

Walkthrough Template - GAMx

Entity	Lehman Brothers Holding Inc.	Workpaper Ref.	B12
Subsidiary or Division	Equity/Equity Derivatives	Prepared by	Lauren DeStefano
Financial Statement Date	November 30,2007	Reviewed by	Stephanie Leight

Significant Class of Transactions/Process name: Global Trading Strategies Walkthrough

Walkthrough Procedures

This template assists in our documentation of walkthroughs under SO4 Perform Walkthroughs of the *EY Global Audit Methodology*. For an integrated audit, we are **required to complete a new template each year** to document the procedures performed, evidence obtained, and our conclusions as to the effective design of the underlying controls and whether the controls have been implemented. For all other audits, use of this template is encouraged. We perform at least one 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. Our walkthrough includes both the manual and automated steps of the process, including 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). We use the same source documents and information technology that client personnel typically would use.

When the client’s IT environment is complex, where appropriate, we work with TSRS (IT professionals) to walk through the automated aspects of the flow of transactions.

As we perform each walkthrough, we should question client personnel involved in the significant class of transactions and sources and preparation of information and the performance of the identified controls about their understanding of the client’s prescribed procedures and controls. We should document whether processing procedures are performed as originally understood and in a timely manner, and we are alert for exceptions to the company’s prescribed procedures and controls. Our inquiries during the walkthrough should include follow-up questions that could help identify the abuse of controls or indicators of fraud. 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. As we perform the walkthrough, we also consider and document whether those individuals performing the controls have any conflicting duties or whether any potentially conflicting duties have been addressed.

EY Form U120 (5/11/07)

When there have been significant changes to flows of significant classes of transactions or sources and preparation of information, including key applications, we need to evaluate the nature of the change(s) and the effect on related accounts and disclosures and determine whether to walkthrough transactions that were processed both before and after the change(s).

If our walkthrough procedures do not confirm our preliminary understanding of controls, 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 deficiencies in internal control that we include on the Summary of Control Deficiencies (EY Form U220).

Walkthrough of Significant Class of Transactions Within Significant Processes and Sources and Preparation of Information Resulting in Significant Disclosures (including steps performed by applications)

Describe the walkthrough procedures 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 to confirm our understanding of the process and sources of information management uses to generate significant disclosures. We should document whether processing procedures are performed as originally understood and in a timely manner.

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 document our understanding of the flow of transactions or the sources and preparation of information resulting in significant disclosures.

Flow of Transactions/Sources and Preparation of Information

Overview

EY auditor Lauren DeStefano met with Will Yelsits from the Middle Office and Phil DeLuca in Finance for the purposes of conducting the Global Trading Strategy Walkthrough (formerly known as Risk Arbitrage).

Global Trading is a strategy of the firm, not a particular type of product. It is strictly a proprietary trading desk that looks to capitalize on the current trends of the economy, similar to the purpose of a hedge fund. The strategies may be riskier than other areas at the firm. For example, in 2004, the strategy was to invest in equities (approx 60%) and high yields (approx 40%). That strategy has changed slightly in 2005, as approximately 75-80% of risk arbitrage is equity-based, while approximately 15-20% is high yield. Additionally in 2005, Lehman increased its investment in private placement deals. Please see **B12.3a** for the Global Trading Strategies balance sheet by strategy for May 2007. Per discussion with Phil, Deluca, assessing the business breakup by strategy presents a more accurate picture than solely by products.

There are various strategies/books within Global Trading, including Mergers & Acquisitions (M&A), Long/Short Trading, High Yield/Distressed Bonds and other strategies. The M&A book consists of

Lehman's strategy to make a profit on merger & acquisition deals (as long as Lehman is not an advisor in the particular merger & acquisition). The intent is to purchase a long position in the stock of the company Lehman believes will be acquired (since the value of the stock of the acquired company typically increases after the acquisition) and sell short the stock of the company making the acquisition (since the value of the stock of the acquiring company typically decreases after the acquisition). In the Long/Short book, Lehman invests in different basket trades of competitors' stock, similar to a hedge fund (Example: long Sirius stock and short XM Satellite stock). This trading strategy typically produces a net hedge of 0 producing limited risk for the GTS group. The traders make money on the long shares and hedge their exposure with competitor shorts. The Distressed book includes investments in distressed loans (i.e. Enron, WorldCom) and does not currently have much activity. Although it is a small percentage of activity, EY inquired as to what trades were included in "special situations." As per Phil Deluca, special situations include a trade of company stock where the company is experiencing inner turmoil; this includes changes in management or any restrictions/legal proceedings within a company (ex: Philip Morris).

In this fiscal year, Lehman has also engaged heavily in Credit Default Swaps ("CDS"). This is an off-balance sheet activity and therefore the total dollar amount of that activity will not be reflected on **B12.3a** Global Trading Strategies balance sheet. Credit Default Swaps engaged in by Global Trading are generally used as a hedging activity to balance trading done in the Long/Short book. The CDS trading is a way for the traders to synthetically create positions in their account without investing large amounts of capital.

The Global Trading Strategies desk generally transacts in a small number of deals that have a high dollar amount. The firm's capital is utilized to make the investments, and their gross balance sheet utilization is approximately \$7.3 billion at 5/31/07, up approximately \$3.2 billion in 11 months. In order to achieve these investment strategies, the Global Trading Strategies area uses a variety of different products offered in the global market, including equities, fixed income, derivatives, etc. Therefore, the products traded in this area can include products from any of the mainframe systems (i.e. TMS, MTS, ITS, Loan IQ, and RISC).

Our purpose is to gain an understanding of the Global Trading Strategies trade cycle, middle office procedures and the product control monthly and daily procedures of the Global Trading securities.

Lehman Process

Trading Systems:

Product	F.O. System	Mainframe
Equities	MacGregor	TMS
High Yield Bonds *	Laura/MacGregor	TMS/ ITS
Treasuries	CATS	MTS
Futures	Clearing 21/TIPS	RISC
Loans	Laura	Loan IQ
CDS	SmartTicket	CDS-Carusso

NOTE: All of the mainframe systems feed G-Quest, the firmwide P&L management system, and DBS, the general ledger system. Bonds are booked into Laura for Treasury Reporting and into MacGregor in order to flow to TMS.

In addition to entering all transactions into the Lehman front office systems so that they are properly recorded, if the trade ticket is coded for a Global Trading Strategies trader, the trade is also entered into the Risk Arbitrage system: Risk Arbitrage Position Management System ("RAPMS"), a central database, stand alone system. Only the Global Trading Strategies group has access to RAPMS. Since Global Trading Strategies encompasses several different products that are entered into multiple systems, RAPMS allows the GTS personnel to properly identify and monitor the risks and returns associated with the global trading strategies portfolio. MacGregor was implemented as of June 2006 for US Cash Equities, September 2006 for Euro Equities and October 2006 for Japanese Equities. It is planned that MacGregor will eventually have the functionality of RAPMS, and will then replace that system. As of our walkthroughs, there is no estimated date for that roll out.

Trade Cycle

For walkthrough purposes, EY selected a US Equities trade from the Trade History Report for trade date 7/12/07 (See **B12.1.1**) of Alcan Inc. from the Merger and Acquisitions book.

The trader manually inputs the trade into the MacGregor System (See **B12.1.2**). MacGregor is the front end order entry system for equities products traded by the Global Trading Strategies Desk. This is a new automated system implemented for the GTS traders and it replaces a majority of the manual tickets that used to be used and prepared for GTS trades. The traders simultaneously enter the trades into RAPMS. It monitors the traders' positions, keeping an up to date tracking of the number of positions on hand. MacGregor (See **B12.1.3**) also executes the trade. The Alcan trade selected for walkthrough purposes was executed with 3 different brokers.

All equities trades entered into MacGregor automatically flow and are booked to the TMS subledger (See **B12.1.4**).

TMS in turn feeds QUEST (the P&L reporting system) (See **B12.1.5**) and ADP (See **B12.1.6a-c**) (the clearance and settlement books and records). For work performed around Clearance and Settlement, please refer to **B3** workpapers.

The Global Trading Strategies Desk utilizes the OASYS system as a means to communicate to other brokers. After market close, Lehman sends out an OASYS confirmation to the counterparty. The broker (counterparty) responds via OASYS and notes whether they agree to the terms that Lehman agrees to. If there are discrepancies, they will be noted on the T+1 reconciliation's performed by Middle Office and will be subsequently investigated and corrected prior to market open.

There are still a small number of trades that use manual trade tickets. These trades make up roughly less than 10% of the daily trade volume and are for specific products. These products include US Treasuries, Fx Trades, Futures and debt. These trades still follow all manual procedures: trade tickets are filled out by the trader and are manually entered into the correct front office system that handles that particular financial instrument. Trade tickets are timestamped on the front when the order was placed and on the back when the order is executed. The trader then transfers the information from the timestamped ticket to a second ticket and indicates the account number in the mainframe system where the trade should be

recorded. The trader will also indicate the final balance (cumulative positions from prior day plus the current day positions) on the second trade ticket. The trader gives the second trade ticket to Middle Office in order for them to perform all T+1 reconciliations. EY auditor did not walkthrough a trade requiring a manual trade ticket because it made up such a small percentage of the business.

Middle Office

MacGregor Email (See B12.2.1)

After market close on trade date, Middle Office receives an email generated by the IT department responsible for monitoring the MacGregor system. This email shows all trades entered into MacGregor on that date and uses the email to verify that the end of day positions in MacGregor agree to the positions in RAPMS.

RAPMS Trade History Report (See B12.2.2)

The RAPMS Trade History Report is generated by Middle Office on T+1 from the RAPMS system. Middle Office performs no position verification on trade date; instead, on the morning of T+1, Middle Office verifies that the start of day positions in RAPMS agree to the start of day positions in MacGregor.

MacGregor vs. TMS/ITS Break Report (See B 12.2.3)

Upon implementation of the MacGregor system, and since it flows to all mainframe systems, Middle Office now performs a reconciliation from MacGregor to each of the mainframe systems (TMS and ITS). In a nightly batch process, MacGregor groups all trades set for booking in the same mainframe system and sends the information to the respective mainframes overnight. On T+1, an automated break report is generated listing all breaks. It is sent via email to Middle Office who clears all breaks by applying the correction to the applicable mainframe system. EY auditor notes that through discussion with Middle Office, the only formal break report Middle Office receives is for the MacGregor system. For breaks occurring for all non-MacGregor products, Middle Office reviews QUEST daily and notes that the beginning positions on T+1 in QUEST agrees to RAPMS. Through this verification, Middle Office is comfortable that the positions in QUEST flowed correctly from the respective front office entry system.

Estimate vs. Actual P&L (See B12.2.4)

On a daily basis, Middle Office performs a P&L reasonableness analysis by comparing P&L estimate to P&L actual numbers. GTS P&L is estimated on trade date and P&L actual numbers are put together on T+1. This reconciliation from RAPMS to GQUEST is performed by Middle Office to verify that the traders are properly marking the price of the different securities.

1. Estimate P&L – Positions are extracted from RAPMS each night. As mentioned in the trade capture portion of this narrative, when trades are entered into the Front Office system by the trader, they are also manually entered in RAPMS.
2. Actual P&L – The actual P&L is downloaded from GQuest.

The position information from RAPMS is downloaded to an excel file that contains a direct Reuters link to market information. All positions are marked to market with the close price from Reuters. These

marked positions are then compared to actual P&L downloaded from QUEST. Differences greater than \$100,000 are investigated by Middle Office. Differences often occur because there was a bad mark of the estimate, there was interest on bonds, or if there was any realized gain or loss on the sale of trades (trading P&L). Interest and Trading P&L would be included in the actual P&L amount and not the estimated P&L amount.

Trade Ticket vs. QUEST

Due to the manual nature of entering the trade information from the trade ticket into the Lehman systems, which in some cases is done by a separate department, there are checks done by Middle Office to verify that the input was performed correctly. As per conversation with Will Yelsits, of Middle Office, there are few trades still recorded/entered from manual trade tickets: roughly 10% of the entire business is manually ticketed and on a daily basis, only an average of 1-2 trades is manual. Middle Office performs a trade ticket vs. QUEST reconciliation because at the time of the break Middle Office is not aware what subledger the trade was originally ticketed to. Middle Office will review the trade and determine if the break was the result of the Lehman side or client side of the trade. Middle Office will then manually adjust the applicable subledger (TMS, ITS, MTS, RISC) for the required adjustments. Since these types of trades are so infrequent, breaks occurring on these trades are even rarer.

Product Control

Footnote Adjustments (See B12.3.1)

Middle Office prepares footnote adjustments on a monthly basis. *Footnotes are documented and reviewed appropriately.* There are 2 types of footnote adjustments: reversing adjustments, which will automatically be fed to the GL at month end, and non-reversing adjustments, which have to be manually posted to the GL. Middle Office downloads all reversing adjustments on month end date and all non-reversing adjustments posted throughout the month from Fixed Income and Equities QUEST. However, roughly 95% of the information is pulled from Equities Quest because the Global Trading Strategies group trades more equity than fixed income products. Middle Office then sends the footnote adjustments to Product Control for review. Product Control investigates any adjustments greater than \$100,000 and prints a report listing all those adjustments. Footnote adjustments greater than \$100,000 require documentation of a reason for and understanding of the adjustment. Adjustments are generally attributable to mark adjustments, legal fees and money wired out by the GTS group.

Price Testing (See B12.3.2)

At month end, Product Control independently prices securities by comparing the marks in Quest to those of an independent source. Breaks over \$300k are investigated to determine the cause and are reported to senior finance managers and discussed with the trader. EY selected the May month-end for price testing walkthrough purposes (See B12.3.2).

There are three main parts to performing the price testing.

1. Phil Deluca receives the Management Balance Sheet (See 12.3.2.1) from the Financial Controllers Department, containing all the accounts that relate to Global Trading Strategies. Note that shorts are reported on settlement date, not trade date, because an asset (borrow) is created on settlement date, and the purpose of the Management Balance Sheet is to allocate usage back to the business. The spreadsheet is broken down by region (Europe, America, Asia).

2. Phil accesses GFS to obtain the detail of each of the accounts found on the Management Balance Sheet. The detail includes each position that is held in the accounts summarized on the balance sheet. A reconciliation is performed to reconcile the gross longs and gross shorts per GFS to the Management Balance Sheet. Reconciling items include:
 - A. Fails: fails are captured on the Management Balance Sheet, but are not included in the price testing population (the GFS detail). GFS is an inventory system, so it does not contain fails. Fails information is provided by the Balance Sheet Control group.
 - B. Adjustments: the Management Balance Sheet is received at approximately 10 AM on the month-end date. Quest footnotes are typically done later in the day; therefore, they are included in GFS, but are not included in the first cut of the Management Balance Sheet.
3. Phil prepares a reconciliation that encompasses all the Global Trading Strategies positions received for all mainframes (TMS, MTS, ITS, and Loan IQ)
 - All detail position information is extracted from GFS. TMS information is provided by Inventory Control, whereas MTS, ITS, and Loan IQ positions are extracted by Phil. TMS positions obtained from John are reconciled by Phil to those in GFS to verify validity of the data.
 - Positions (Long or Short) with a market value greater than \$3,000,000 are compared to external prices (IDSI) (IDSI provides Lehman with an external pricing feed, and automatically feeds the Firm Trading Lan). If a price is not available from IDSI then Phil utilizes Bloomberg for Bonds and Finance web pages (i.e. yahoo, cnn) for equities. As a last resort, Phil will inquire with the trader how the price was determined and obtain any documentation available to determine if the rationale is acceptable.
 - Any breaks between Lehman's quote and the external quote greater than \$1 price or a market value difference of \$300,000 and over 5% of market value are investigated, and the reasons for the differences are documented and retained. The percentage of market value policy was adopted in order to take into consideration the size of the price difference in relation to the size of the position. Breaks are usually attributed to the following:
 1. Bonds: the concept of accrued interest. GFS uses a dirty price, which means it includes the amount of accrued interest, while the external quotes use a clean price.
 2. GFS picks up the dividend accrual (the stock is "ex-dividend"); therefore, there can be differences in the prices for dividend-paying stocks.

Phil noted that based on his testing there have not been significant adjustments needed. See workpaper **B12.3.2** for the summary of balance sheet coverage (including the different levels of securities) price tested by Finance. The coverage summary sheet is used by management to see the amount of price testing that was performed. Price testing is performed by Product Control based on gross amounts, as opposed to the management balance sheet which is presented after cusip netdown.

Flash vs. G/L (See B12.3.3)

A reconciliation between QUEST and DBS is performed on a monthly basis. Differences greater than \$100K are investigated: smaller variances will be investigated if necessary. EY obtained the Flash to General Ledger (DBS) Reconciliation prepared at month end by Product Control for month ended 5/31/07 (See B12.3.3). Product Control downloads figures from QUEST and uses Essbase to query and download information from DBS. Differences greater than \$100,000 are researched and corrected prior to end of month-end close. Remaining differences are deferred on the G/L and researched during the following month for appropriate adjustment and correction. Frequently, the variances shown are due to different ways of classifying sectors between GQUEST and DBS.

Valuation Adjustments/Reserves (See B12.3.4)

At month end, Product Control reviews the portfolio of securities and takes valuation adjustments on those securities that fall within reason. Product Control then reviews these reserves for reasonableness. Fiscal Year 2007, is the first year that Lehman is following the regulations set forth by FAS 157. FAS 157 states that valuation discounts are taken on certain securities based on security restrictions. Securities are broken out into different levels (levels 1, 2 and 3) depending on the ease of which price information can be obtained on the security. A level 1 security is generally any equity, level 2 securities are generally fixed income securities and level 3 securities are generally private equities that use model determined pricing. Reserves are taken on level 3 securities, any securities with legal restrictions (e.g. Lehman had a position on their book last year that had a stipulation that they were not allowed to trade that stock for 1 year). Reserves are not taken on any level 1 security. Currently in the book, there are a small amount of positions that reserves are taken on. EY obtained the May 2007 month end reserves file and selected 1 reserve to walkthrough and obtained the applicable support verifying that the reserve appropriate.

Walkthrough of Controls (including application controls)

We always complete this section for integrated audits. For all other audits, we complete this section when we plan to use the Controls Strategy (i.e., assess control risk at less than the maximum) or when the class of transactions contains a significant risk, in which case we must walkthrough the controls over the assertions affected by the significant risk.

Describe the walkthrough procedures to confirm our understanding of the design of the controls and that they have been implemented. 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.

Our inquiries during the walk-through should include follow-up questions that could help identify the abuse of controls or indicators of fraud. 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.

We summarize the results from our inquiries during the walkthrough in this form.

Manual and IT-Dependent Manual Controls

On a daily basis, Middle Office performs a P&L reasonableness analysis by comparing P&L estimate to P&L actual numbers	
<i>Procedures Performed</i>	<i>Documents Obtained</i>
<ul style="list-style-type: none"> EY obtained the Estimate vs. Actual reconciliation EY footed and recalculated P&L differences and waived immaterial difference due to rounding EY selected 1 P&L center and obtained the explanation and support for the variance between the estimated and actual P&L. No unusual items noted. 	<p>B12.2.4 Estimate vs. Actual Reconciliation 7/12/07</p> <p>B12.2.4a Estimate vs. Actual Variance Explanations</p>
Footnotes are documents and reviewed appropriately.	
<i>Procedures Performed</i>	<i>Documents Obtained</i>
<ul style="list-style-type: none"> EY obtained all reversing and non-reversing footnote adjustments downloaded from for FID and Equity QUEST EY obtained the Footnote Adjustments Summary prepared by Product Control listing all adjustments greater than \$100K EY judgmentally selected 1 adjustment from the Footnote Adjustments Summary , an Equity QUEST reversing adjustment, for walkthrough purposes EY obtained the support for the correct value of the security and agreed it to the Footnote Adjustment workpapers w/o/e 	<p>B12.3.1 Footnote Adjustments Summary May 2007</p> <p>B12.3.1a FID QUEST Non-Reversing Adjustments</p> <p>B12.3.1b FID QUEST Reversing Adjustments</p> <p>B12.3.1c Equity QUEST Non-Reversing Adjustments</p> <p>B12.3.1d Equity QUEST Reversing Adjustments</p> <p>B12.3.1e Sequenom Support</p>
At month end, Product Control independently prices securities by comparing the marks in QUEST to those of an independent source. Breaks over \$300k are investigated to determine the cause and are reported to senior finance managers and discussed with the trader.	
<i>Procedures Performed</i>	<i>Documents Obtained</i>
<ul style="list-style-type: none"> EY obtained the May 2007 price verification file EY agreed the positions from the Management Balance Sheet to GFS EY selected 1 security verified the independent price using EY ISP, no exceptions noted For completeness, EY agreed the selected security to GFS 	<p>B12.3.2 Price Verification May 2007</p> <p>B12.3.2a GFS Data Dump Revised</p> <p>B12.3.2.1 Management Balance Sheet May 2007</p> <p>B12.3.2.2 EY ISP Price Verification</p>
A reconciliation between QUEST and DBS is performed on a monthly basis. Differences greater than \$100K are investigated: smaller variances will be investigated if necessary.	
<i>Procedures Performed</i>	<i>Documents Obtained</i>
<ul style="list-style-type: none"> EY obtained the QUEST vs. DBS Reconciliation performed at month end May 2007. 	<p>B12.3.3 QUEST vs. DBS Reconciliation May 2007</p> <p>B12.3.3a QUEST MTD 5/31/07 Screenshots</p> <p>B12.3.3b QUEST YTD 5/31/07 Screenshots</p>

<ul style="list-style-type: none"> EY obtained QUEST screenshots agreed QUEST balances to the reconciliation w/o/e EY reperformed the GTS Essbase Query and agreed the total revenue per Essbase to the Flash vs. GL Reconciliation w/o/e. 	B12.3.3c GTS Essbase Query
At month end, Product Control reviews the portfolio of securities and takes valuation adjustments on those securities that fall within reason. Product Control then reviews these reserves for reasonableness.	
<i>Procedures Performed</i>	<i>Documents Obtained</i>
<ul style="list-style-type: none"> EY obtained the Valuation Adjustments taken at month end May 2007 EY randomly selected 1 reserve for walkthrough purposes EY obtained all applicable support and reviewed the reserve taken for reasonableness, no exceptions noted 	B12.3.4 Valuation Adjustments May 2007 B12.3.4a Itron Inc. Investment B12.3.4b Itron Inc. Bloomberg Printscreen

Application Controls

Program controls ensure the completeness feeds from TMS to QUEST.	
<i>Procedures Performed</i>	<i>Documents Obtained</i>
<ul style="list-style-type: none"> To be tested by TSRS 	

Segregation of Incompatible Duties

We consider whether those individuals performing the procedures and controls (if we plan to assess control risk at less than the maximum or are performing an integrated audit) have any conflicting duties and whether any potential conflicting duties have been addressed in the design of the procedures and controls. For further guidance, refer to Attachment A (Segregation of Incompatible Duties Considerations) to this form.

Document below our observations as to any potential conflicting duties that have not been addressed in the design of the controls. If we identify one or more segregation of incompatible duties issues relating to this class of transactions or source and preparation of information, we document the issues below, determine if the issues represent risks of material misstatement due to fraud or error, and consider the issues in reaching our conclusion regarding the design effectiveness of related controls.

If we determine that an individual has incompatible duties, all duties performed by that individual should be considered to determine the degree to which the effectiveness of those duties is affected by the incompatible duties identified in our walkthrough. Incompatible duties also may indicate other weaknesses in procedures and controls over authorization of transactions, safeguarding of assets, or asset accountability procedures. In addition, we consider whether IT access does not adequately prevent incompatible duties. This may indicate the need to challenge the nature and extent of our procedures for testing the existence of assets as of the balance sheet date.

Segregation of Incompatible Duties

We did not identify any issues in relation to the segregation of duties in these processes.

Performance Requirements

Initial and date each step to indicate that our walkthrough addressed these requirements.

	Initials and Date
<p>a. The walkthrough encompassed the entire process of:</p> <ul style="list-style-type: none"> - initiating, - authorizing, - recording, - processing, and - reporting individual transactions and related controls. 	<p>LD 10/17/07 SL 10/18/07</p>
<p>b. We inquired of the Company's personnel about their understanding of what is required by the Company's prescribed procedures and controls to determine whether the processing procedures are performed as originally understood and on a timely basis.</p>	<p>LD 10/17/07 SL 10/18/07</p>
<p>c. We were alert for exceptions to the company's prescribed procedures and controls.</p>	<p>LD 10/17/07 SL 10/18/07</p>
<p>d. If we planned to assess control risk at less than the maximum or we are performing an integrated audit, we evaluated whether the quality of evidence obtained in performing the walkthrough procedures was sufficient to determine the effectiveness of the design of the controls and whether controls have been implemented.</p>	<p>LD 10/17/07 SL 10/18/07</p>
<p>e. We used the same source documents and information technology that client personnel typically would use in the flow of transactions.</p>	<p>LD 10/17/07 SL 10/18/07</p>
<p>f. Our inquiries of company personnel included follow-up questions that could help identify the abuse of controls or indicators of fraud.</p>	<p>LD 10/17/07 SL 10/18/07</p>
<p>g. Where we identified significant changes in the flow of transactions, we evaluated the nature of the change to determine whether to walkthrough transactions processed both before and after the change.</p>	<p>LD 10/17/07 SL 10/18/07</p>

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. 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:

- The accuracy of the information we have obtained about the relevant prevent and/or detect controls over the flow of transactions or sources and preparation of information.
- Whether the controls have been implemented.
- 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 deficiencies in internal control that we include on the Summary of Control Deficiencies.

When evaluating the design effectiveness of controls, we should consider whether the controls were:

- Responsive to related WCGWs
- Performed by appropriately qualified personnel
- Sufficiently sensitive to prevent or detect and correct material misstatements
- Susceptible to management override

We also consider whether:

- Incompatible duties are appropriately segregated
- Underlying data/reports used in performing controls were complete and accurate

Conclusion

Document in GAMx (Perform Walkthrough screen) our conclusion on whether our results confirmed our understanding of the flow of transactions or sources and preparation of information.

Attachment A – Segregation of Incompatible Duties Considerations

Adequate segregation of incompatible duties is an important consideration in determining if a client’s control activities are effective in achieving the objectives of internal control. Inadequate segregation of incompatible duties may reduce or eliminate the design effectiveness of a control. In addition, incompatible duties may indicate inappropriate authorization, safeguarding of assets, or asset accountability procedures, such as when the same person has custody of assets and records transactions. These circumstances may indicate the need to challenge the nature and extent of our tests for the existence of assets as of the balance sheet date. We consider whether those individuals performing the controls have any incompatible duties and whether any potentially incompatible duties have been addressed in the design of the controls.

[AMER] Guidance on assessing the adequacy of a client’s segregation of incompatible duties organized by application is found in, “**Example Guidance on Understanding and Evaluating Classes of Routine Transactions,**” (Part C–Segregation of Incompatible Duties). Engagement teams are also encouraged to complete EY Form U107, “Segregation of Incompatible Duties in Significant Accounting Applications,” (or similar documentation) to assist in identifying, documenting, and evaluating potential segregation of incompatible duties matters. [AMER]

In general, the principal incompatible duties to segregate are:

- (1) custody of assets,
- (2) authorization or approval of related transactions affecting those assets, and
- (3) recording or reporting of related transactions.

In addition, an individual should not be responsible for performing a control over the same transaction that the individual is responsible for recording/reporting. Segregation of incompatible duties also encompasses access to applications and data either through ineffective security over the applications and data, or granting user access to individuals that have incompatible duties (e.g., access to vendor master file and responsibilities for disbursement of cash). Key IT functions such as programming, operations, data entry, and security should be segregated and those involved should not have accounting responsibilities or access to assets. We also consider whether there are other individuals that, while not having day-to-day responsibilities with respect to a class of transactions, have access to assets, applications, data, and other records relating to a class of transactions that pose segregation of duties concerns.

As part of evaluating whether there is adequate segregation of incompatible duties, we consider whether any individuals perform:

1. Incompatible processing or control procedures within applications
2. Control or processing procedures within one class of transactions that are incompatible with duties [control or processing procedures] relating to other classes of transactions.

Examples of incompatible duties we might observe include the following (see further examples in “Example Guidance on Understanding and Evaluating Classes of Routine Transactions”).

- Cash Disbursements:
 - same person approves the execution of electronic payments (authorization) and records cash disbursements (recording)
 - same person maintains cash disbursements journal (recording) and performs the bank reconciliation (control)
 - same person with access to cash disbursements IT programs and data files (control) maintains accounts payable records (recording)

- Sales:
 - same person approves credit for customers (authorization) and maintains accounts receivable records (recording)
 - same person maintains accounts receivable records (recording) and reconciles the records with the general ledger control account (control)

We are not required to identify every instance where someone else could perform a control or processing procedure, but should understand who, in the normal course of performing these functions, has the responsibility to process transactions.

For non-routine and estimation transactions, we generally focus on whether there is adequate segregation of incompatible duties between the individuals who prepare, review, and record transactions.

The identification of incompatible duties does not always result in ineffective controls. There may be other controls in place specifically designed to address a recognized lack of segregation of incompatible duties. We consider what other controls exist that achieve this objective and make a determination as to whether they are sufficient to mitigate the identified incompatible duties.

Note: If management has specifically designed the controls to mitigate incompatible duties and we believe such controls are sufficient, we ordinarily would not conclude that the incompatible duties represents a deficiency in the design of the controls. On the other hand, if management did not specifically design other controls to mitigate the potential effects of incompatible duties, we ordinarily would conclude that a deficiency in the design of the controls exists. We then would consider the mitigating effect of compensating controls in determining whether the design deficiency is a significant deficiency or a material weakness.