentation of Walkthrough Procedures Performed*

Transaction selected for walkthrough (Substantive and Controls Strategy):	Balance Sheet Close Process
Individual(s) we talked with to confirm our understanding (Substantive and Controls Strategy):	Aysha Abedeen, Yong Yi, Janine Pakiry and Richa Bhansali

*Confirming our Understanding of the Flows of Significant Transactions (Substantive and Controls Strategy)*

Describe the walkthrough procedures performed, addressing the points at which the transactions are initiated, authorized, recorded, processed, and ultimately reported in the general ledger (or serve as the basis for disclosures), including both the manual and automated steps of the process. For sources and preparation of information resulting in significant disclosures, describe the procedures performed to confirm our understanding of the process and sources of information management uses to generate significant disclosures. We document whether processing procedures are performed as originally understood and in a timely manner.

While performing the walkthrough, we ask probing questions about the client's processes and procedures and related controls to gain a sufficient understanding to be able to identify important points at which a necessary control is missing or not designed effectively. For example, our follow-up inquiries might include asking personnel what they do when they encounter errors, the types of errors they have encountered, what happened as a result of finding errors, and how the errors were resolved. We might also question client personnel as to whether they have ever been asked to override the process or controls, and if so, to describe the situation, why it occurred, and what happened. Our inquiries also should include follow-up questions that could help identify the abuse or override of controls, or indicators of fraud.

**Overview**

The purpose of this memo is to document our understanding of the Balance Sheet Close Process ("BSCP") at Lehman Brothers Holdings Inc. ("Lehman") and the related procedures and controls performed by the Consolidations Group ("the Group"). This memo should be read in conjunction with the Financial Statement Close Process ("FSCP") flowchart located at **B21.Flow**. The procedures related to this process include:

- 1.) Balance Sheet Fluctuation Report and Analysis
- 2.) Intercompany Account Reconciliations
- 3.) Intercompany Notes Reconciliation
- 4.) Investment in Subsidiaries Reconciliation
- 5.) Manual Intercompany Elimination Entries
- 6.) Creation and Renaming of DBS BS Accounts
- 7.) Creation and Renaming of Legal Entities
- 8.) Late Entry Approval (JVE)

## 9.) Legal Entity Financial Statement Certification

### **FSCP Summary**

Lehman Brothers FSCP begins on an entity level basis, for every global entity, with information from multiple subledger systems flowing into one consolidated General Ledger System (“DBS”). There are three primary subledger systems that flow into DBS: International Trading System (“ITS”), Mainframe Trading System (“MTS”) and Trading Management System (“TMS”). There are also various other subledger systems that flow into the DBS including: GEDS, Summit, Rolfe and Nolan, Murex, Loan IQ, RISC, PeopleSoft, and Treasury Workstation System (“TWS”). From these subledger systems, various Balance Sheet and related P&L accounts flow into DBS on a legal entity basis. DBS shows each Lehman subsidiary on a stand-alone basis.

Once the subledger systems are closed and balances are automatically fed to DBS, additional entries known as manual source code (“000”) entries are booked directly to DBS through the Journal Validation Engine (JVE) on a legal entity basis (see below for further discussion around the JVE).

After all of the subledger systems have been closed and the ‘000’ entries have been booked through JVE, Lehman has complete financial information on a legal entity basis. In order to consolidate the account balances of each legal entity, DBS feeds Hyperion, which is the consolidation system where all elimination and consolidation entries occur.

### **Balance Sheet Fluctuation Report and Analysis**

The Group prepares a fluctuation report and analysis on each quarter’s consolidated balance sheet by comparing it to the balance sheet from the previous quarter and the prior year-end. The Group will review all of the fluctuations and provide explanations for changes they deem to be material. This report is then reviewed by a member of Senior Finance Management. Please refer to workpaper **B21.b.29** for the Group’s fluctuation report and analysis for 3Q 2007.

### **Intercompany Account Reconciliations**

Intercompany transactions are those that occur between consolidated companies. When reporting consolidated figures, it is important that the figures represent one single entity and that no duplicate accounting takes place. In order to ensure that the balances reported do not reflect transactions with affiliated entities, intercompany transactions are eliminated automatically via Hyperion. Intercompany accounts are identified in Hyperion by its account range. Please see chart below for account ranges for each individual intercompany account. In Hyperion these accounts are linked to the other side of the intercompany relationship. Once all of the entities and accounts are consolidated, there should be no intercompany differences. To ensure that there are no un-eliminated account balances, the Group runs intercompany account reconciliations out of Hyperion. The Group is responsible for reconciling all intercompany account ranges and any unresolved differences are booked to respective Hyperion offset accounts (see table below). Per

Aysha Abedeen of the Global B/S and LE Accounting Group, the Group notes all of the breaks in the report and either explains them or monitors them until they are cleared. The Group investigates significant breaks over a threshold of 10 million. These breaks are primarily due to timing differences of LE-1 posting their balance before LE-2. Please note that these offset accounts do not exist in the General Ledger.

<b>DBS Account Summary Point</b>	<b>Acct Range</b>	<b>Nickname</b>	<b>Hyperion Offset</b>	<b>Ref.</b>
13010SUM INVESTMENT IN CONSOL. SUBS.	<b>13010</b>		24015 - 99998	<b>B21.b.25</b>
12620 / 12621SUM INTER-COMPANY / BRANCH	<b>12620 / 12621</b>		24015 - 99999	<b>B21.b.13</b>
12520SUM I/CO SECURITIES RELATED / BRANCH	<b>12520 / 12521</b>		24015 - 99992	<b>B21.b.31</b>
11084 / 21084 SUM ICO DERIV – LONG/SHORT	<b>11084 / 21084</b>	DERIVATIVES	11083 - 99999	<b>(*1)</b>
11520 / 21020 SUM REPO / REV REPOS- I/C	<b>11520 / 21020</b>	FINANCING	24015 - 99998	<b>B21.b.09</b>
11720 / 21335 SUM BORROW / LOAN VS CASH-I/C	<b>11720 / 21335</b>	FINANCING	24015 - 99996	<b>B21.b.09</b>
12720 / 22720 SUM I/C DEBT	<b>12720 / 22720</b>	NOTES	24015 - 99995	<b>B21.b.01</b>
27330 / 27630 SUM I/C - DEBT	<b>27330 / 27630</b>			
12645 / 22645 SUM COLLATERALIZED REC / PAY I/C	<b>12645 / 22645</b>	COLLATERAL	24015 - 99994	<b>B21.b.03</b>
12480 / 26050 SUM	<b>12480 / 26050</b>	INTEREST	24015 - 99993	<b>B21.b.11</b>

INTEREST RECEIVABLE / PAYABLE I/C				
12090 / 22090 SUM REC.FROM B/D-FTD I/C / CUST PAY - FAILS I/C	<b>12090 / 22090</b>	FAILS	22050 - 99999	<b>B21.b.07</b>
12060 / 22040 SUM I/CO COMMODITY BROKER FCM	<b>12060 / 22040</b>	COMMODITIES	22050 - 99998	<b>B21.b.05</b>
12030 / 10016 SUM I/CO COMMODITY BROKER FCM BD	<b>12030 / 10016</b>			

(\*1) Covered by FID/FX Derivatives team

For the traditional intercompany payable/receivable account range (12620sum), the Group runs the Pre-Deferral Report on a monthly basis, typically on the seventh business day after each month-end. The Pre-Deferral Report details all intercompany relationships and the respective account balances. The Pre-Deferral Report, as well as the Post-Deferral Report which is discussed further below, now comes in the form of an electronic text file, which is then formatted into an Excel file by the Group to be more user-friendly. Previously, both the Pre-Deferral and Post-Deferral Reports were large hard copy reports. All intercompany account balances should be equal and off-setting on the corresponding legal entities' books. For walkthrough purposes, EY auditor obtained the May 2007 Pre-Deferral Report (see **B21b.13 1/**). The Pre-Deferral Report illustrates side-by-side which legal entities have balances with one another and the net amount between the two legal entities after consolidation. All net amounts should be zero, but occasionally there are differences that result in a balance between the two legal entities.

For example, the May 2007 Pre-Deferral Report (see **B21b.13 1/**) shows that legal entity 0370 has an intercompany balance with legal entity 0000 for \$462,648.03. On the same line, the report shows that legal entity 0000 has an intercompany balance with entity 0370 for \$564,400.92 – indicating a break of \$1,027,049.22.

If one entity enters into a transaction with another entity, the receivable amount on the General Ledger of one entity should match the payable amount on the General Ledger of the counterparty. Intercompany breaks over \$1,000k, as in the abovementioned example, are actively investigated by the Group during the month-end close. The Group begins the process of investigating the differences by notifying the appropriate Legal Entity Controllers (“LEC”) or the employees responsible for posting the entries that caused the break. They continually monitor each discrepancy until the breaks are cleared. According to the Group, all breaks recorded in the 12620 and 12520 - account ranges (traditional intercompany transactions) that are above the \$1,000k threshold are cleared. If the LEC’s do not confirm the account balances, breaks are

isolated and the LEC is contacted to clear the break. If a break needs further investigation or cannot be cleared before the month-end close, it is taken out of the intercompany account and posted to the deferral / suspense account range 26035-00032. The deferral / suspense account range 26035-00032 has debit / credit logic, which means that a positive number means an asset (I/C receivable) and a negative number means a liability (I/C payable). Please see **B21b.14a** for an Essbase query showing the net intercompany break balances in the deferral / suspense account range across all entities as of May month-end. These net intercompany breaks remain in this deferral / suspense account range until they can be resolved. If possible, the Group attempts to have all material net intercompany breaks resolved before the end of the month-end close. Those material breaks that remain outstanding after month-end are cleared by the end of the subsequent month by the Group with the assistance of the LEC's.

Typically on the eighth day of the month end close, a "Post-Deferral Report", also generated out of Hyperion, is reviewed to ensure that all of the material breaks have either been cleared or posted to the deferral / suspense account mentioned above. EY auditor obtained and reviewed the Post-Deferral Report for the month of May 2007 (see **B21b.13 2/**) to ensure that all significant breaks had been followed-up on by the Group. Per the Post-Deferral Report at **B21b.13 2/**, legal entity 0370 has an \$564,400.92 intercompany balance with legal entity 0000, and legal entity 0000 has an \$564,400.92 intercompany balance with entity 0370. Thus, the intercompany break has been resolved and the legal entities' account balances net to zero. The intercompany balances per the Post-Deferral Report are the balances that are recorded in the month-end General Ledger. All intercompany receivables and payables are recorded in the 12620 and 12520 - account ranges with a suffix equivalent to the counterparty's DBS legal entity number. For example, on entity 0370's balance sheet, DBS account number 12620-00000 holds the intercompany balance with entity 0000. Similarly, DBS account number 12620-00370 on entity 0000's balance sheet holds the intercompany balance that represents its transaction with entity 0370.

After ensuring that the example above was cleared on the Post-Deferral Report, EY auditor verified that the balances shown on the Post-Deferral Report tied to DBS for the respective legal entities without exception by running an Essbase query of DBS (see **B21b.14**).

A similar process is performed by the Group for each of the other intercompany account ranges. Please see workpapers **B21b.3 – B21b.12** for further reference regarding these intercompany account ranges.

### **Intercompany Notes Reconciliation**

The 12720 account range represents notes receivable amounts from a company's subsidiary. The notes receivable is offset by a notes payable on the subsidiary's books, which are typically in the 27630, 22720 or 27330 DBS account ranges.

On day 6, a Hyperion download is run for all 12720 accounts and their corresponding notes payable accounts (27630, 22720 and 27330) to ensure that all intercompany notes are equal and

offsetting. A copy of this report run for the month of May can be seen at **B21b.1**. Typically, these amounts do not change from month to month and there will not be fluctuations on these balances. If a break does occur, Mr. Mancuso will contact the legal entity controller for an explanation and to confirm whether or not there is a new note on the books that should be eliminated.

**Investment in Subsidiaries Reconciliation**

Another procedure that is performed by the Group around the FSCP is the reconciliation that is performed on the Investments in Subsidiaries.

Definitions of terms on this reconciliation sheet:

For Hyperion, “Subsidiary” means a company of which shares issued are owned by “parent company(s)”. “Parent Company” means a company which owns the shared issued of the “Subsidiary”. For example, Lehman Brothers Communications (legal entity 0A24) is a “subsidiary” of LBHI (legal entity 0099), as LBHI owns the shares issued of Lehman Brothers Communications.

“Affiliate” is used when both the “Subsidiary” and “Parent Company” are in the Lehman group. For example, Lehman Brothers Commercial Paper, Inc. (“LCPI”, legal entity 0045) and Lehman Brothers Inc (“LBI”, legal entity 0000) are affiliates, because although LBI owns shares in LCPI, they both are subsidiaries of LBHI.

There are a number of parent-subsidiary and parent-affiliate relationships within LBHI. Eventually, all entities are subsidiaries of LBHI, termed a “Holding Company”, because it has no operations of its own.

Investments in subsidiaries are reflected on the General Ledger in two ways. The subsidiary’s General Ledger shows all of the equity in that entity. The following details each equity account number and the type of equity it contains:

Account Number	Equity Account
30010	Preferred Stock
30012	Preferred Stock Dividends
30015	Common Stock
30016	Common Stock Dividends
30017	Restricted Stock Units
30018	Deferred Stock Compensation
30019	Cash & Stock Held in RSU Trust
30020	Capital Surplus
30022	Treasury Stock
30030	FX Translation Adjustment
30032	FAS 133 Non-CTA Hedging
30034	RSU MTM Appreciation

30035	Retained Earnings
30040	SH-Cap Reduction

Under the parent company’s General Ledger, the sum of all invest on the aforementioned equity accounts is treated as an asset under an account number that begins with “13010”. The last five digits of the account number represent the entity in which the investment is made. For example, an investment in LCPI (legal entity 0045) would be shown by account 1301000045. During consolidation into LBHI, the net assets of the subsidiary cancel out and the subsidiary’s income flows into the retained earnings of the parent company.

The Group performs a reconciliation to verify that all investments in subsidiaries on the Balance Sheet of the parent company match the equity on the Balance Sheet of the subsidiary. To do so, the Group performs a monthly reconciliation process that reviews accounts on a DBS level. Please refer to **BB21b.25** for May’s Investments in Subsidiaries Report, which is used during the reconciliation process. This report is generated from Hyperion using “XL” and shows balances on a DBS account level for all subsidiaries and parent companies. The Group notes all of the breaks in the report and either explains them or monitors them until they are cleared.

As part of this walkthrough, EY auditor began by matching the equity and investment balances per the report to the balances appearing in DBS for one parent-subsidiary relationship. The relationship we selected for walkthrough purposes is between legal entities 0045 and 0A98. On the Investment in Subs Report at **B21b.25**, legal entity 0045 (parent) shows an investment in legal entity 0A98 (subsidiary) for \$161,266,620.25, which agrees without exception to the Essbase query of DBS at **B21b.26 1/**.

All equity numbers in DBS with 00 at the end of the entry represent the equity that is eventually consolidated by Hyperion. DBS entries with 03 and 05 account numbers do not consolidate into Hyperion and therefore are not included in the Investment in the Subsidiaries report. Per the External Reporting group, these types of entries result from a discrepancy between local reporting requirements and GAAP standards. For example, an 05 entry pertaining to an entity situated in Germany could correspond to regulatory requirements in Germany that require an adjustment to the amount required by GAAP standards. That adjustment is marked in an 05 entry and does not consolidate into its parent according to GAAP rules.

Investments in companies that are not consolidated legal entities are booked to the General Ledger in the 13010sum and 13020sum account ranges titled “Investments in Partnerships and Joint Ventures.” E&Y auditor noted that these investments are audited as part our work around Strategic Investments. Please see **B16** workpapers for further information.

**Manual Intercompany Elimination Entries**

In addition to the automated elimination process described above, there is also a process for specific manual eliminations. These are the handful of intercompany accounts that do not fall into the 12620 or 12520 account ranges and are not booked until after month-end. Commonly, these

accounts are booked on a 3<sup>rd</sup> party account even though they are intercompany in nature. These accounts are used for non-recurring intercompany eliminations. Recurring intercompany accounts (i.e. 12520 and 12620 DBS Accounts) will eliminate via an automated process with the '800' level company codes. Any company codes in the '800' level that are followed by an X (i.e. 899X) are considered manual eliminations.

The Group is responsible for ensuring that all intercompany balances are eliminated properly, including those that are non-recurring. Typical non-recurring eliminations usually pertain to inventory accounts. Since intercompany inventory balances are frequently combined with 3<sup>rd</sup> party balances, a manual entry must be made to eliminate the intercompany balance. When this situation occurs, the subsidiary or division contacts the Group to ask for permission to close the account. The Group receives journal entries from the product controllers and confirmations from the legal entity controllers who are responsible for ensuring that their accounts are recorded at the proper amount at each month-end. These confirmations are mandatory, generally received by day 6 of the month-end close process, and will advise the Group which intercompany entries to book. The Group receives between 50 - 75 confirmations each month-end. The Group reviews, investigates, approves and then requests the DBS Admin Group to book each entry. The Group is familiar with the elimination entries that need to be manually posted on a monthly basis and as such, are aware of which legal entity controllers ("LEC's") should be sending the list of balances needing to be eliminated and which accounts generally need to be manually eliminated each month. As such, if a confirmation is not received from a controller that normally has balances that need to be eliminated manually, the Group will follow-up. Please see **BB21b.17a** for a listing of the manual elimination submitters that the Group expects to receive a request for a manual elimination from for May 2007.

As of August 1, 2006, many of the previously manual elimination entries have become part of the automated process (i.e. intercompany derivative accounts and intercompany future margin accounts). Per our conversation with the Group, EY auditor noted that the remaining manual intercompany eliminations relate to GFS inventory netdowns, QSIP netdowns, and other one off issues, such as no match in the case of a repo / reverse repo.

EY auditor obtained the final population of May 2007 manual eliminations (see **B21b.17**), and then made a selection for walkthrough purposes (see row highlighted in yellow at **B21b.17 1/**). EY notes that all manual eliminations are posted by either Aysha Abedeen or Yong Yi of the Group – we reviewed the report to ensure that all entries here referenced their user ID – LUA5001. Since the Group does not have access to post manual entries into DBS, they need to contact the DBS Admin Group, who will complete the process by posting the entry into DBS. EY auditor obtained a copy of the email correspondence between the Consolidations Group and the DBS Admin Group (see **BB21b.17.1**) to evidence the proper request and approval of the manual elimination entry. EY auditor also ensured that the amount appearing on each of the DBS entry pages (see **B21b.18** and **B21b.19**) attached to the email approval (see **BB21b.17.1**) agrees to the manual elimination chosen from the final population of May 2007 Manual Eliminations (see **BB21b.17 1/**).

#### **Creation and Renaming of DBS BS Accounts**

The creation or renaming of DBS BS accounts begins when an employee submits a New DBS Account Request Form to Janine Pakiry of the Group. Any person in Lehman's Finance Department can submit a request for the creation of a DBS account. EY auditor obtained the Group's YTD Log of New DBS Account Requests (see **B21b.15**) and made a selection for walkthrough purposes (see row highlighted in yellow at **B21b.15**). For the walkthrough selections, EY auditor obtained a copy of the New DBS Account Request Form from the Group (see **B21b.15.1**), as well as the email correspondence between the requestor and the Group (see **B21b.15.2**). Per our conversation with Janine Pakiry of the Group, EY auditor noted that the form must include the following information: Cullinet relevance (summary account), business purpose and the requestor's name. As part of the Group's review, approval and designation process, Ms. Pakiry verifies that the requestor and the purpose of the account are valid, and that the account will roll up into the appropriate account on the Balance Sheet. After Ms. Pakiry performs the review of the form, she will approve the DBS account request and assign a detail account number to the summary account number provided on the form by the requestor. After this review, approval and designation process has been performed, Ms. Pakiry will initial and date the bottom of the New DBS Account Request Form as part of the approval process (see **B21b.15.1**).

After a new DBS account has been approved, the Group will send an email to Nadya Romero of the DBS Admin Group requesting her to set up the account in DBS. The Group usually tries to consolidate this request into a monthly list of new DBS account requests, rather than sending an email for each individual account request. Typically, the creation of new accounts is requested during the last week of a given month, and the process is completed during the first week of the subsequent month. However, a request can come during the time frame new accounts are being set up and Janine will complete the request. When she has finished setting up the accounts in DBS, Ms. Romero will send an email to Ms. Pakiry to inform her that she has completed the request (see **B21b.15.2**). Now that she knows the accounts have been created in DBS, Ms. Pakiry will go ahead and set these accounts up in Hyperion. Ms. Pakiry will also email the individuals who requested the accounts to inform them that the process has been completed. The Group maintains a YTD log of all the new accounts created in Hyperion by the month the accounts were requested. The purpose of this log is to ensure that all of the new accounts that are created in DBS are also created in Hyperion. EY auditor ensured that the new DBS account that was approved to be opened (see **B21b.15.2** and **B21b.15.1**) was properly opened in DBS by running a query of the General Ledger using the Essbase tool (see **B21b.16**) and in Hyperion by obtaining a screenshot of the account in the Hyperion system (see **B21b.15.3**).

Per our conversation with Janine Pakiry of the Group, EY auditor notes that this process is expected to become fully automated for FY2008 through the implementation of the Chart of Values Entry (COVE) application. EY auditor will follow up on this during the FY2008 audit.

### **Creation and Renaming of Legal Entities**

The creation or renaming of a legal entity begins with a request from a member of the Finance or

Product Control Divisions. The request usually takes the form of an email (see **B21b.21.2**) and the submission of a completed New Legal Entity Request Form is required. If the new legal entity is going to be set-up as a parent company, a New Elimination Entity Request Form must be submitted as well. If the legal entity is not going to be set up as a parent, a New Elimination Entity Request Form is not required. EY auditor obtained a list of the New Legal Entities that had been created in FY 2007 (see **B21b.20**), and made a selection for walkthrough purposes (see row highlighted in yellow at **B21b.20**). Please refer to **B21b.21.1** for the New Legal Entity Request Form that was submitted for legal entity 01R4 – LightPoint Capital Mgt Ltd.. After receiving the request for the creation of a new legal entity, the Group follows up with Lehman Brothers’ Legal Department to ensure that the company has completed its legal formation as a valid form of business. The Group reviews the form to verify a new legal entity is needed and then assigns it a legal entity number. If the request is for the new legal entity to be set-up as a parent, the Group will also create an elimination entity. All new legal entity requests will be collected and sent via email to the DBS Admin Group once controllers have been assigned to each new legal entity. Please refer to **B21b.21.2** for the email sent from Damon Lerner of the Financial & Regulatory Reporting Group to Amy Liu of the Consolidations Group approving the opening of 01R4 – LightPoint Capital Mgt Europe Ltd. The DBS Legal Entity Admin Group will set-up the new legal entity in DBS based on how the structure is defined for reporting purposes (e.g. whether it’s a tax or foreign entity) on the New Legal Entity Request Form. Each legal entity will have the appropriate legal documents as part of its legal creation as a new entity. Please refer to **B21b.21.3** for the legal documentation EY auditor obtained to ensure that LightPoint Capital Mgt Europe Ltd was legally formed prior to being set up as legal entity 01R4 – LightPoint Capital Mgt Europe Ltd in DBS. To verify the execution of the new legal entity request, EY auditor ensured that the entity existed on the General Ledger by using the Essbase query tool (see **B21b.22**). EY auditor also verified that legal entity 01R4 – LightPoint Capital Mgt Europe Ltd was included in the LBHI Scope Analysis as of 8/31/07 (see **A8** workpapers).

#### **Late Journal Entry Approval**

For FY 2007, the late journal entry approval process takes place entirely in a system called the Journal Validation Engine (“JVE”). Late journal entries, traditionally referred to as ‘000’ topsides, cannot be booked to the GL without obtaining approval from Aysha Abedeen, Yong Yi or Rose Hauzenberg of the Group. After obtaining approval from the business area’s manager, an employee can submit a late journal entry through JVE to authorized members of the Group requesting their approval. The authorized members of the Group download the queue of journal entries via JVE multiple times a day during Days 7 – 10. Each late journal entry is reviewed to ensure that the requestor is a member of that particular business group, that the business area’s manager approved the request and that the entry has a clear, valid business description / purpose. A decision will then be made one of the authorized members of the Group to either accept or reject the entry based on the criteria mentioned above. If the entry is accepted in JVE, it will automatically be posted to the General Ledger.

Any journal entry requests that are received after the 10<sup>th</sup> business day are compiled into a list (see **BB21b.27**) and sent to Aysha Abedeen (Global B/S and L.E. Accounting Group) for her

review with the Balance Sheet Controller, Anuraj Bismal (Global B/S and L.E. Accounting Group). The PADJ schedule includes the name of the person proposing the entry, dollar amount and the balance sheet line items that would be impacted. Typically, if one adjustment is deemed material enough to open up the balance sheet to post, then all adjustments accumulated on the PADJ schedule are posted. On the other hand, if none of the entries are deemed material enough, then none of the entries will be posted. If the entries are not posted, then it is assumed that the entries will be booked the following month by the respective Legal Entity Controller. Materiality is usually defined as any item individually, or in the aggregate, that moves net leverage by 0.1 or more (typically \$1.8 billion). Net leverage is an important ratio analyzed by the rating agencies and included in Lehman's earnings release. Net leverage represents Net Assets divided by Tangible Net Equity, which is calculated as follows:

$$\frac{\text{Gross Assets} - \text{Fully Secured Assets}^1}{\text{Equity} - \text{Goodwill} + \text{Junior Subordinated Notes}^2}$$

In addition to net leverage, other factors may be considered in Lehman's process of booking balance sheet adjustments such as the nature of the account affected and whether the users of the financial statements could potentially be misled by not booking the adjustment. For example, this would include income tax entries and those that would materially affect a footnote disclosure. The late income tax entries posted by the Tax Group do require approval or correspondence with the Group, but due to the nature of these entries, an intense investigation or review is deemed not to be necessary. Since these entries can't be calculated before the MTD income statement is final, the income tax entries are always posted late.

Please refer to **BB21b.28** for the May 2007 Month-End Close Process Schedule for additional information.

### **LECReport Database & Legal Entity Certification Process**

To support the Finance Division's stated control objective to obtain certification for the financial statements of all legal entities that consolidate to Lehman Brothers Holding Inc., the BSC&V Group directed the development of the LehmanLive database, LECReport. The LECReport database maintains the Legal Entity Controllorship of all consolidated legal entities and is currently being administered by the Consolidations Group.

The LECReport database is accessible to all firm professionals via LehmanLive, keyword: LECReport. The database combines information fed from the General Ledger nightly and of information assigned by the database administrator. The General Ledger feed provides a complete list of consolidated legal entities, their L.E. code, description and parent entity, if

<sup>1</sup> Fully Secured Assets include segregated cash, reverse repos, stock borrows, goodwill, pledged collateral, etc.)

<sup>2</sup> The Junior Subordinated Notes include Trust Preferred Securities, Euro Perpetual Preferred Securities and Enhanced Capital Advantaged Preferred Securities (ECAPS)

available. The administrator is then responsible for the assignment of tier, controller status and manager. The tier system was designed to break the entities into three groups based mainly on the size of each entity's adjusted assets; Tier 1 is generally made up of entities with an adjusted asset balance greater than \$1 billion and regulated entities, Tier 2 is generally made up of entities with an adjusted asset balance of \$50 million to \$1 billion, and Tier 3 is made of up of entities with adjusted assets of less than \$50 million. Other characteristics are taken into consideration when assigning tiers, including whether the entity is regulated or if the entity has specific contractual obligations that must be monitored (i.e. debt covenants). According to Brian Nicholson (SVP – Global B/S and L.E. Accounting Group), regulated entities or those registered on a stock exchange are generally considered to be Tier 1, although there are exceptions. Once a new legal entity is “tiered”, the administrator refers to the New Legal Entity Request Form to designate the appropriate legal entity controller (“LEC”) and manager to the legal entity in the database (see description of process in section above titled, “Creation and Renaming of Legal Entities”). The LEC will have to visit LehmanLive, keyword: MYLEC, to confirm controllership, as he or she will ultimately be responsible for the legal entity's financial statements.

On a quarterly basis, Mr. Nicholson's group performs a re-validation of the tier assignments. An individual in the group performs an overall review and notes any entities that appear to be assigned to an incorrect tier or that have undergone any changes that would warrant a change in tier assignment. The legal entity controller for any identified entities is then contacted and will comment on the appropriateness of the tier assignment or the need for a change. The Legal Entity Control Committee will then review the tier assignments and approves any recommended changes. Please see **B21b.23** for an example of the LECReport.

There is a workflow built into this application that sends emails to the Legal Entity Mailbox, which is owned by the administrator, alerting them of new entities or entities that have been closed. In addition, the database reconciles against the PeopleSoft – HR system nightly to alert the administrator if any of the LEC's or managers have left the firm or moved internally to another group / division. If an LEC leaves the firm, the entity will need to be reassigned to his or her replacement. This information is obtained by sending an email to the manager. In the case that an LEC changes roles, the administrator will contact the LEC to see if he or she should still be the owner of the entity and if not, who the replacement should be.

The Legal Entity Month-end Assertion Process (LEMAP) is the primary tool that assists LEC's complete their period-end financial analysis and assertion process. The assertions are based on standardized certification language and typically relate to existence / ownership, completeness, rights and obligations, valuations / accuracy / allocation, presentation / disclosure, etc. Currently, there is a Microsoft Excel / Access based prototype of the “Drilldowns” that is being utilized to retrieve various levels of account ownership information. LEMAP retrieves data from DBS (via Essbase) and where applicable, drills down further into detailed data from various sub-ledger systems in the form of InfoPac reports that are maintained in pivot tables in the Microsoft Access database. The current Excel front end file is linking to the Microsoft Access database to show the related ownership information.

A periodic control has been implemented that requires all consolidated legal entities, which consolidate into Lehman Brothers Holdings Inc.'s books and records, to be reviewed and certified by the entity's LEC. The frequency of this certification process is based on the tier designation assigned to the legal entity in the LECREPORT database. Certification is required on a monthly basis for Tier 1 entities, on a quarterly basis for Tier 2 entities, and on a semi-annual basis for Tier 3 entities (at Q1 and Q3). Currently, Erin Kane of the BSC&V Group is coordinating the certification process.

After the balance sheet has been officially closed, the LEMAP application initiates the certification process by sending an email to all of the relevant LEC's and managers alerting them that the LEC's have ten business days to complete their certifications. The email also provides them with step-by-step instructions on how to extract their entities' financial information from an Essbase Macro (mentioned above) and how to submit the signed certification letter through the Sarbox application, which is currently being used as a document repository. The LEC will have the following options regarding the certification of their entity's financial statements: a) "to Certify", b) "to Certify With Exception" or c) "Not to Certify".

If the LEC chooses "to Certify", it indicates that he/she is fully comfortable with each of the 10-digit Balance Sheet and Income Statement account balances of his/her respective legal entity. In this case, all that is required of the LEC is the submission of a signed certification letter through the Sarbox application.

If, however, there are some exceptions that the LEC cannot explain, he/she must choose to either "Certify With Exception" or "Not to Certify". In either case, the LEC is required to submit commentary and/or supporting documentation outlining the exceptions or explaining why they are unable to certify the financial statements.

The BSC&V Group is also responsible for aggregating this information and maintaining a summary of response rates by region (see **BB21b.24** for an example of the Certification Summary Report). These results are frequently reviewed by the LECC, which is made up of senior managers across the regions who are responsible for the legal entity control groups. Monthly summaries are also produced and provided to the Controller in his monthly package.

#### **Additional BSCP Information**

After all of the processes and procedures of the BSCP have been performed, the Group runs their final piece of documentation: the Consolidation and Financial Reporting System Balance Sheet by Summary Account (see **1Q-BS.01** in the E&Y Corporate Team's 1Q 2007 AWS engagement). This Balance Sheet by Summary Account is the same report that is obtained and reviewed by E&Y Corporate Team on a monthly basis as part of their procedures for comfort and consent letters. The final LBHI Consolidated Balance Sheet disclosed in the Annual Report, 10-K, 10-Q's, and X-17 reports are derived from this report as well. The EY Corporate Team relies on the work performed by the domestic and international teams throughout the audit, and

performs additional procedures as necessary, to effectively audit / review this report. The E&Y TSRS Team recreates the Balance Sheet through their Hyperion CAAT (Computer Assisted Auditing Technique).

In addition to EY auditor's walkthrough and test of controls, Lehman Brothers' Internal Audit Department is performing a walkthrough and test of control procedures on the Financial Statement Close Process. Please refer to Internal Audit's Test of Controls Matrix (included for informational purposes only) (see **IA – B21**) and memo (see **IA – B21a**) discussing the work that they performed regarding the BSCP.

### *Confirming our Understanding of Controls (Controls Strategy)*

Describe the walkthrough procedures to confirm our understanding of the design of the controls and that they have been placed into operation. As we walkthrough the prescribed procedures and controls, we should ask personnel to describe their understanding of the control activities and demonstrate how they are performed. We keep in mind that controls may be manual, automated, or a combination of both. Application controls are fully automated controls that apply to the processing of individual transactions. IT-dependent manual controls are dependent upon complete and accurate IT processing to be fully effective.

**Control:** A fluctuation analysis is performed quarterly by the Consolidations Group for management reporting purposes to explain material fluctuations in balance sheet amounts and is reviewed by senior Finance department management.

**Control:** A new DBS account request form must be filled out and submitted to the Consolidations Group which is then reviewed for completeness and accurateness and are signed and dated by the reviewer.

**Control:** A new legal entity can only be created upon its successful completion of legal formation.

**Control:** A new legal entity request form must be filled out and submitted to the Consolidations Group who then reviews the request and assigns an entity number.

**Control:** A reconciliation is performed using an Investment in Subs report generated out of Hyperion to ensure total investment on the parent's books matches the equity on sub's books. The Group explains and/or monitors the breaks until they are cleared.

**Control:** A yearly log of request forms is retained of accounts established in DBS that is used to ensure that all new accounts set up in DBS are also set up in Hyperion.

**Control:** All manual elimination entries are reviewed and approved by the Consolidations Group.

**Control:** All new legal entities are assigned a legal entity controller who must review and certify the financial statements of that entity.

**Control:** Any entries that need to be booked after the 10th business day after month-end are compiled into a list (referred to as the PAJE list) and sent to Aysha Abedeen and Anuraj Bismal (Global B.S. and L.E. Accounting Group) for his review and approval.

**Control:** Any entries that need to be booked after the 4th business day after month-end (day 5 -

9) must be submitted through JVE and approved by authorized members of the Consolidations Group.

**Control:** Balance Sheet consolidation is automated in Hyperion.

**Control:** Hyperion automatically zeros the net assets of the subsidiary and the subsidiary's income flows into the retained earnings of the parent company during consolidation into LBHI.

**Control:** Hyperion performs automatic eliminations of investment in subsidiaries with the subs equity, intercompany receivables and payables.

**Control:** If a new entity is created as a parent, the Consolidations Group will also create an elimination entity.

**Control:** Intercompany account reconciliations are performed using reports generated out of Hyperion to ensure that all intercompany account balances are equal and offsetting. The Group explains and/or monitors the breaks until they are cleared.

**Control:** LEC's must certify the Financial Statements of the legal entities that they are responsible for on a monthly, quarterly or semi-annual basis (at Q1 and Q3), depending on the tier assigned to that entity.

**Control:** New accounts are only set up in DBS by the DBS Admin Group after notification of approval from the Consolidations Group.

**Control:** On a monthly basis, all legal entity controllers must confirm inter-company balances requiring manual elimination to the Consolidations Group via e-mail.

**Control:** Once approved, new legal entity requests are sent via email from the Consolidations Group to the DBS Admin Group to be set up based on how the structure is defined for reporting purposes (e.g. tax vs. foreign entity).

**Control:** Recurring intercompany transactions are eliminated via an automated process.

**Control:** To ensure that new accounts will roll up into the appropriate summary account on the balance sheet, the Consolidations Group assigns a detail account number in Hyperion to the account requested.

## **Section 2: Other Matters—Segregation of Incompatible Duties and Management Override of Controls**

### *Segregation of Incompatible Duties*

S03 Understand Flows of Transactions and WCGWs of *EY GAM* requires that we assess the extent to which significant weaknesses in the proper segregation of incompatible duties could increase the likelihood of material misstatements in account balances. Inadequate segregation of incompatible duties also may reduce or eliminate the design effectiveness of a control.

Accordingly, we consider whether those individuals performing the procedures and controls observed as part of our walkthrough procedures have any conflicting duties and whether any potential conflicting duties have been addressed in the design of the procedures and controls.

Our considerations related to segregation of duties as part of our walkthrough procedures are documented below:

Was anything noted in our walkthrough procedures that would indicate there are incompatible duties?	Yes/No No	
If we answered “Yes” to the above: <ul style="list-style-type: none"> <li>Do the incompatible duties represent a deficiency in the design of controls that is not sufficiently mitigated by other management actions or controls that have been identified (Substantive and Controls Strategy) and tested (Controls Strategy)?</li> </ul>	Yes/No	Additional Observations
	n/a	n/a
If we answered “Yes” to both of the above questions, provide further documentation and the related effect on our audit strategy.	n/a	

*Management Override of Controls*

S04\_Perform Walkthroughs of *EY GAM* requires that we consider whether the results of our inquiries or other evidence obtained during our walkthroughs provides information regarding the possibility of management override of controls or indicators of fraud. The potential for management override of controls is one of the factors that can influence our evaluation of controls, including the effectiveness of internal control at the entity level.

Our considerations related to management override of controls as part of our walkthrough procedures are documented below:

Was anything noted in our walkthrough of controls that indicate the potential for management override of controls or that such override may have occurred?	Yes/No No	
If we answered “Yes” to the above: <ul style="list-style-type: none"> <li>Does the potential for management override of controls represent a deficiency in the design of controls that is not sufficiently mitigated by management actions or controls that have been identified (Substantive and Controls Strategy) and tested (Controls Strategy)?</li> </ul>	Yes/No	Additional Observations
	n/a	n/a
If we answered “Yes” to both of the above questions, provide further documentation and the related effect on our audit strategy.	n/a	

### Section 3: Conclusion

At the completion of our walkthrough procedures, we reach a conclusion on whether our results confirmed our understanding of the flow of transactions or sources and preparation of information. Additionally, if we planned to assess control risk at less than the maximum, we are performing an integrated audit, or the class of transactions contains a significant risk, we reach a conclusion on whether our results confirmed our understanding of whether the controls have been implemented and whether the controls have been designed effectively to prevent or detect and correct material misstatements on a timely basis.

If we are unable to conclude that controls are effectively designed and have been implemented, we may need to reassess our strategy decision (i.e., Controls Strategy v. Substantive Strategy) at the significant class of transactions level and reassess our evaluation of controls. For integrated audits, we determine whether the missing or ineffective control(s) represent one or more control deficiencies that we include on the Summary of Control Deficiencies (EY Form U220).

Our conclusions are documented below or in GAMx (Perform Walkthroughs screen):<sup>3</sup>

	Yes/No	Additional Observations
Did our walkthrough procedures confirm our understanding of the flow of significant classes of transactions within significant processes or sources and preparation of information resulting in significant disclosures (Substantive and Controls Strategy)?	Yes	n/a
Did our walkthrough procedures confirm that the identified WCGWs represent the points within the flow of significant classes of transactions, or sources and preparation of information in significant disclosures, where material misstatements could occur (Substantive and Controls Strategy)?	Yes	n/a
Did our walkthrough procedures confirm that the controls have been effectively designed and placed into operation (Controls Strategy)?	Yes	n/a

<sup>3</sup> If any of the situations are noted, we further describe the issues that were noted, and update our process documentation and GAMx file accordingly.