

FROM COMPLIANCE PROGRAMS TO ERM

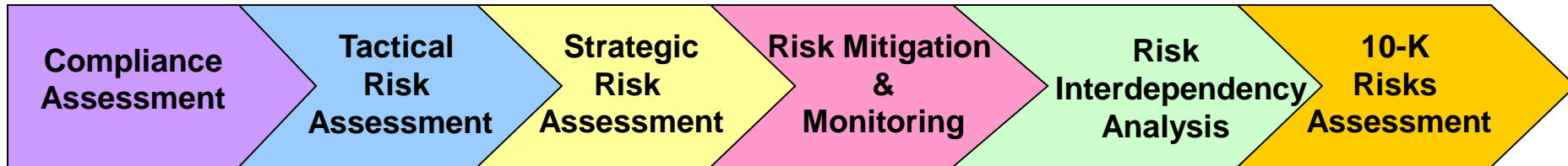
Peter J. Agnoletto, Chief Audit Executive
and ERM Leader/Senior Director, Internal Audit,
Par Pharmaceutical Companies



COMPLIANCE WEEK 2012

Par's ERM Process

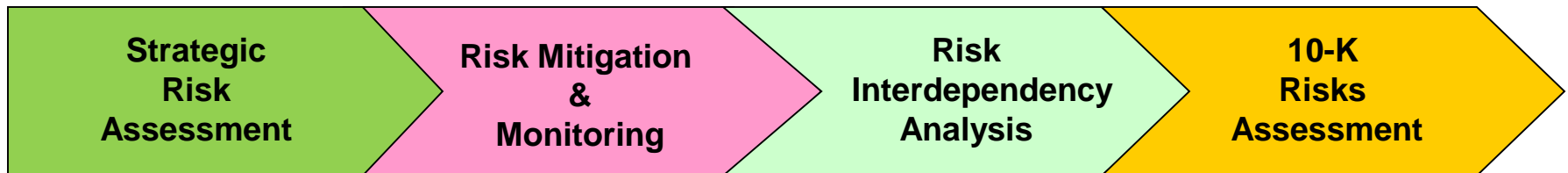
Initial Process



Linked to Objective Setting Process

**Timing of Annual EWRM Process
Aligned with Operating Plan**

Current Process



• Nov 1st – Strat Plan

• Quarterly ERM mtgs
• June 15th Status Update

• Nov / Dec

• January

COMPLIANCE WEEK 2012

Strategic Assessment

Par Pharmaceutical Strategic Risk Assessment

	RISK	INDUSTRY INHERENT RISK RATING	LIKELIHOOD	SEVERITY	NET RISK RATING	Linkage to Tactical Risk Assessment	PERSONS RESPONSIBLE
1		High	1	5	Low		
2		High	6	5	Medium		
3		High	3	7	Medium		
4		Low	7	8	High		
5		Low	6	7	Medium		
6		Medium	7	9	High		
7			9	3	Medium		

INDUSTRY INHERENT RISK RATING - Inherent Risk within the industry without considering existing controls.

Low

There is an unlikely or minimal risk of a regulatory observation or a minimal financial impact.

Medium

There is a possible risk of a regulatory observation or an adverse financial impact.

High

A risk that can result in a significant regulatory sanction or a significant financial impact.

LIKELIHOOD

THE RISK

Rare (1-2)

Negligible probability of impact in the next 12-24 months

Unlikely (3-4)

Low probability of impact in the next 12-24 months

Possible (5-6)

Medium probability of impact in the next 12-24 months

Likely (7-8)

High probability of impact in the next 12-24 months

Very Likely (9-10)

Very high probability of impact in the next 12-24 months

SEVERITY

THE RISK MAY HAVE

Insignificant (1-2)

Almost no financial implications

Minor (3-4)

Minimal impact on financial performance

Moderate (5-6)

Significant impact on financial performance

Major (7-8)

Substantial impact on financial performance requiring multiyear recovery

Extreme (9-10)

Significant impact on corporate solvency

ERM Lessons Learned

- ERM **means different things to different people** – If you ask 10 people what ERM is you will get 10 different answers
- Keep the process as simple as possible – At Par ERM is a process to **assess and manage business risks within the organization**
- Focus on the benefits
 - **Inventory** of risks and a **process** to assess and manage risks
 - **Focus areas** for management
 - **Awareness** for Board and Management

ERM Lessons Learned

- Board Reporting – **High Level Summary** and provide commentary on what the company is doing to **mitigate the risk**
- Executive management **support** and **ownership** by senior management
- Link to **objective setting process**

Board Summary

BOARD SUMMARY

2012 TOP RISKS ---- THEMES/ CATEGORIES WITH MONITORING ACTIVITIES

Note: This document reflects what Management believes to be the Top Risks that the Company may face in 2012 and should be focusing on. This does not mean this is a problem within the Company or a risk because of an existing problem.

THEME / CATEGORY	PROCESS & CONTROL ACTIVITIES	WHERE / HOW COMMUNICATED	MONITORING ACTIVITY
Acquisition Integration Risks – XX •XXX	<ul style="list-style-type: none"> • XXX • XXX • XXX • XXX 	<ul style="list-style-type: none"> • XXX • XXX • XXX • XXX • XXX 	<ul style="list-style-type: none"> • XXX • XXX • XXX
Compliance Risks – XXX •XXX •XXX	<ul style="list-style-type: none"> • XXX • XXX • XXX 	<ul style="list-style-type: none"> • XXX • XXX • XXX 	<ul style="list-style-type: none"> • XXX • XXX • XXX
Third Party Risks – XX •XXX	<ul style="list-style-type: none"> • XXX • XXX • XXX 	<ul style="list-style-type: none"> • XXX • XXX • XXX 	<ul style="list-style-type: none"> • XXX • XXX • XXX

FROM COMPLIANCE PROGRAMS TO ERM

Peter J. Agnoletto, Chief Audit Executive
and ERM Leader/Senior Director, Internal Audit,
Par Pharmaceutical Companies



COMPLIANCE WEEK 2012




Compliance Week's 7th Annual Conference

4^h – 6th June 2012
Washington, D.C.

Presented by
Frank Fiorille
Director of Risk Management
Paychex Inc.

From Compliance Programs to ERM

Paychex Profile

- 
- Provider of comprehensive payroll, human resource, and benefits outsourcing solutions for small to medium sized businesses
 - Approximately 564,000 clients
 - More than 100 offices nationwide
 - Fiscal 2011: Revenue of \$2 billion, pre-tax income of \$0.8 billion, net income of \$0.5 billion

Board & Executive Engagement



Company Strategy

"We are focused on achieving strong, long-term financial performance by..."

"Our future results of operations are subject to a number of risks and uncertainties. These risks and uncertainties could cause actual results to differ materially from historical and current results and from our projections..."



Corporate Governance

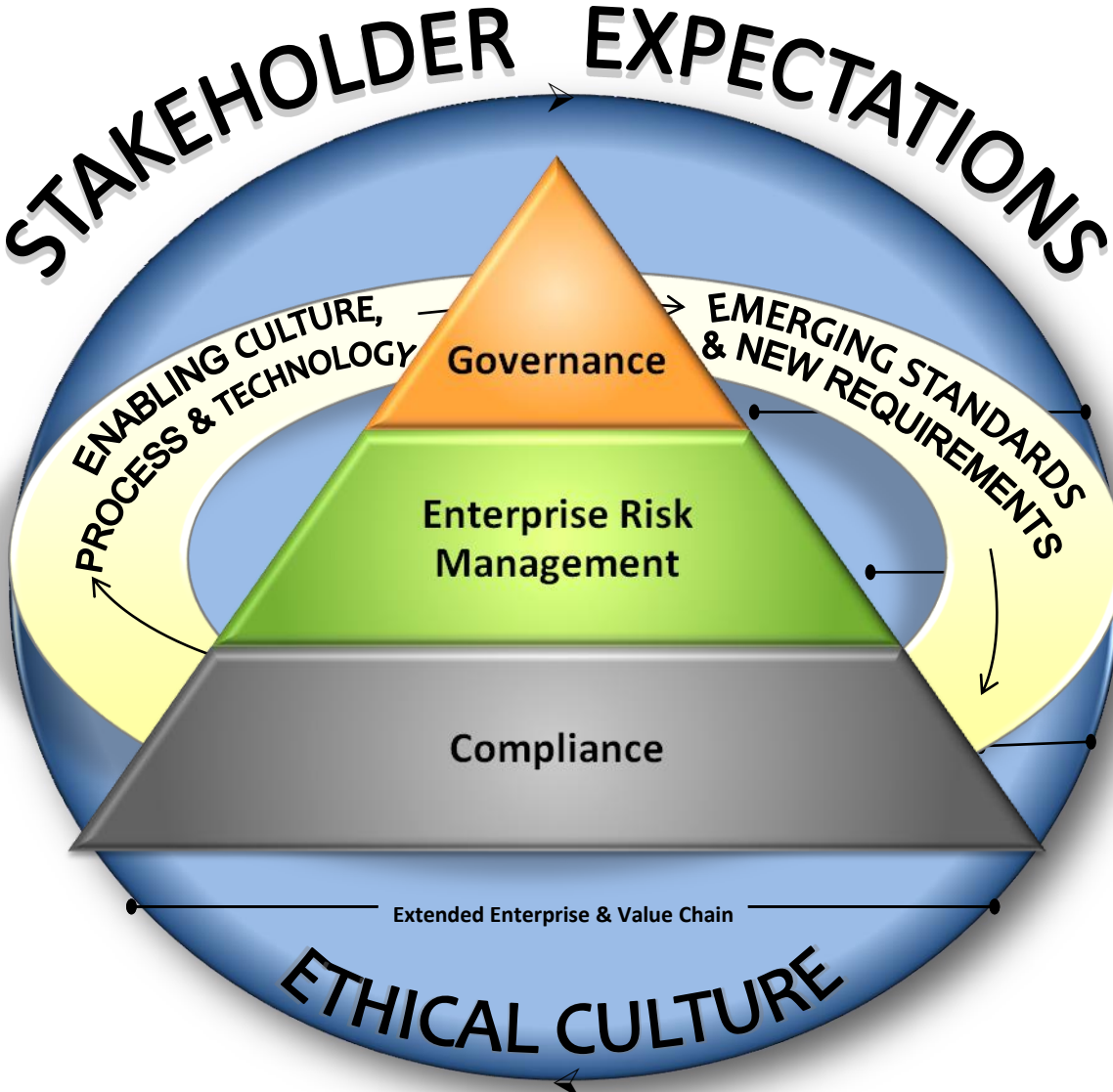
"...lead the Board, particularly as it focuses on strategic risks and opportunities facing the Company."

Risk Oversight

"One of the functions of the Board is oversight of risks inherent in the operation of the Company's business. The Board fulfills this function through reports from officers for oversight of particular risks within the Company, through legal review of the Company's strategic plan, and through delegation of certain risk oversight functions..."

The cover of the Paychex 2011 Annual Report. It features a woman in a dark suit with her arms crossed. The text on the cover includes: "ANNUAL REPORT" in large letters, "PAYCHEX 2011" below it, "\$2.1 Billion Total Revenue", "America's Business Is Our Business" with a sub-headline "The CEO's message to shareholders", "564,000 Clients Nationwide", "PAYX 40th Birthday Celebration at NASDAQ", "*1 in 401(k) Recordkeeping Plans", "HEALTH-CARE REFORM" with a sub-headline "Paychex Insurance Agency, Inc., businesses, and the Affordable Care Act", and "Paychex continues as AICPA accountants' preferred payroll and retirement plan provider".

Establishing Context



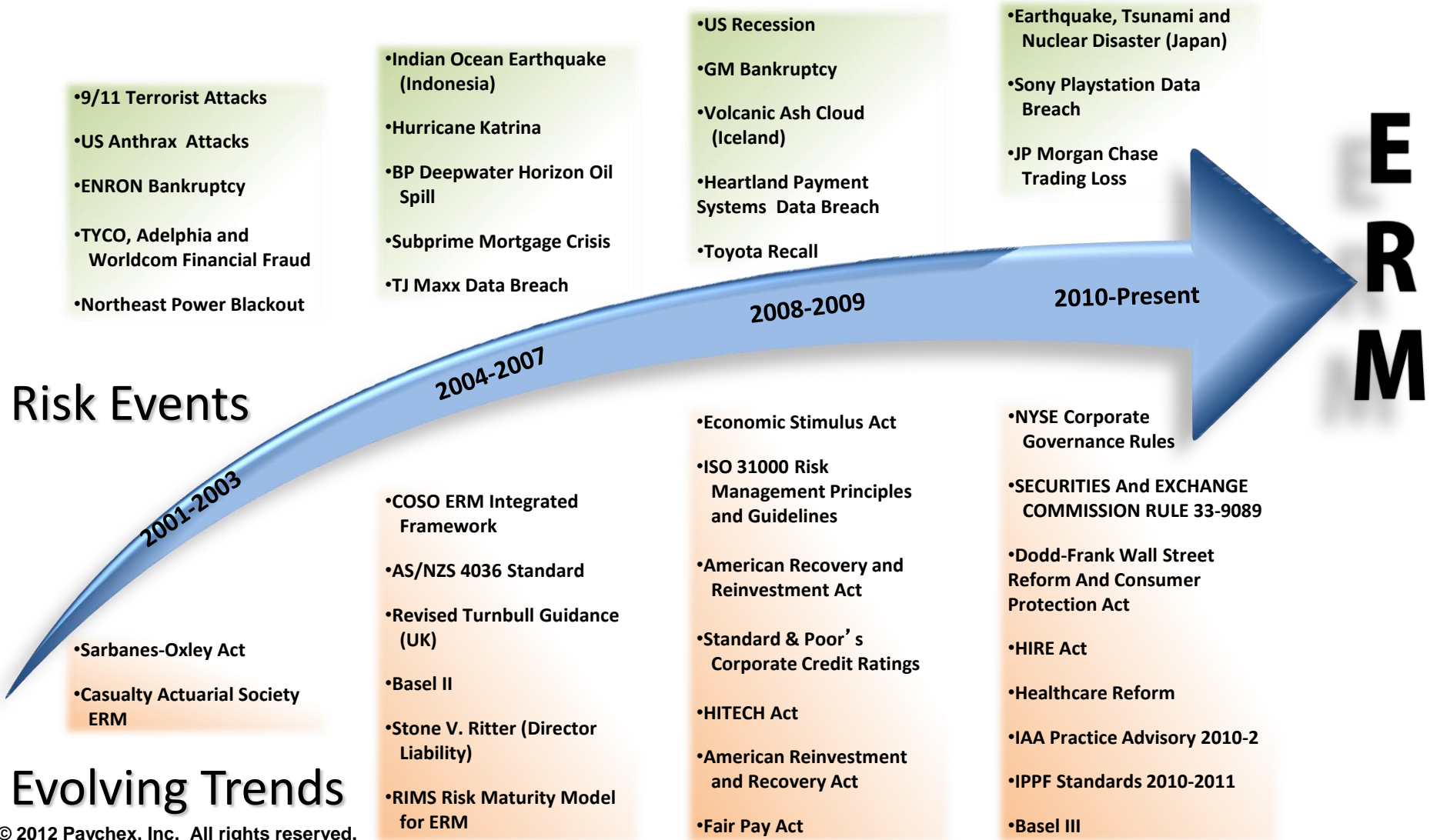
Setting strategy, objectives, tone, policies, risk appetite and accountabilities; monitoring performance.

Identifying and assessing risks that may affect the ability to achieve objectives; determining risk response strategies and control activities.

Operating in accordance with objectives; ensuring adherence to laws and regulations, internal policies and procedures, and stakeholder commitments.

The Case for Effective ERM

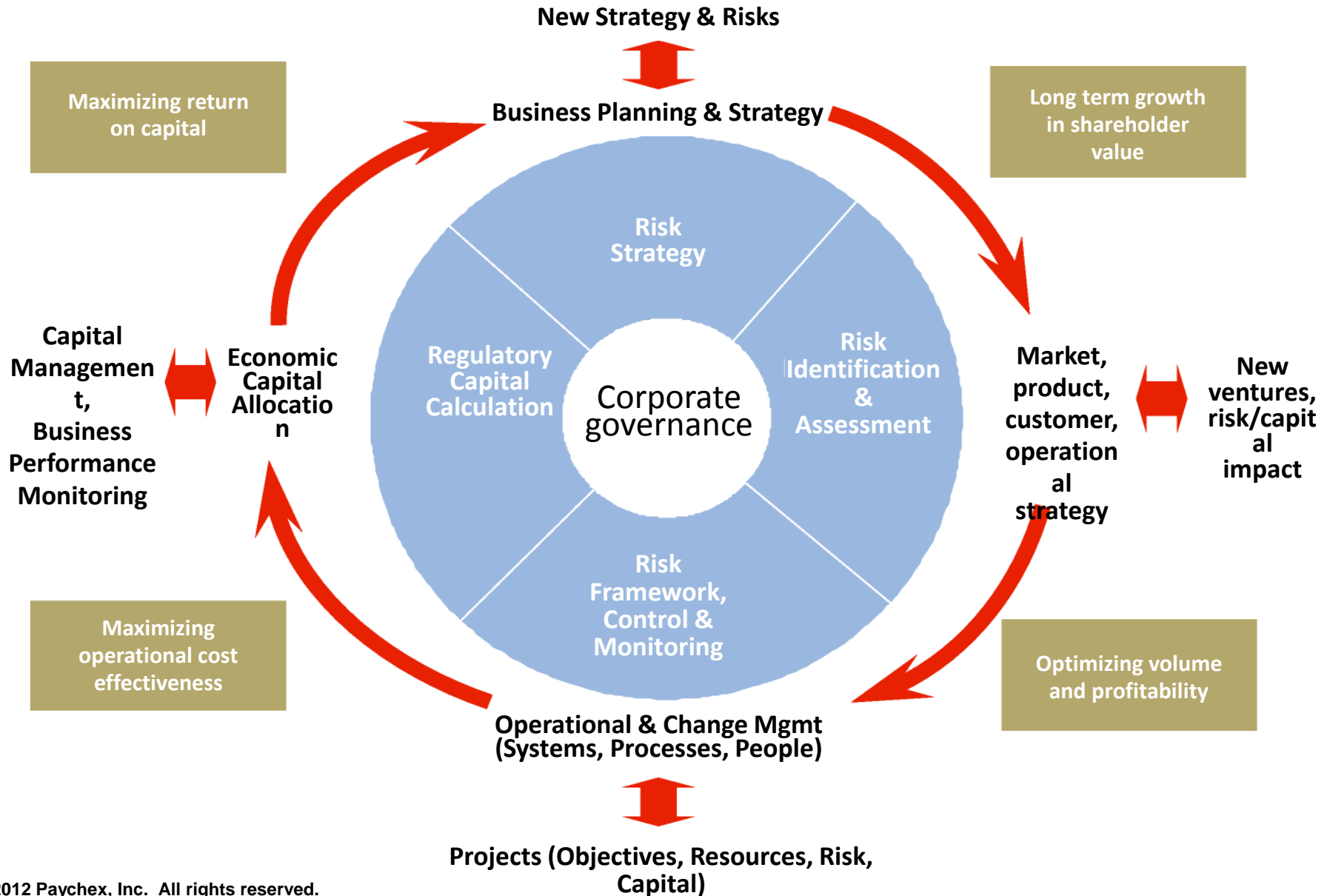
The risk management processes of corporations are under increasing regulatory and private scrutiny. The escalating regulatory trend, both domestically and internationally, combined with an ever-changing risk landscape is pointing to the compelling need to demonstrate a viable ERM framework is in place for managing risks, especially for publically traded companies.



Evolving Trends

© 2012 Paychex, Inc. All rights reserved.

Strategic Risk Management Process



Why Integrate ERM with Strategy?

Classic Risks



“You’ ve got to ante up to get into the game or stay in business.”

“Paychex, like most firms, makes money and creates value by taking intelligent risks and loses money or gets in trouble by failing to manage risk effectively.”

Creative Risks



“The strategic bets that we place during our poker game or try new things.”

Strategic Risk Management

A comprehensive process to identify, evaluate and manage strategic risks to reduce uncertainty AND maximize opportunities

Guiding Principles of SRM:

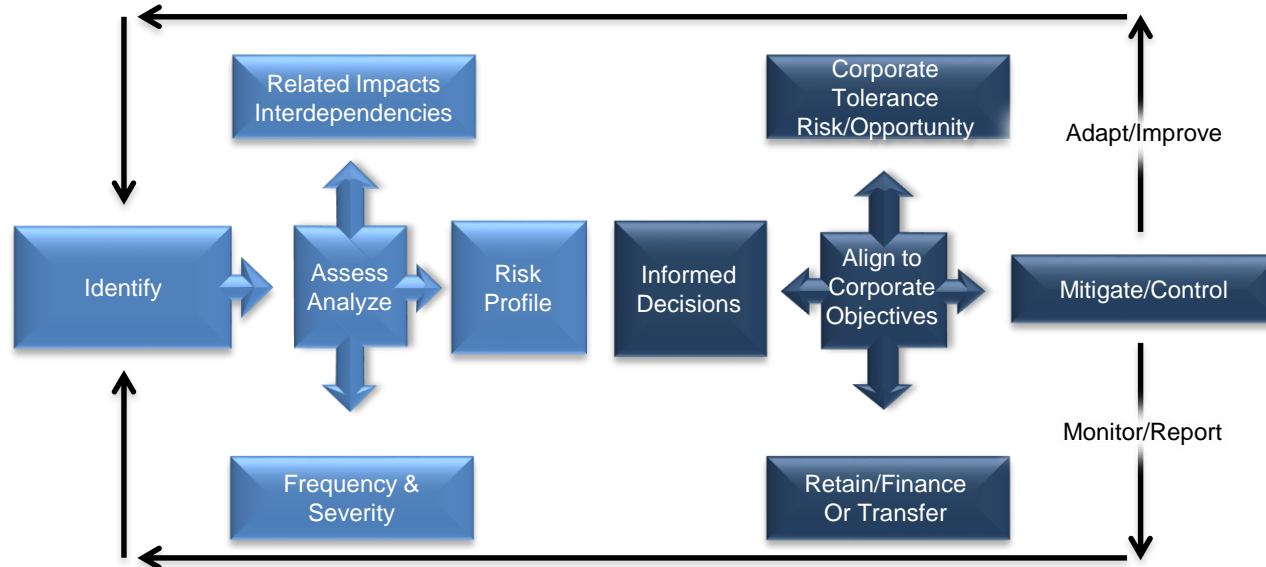
Primary component of an organization's ERM process

Ultimate goal is protecting and enhancing shareholder value

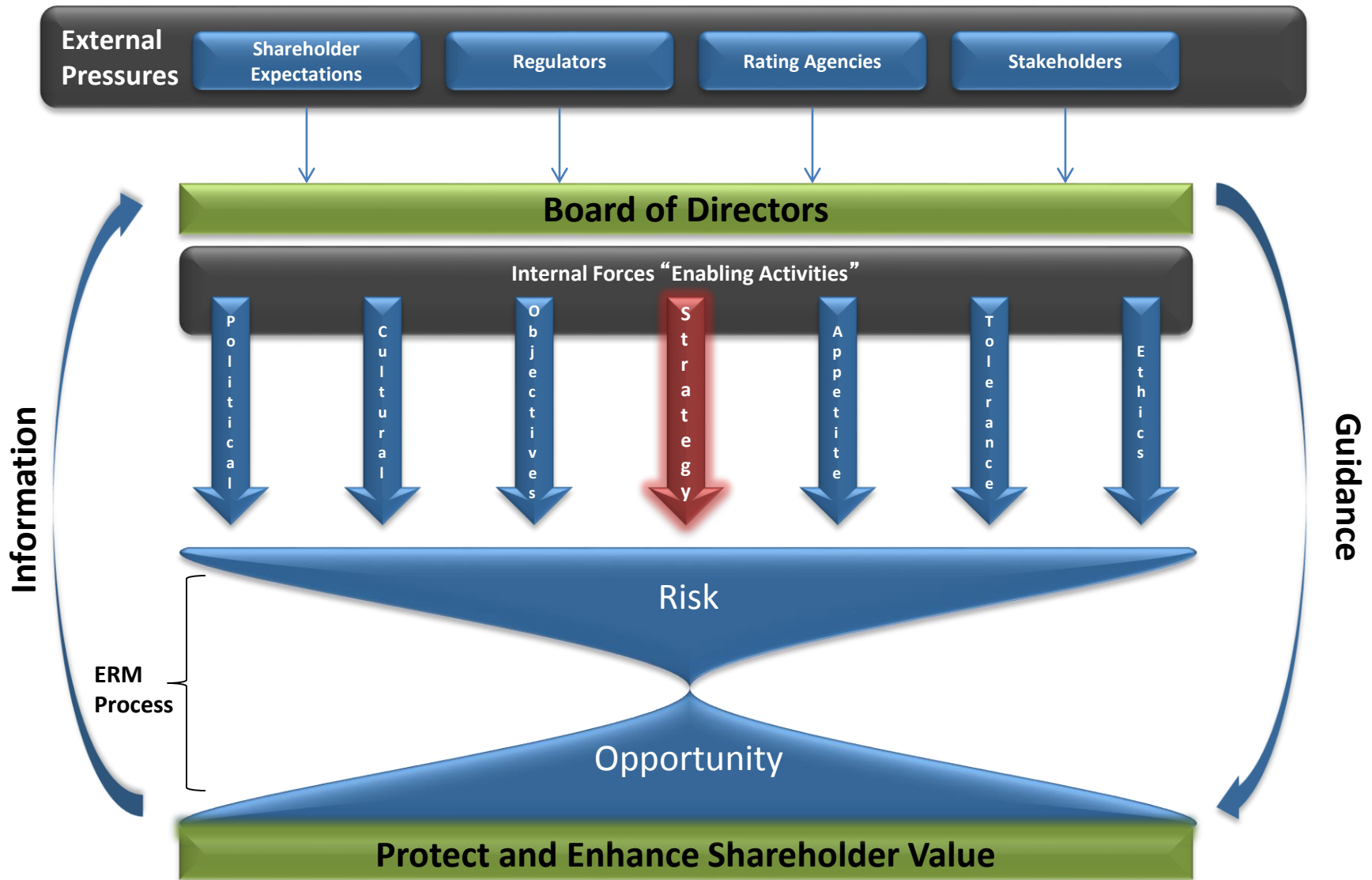
Effectuated by boards of directors, executive management and others

A strategic approach to risk and managing uncertainty is necessary to achieve company objectives

Continuous process



Paychex Strategic Process



Paychex ERM Framework

Mission: Protect and enhance shareholder value

Infrastructure

- Vision/Goals
- Governance
- Oversight structure
- Common language
- Policies
- Technology
- Tools
- Techniques
- Tolerance/appetite
- Monte Carlo simulation

Process



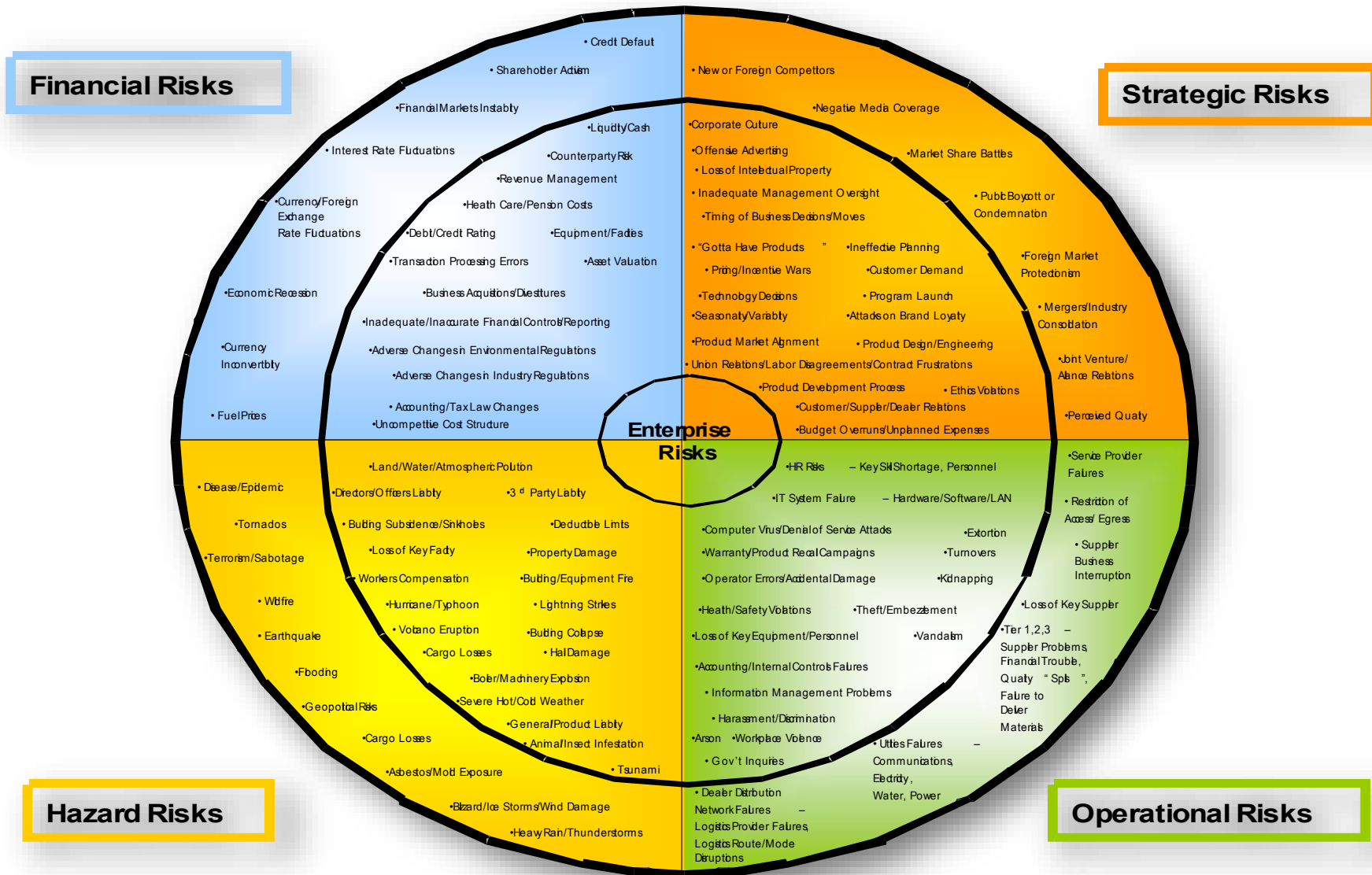
Integration

- Operational processes
- Strategic planning
- Quality process
- Competency models
- Product development
- Capital projects
- Performance management

Culture: Enabling Activities: *"Become a part of the company's DNA"*

- Risk management is recognized as a key contributor to value creation.
- The risk culture is defined and enshrined to give managers and employees the requisite freedom of maneuver.
- An awareness of risk and the need to manage it pervades the enterprise.
- Risks are identified, reported, and quantified to the greatest possible extent.
- Equal attention is paid to both quantifiable and unquantifiable risks.
- Risk management is everyone's responsibility and is not fragmented into compartments and silos.
- The enterprise avoids products and businesses it does not understand.
- Scenario planning embraces uncertainty and considers all possible developments.

Environmental Scan



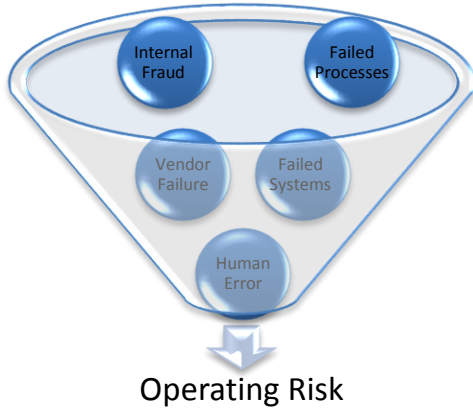
Identify & Assess Risk



Interactive Risk Assessments

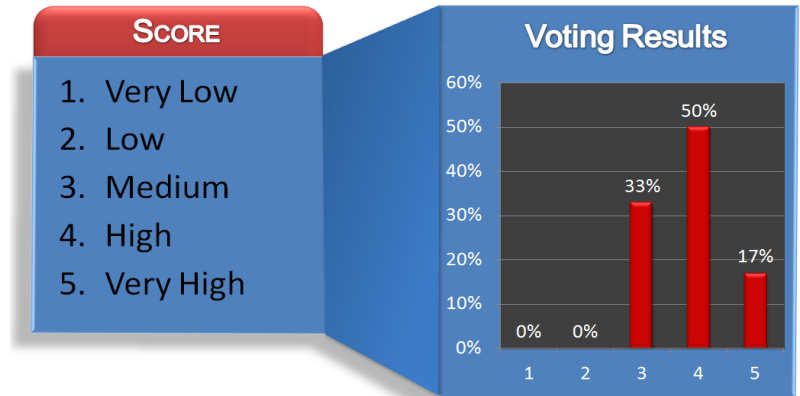
Identifying the effectiveness of processes and controls via interactive participation with subject matter experts.

Step 1: Pre-work:



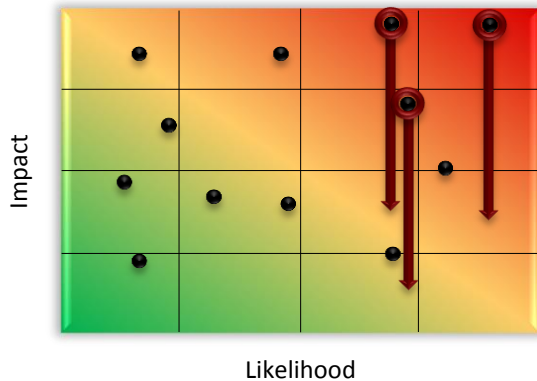
- Business unit identifies risks associated with operational errors.

Step 2: Workshop



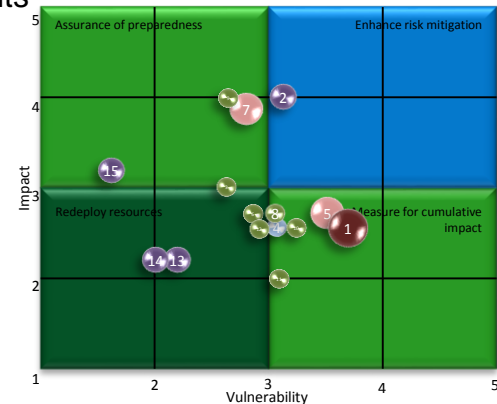
- Voting technology is utilized to score/rank the risks

Step 3: Mitigation



- Top-ranked risks are identified and reviewed to assess counter-measures

Step 4: Results

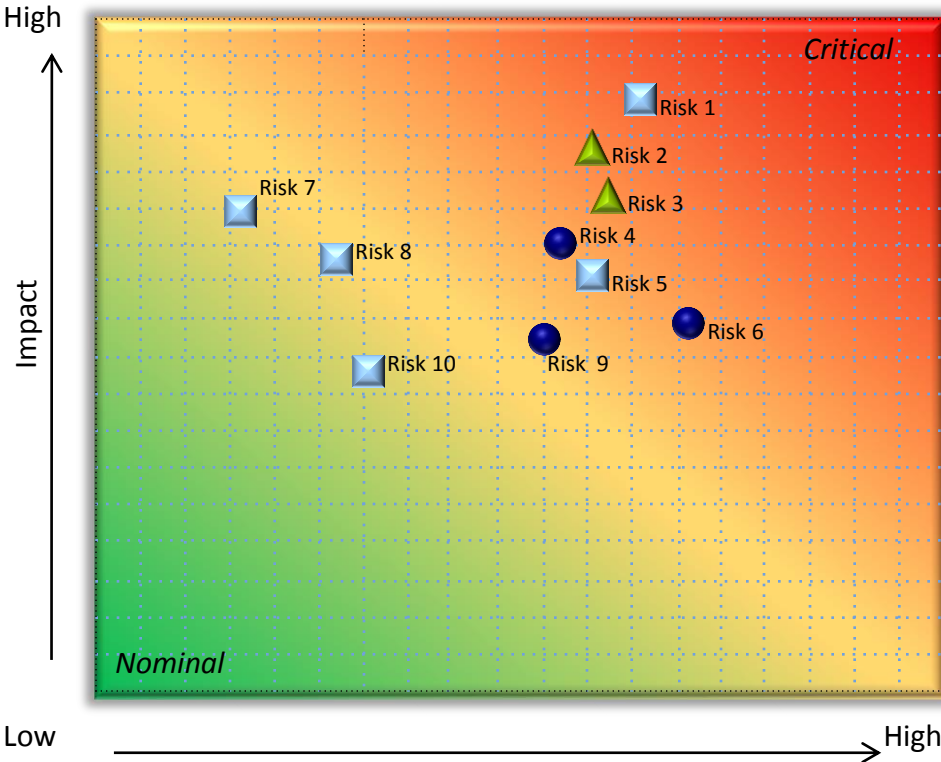


- Key risks are identified and better understood creating awareness and accountability

Dimensioning Risk

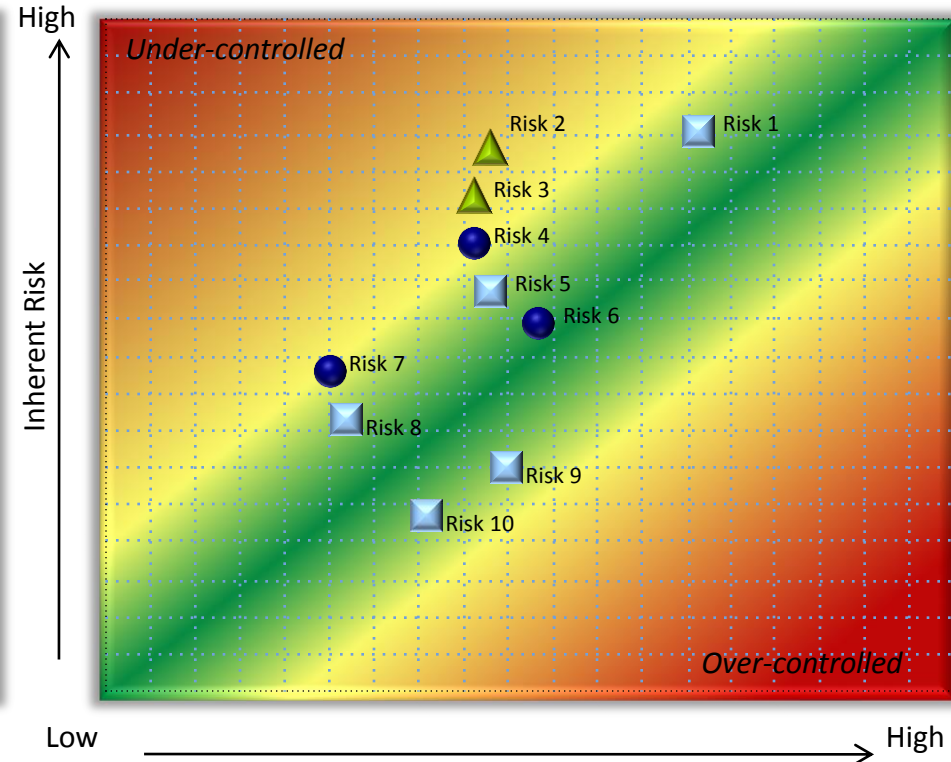
Inherent Risk

Inherent Risk = Impact x Likelihood



Residual Risk

Residual Risk = Inherent Risk x Uncontrolled Management Effectiveness



Risk Velocity

- Slow
- Average
- Fast

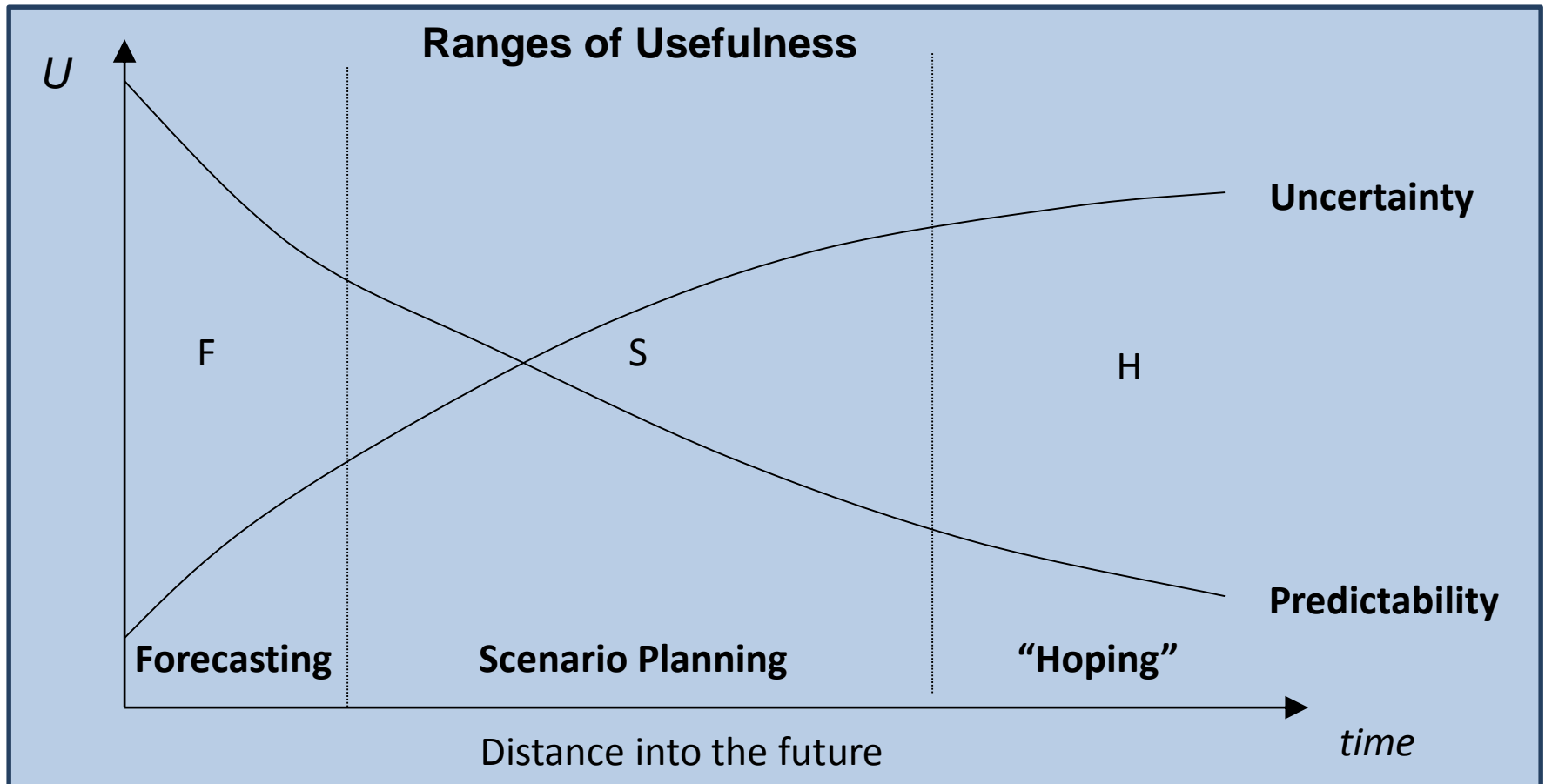
Methodology – Top enterprise level risks are dimensioned using a proprietary 10 factor probability risk scoring formula. Risk velocity is incorporated and weighted in the calculation of inherent and residual risk to represent how quickly the onset of each risk measured translates to impact.

Risk Scenario Planning

“The present moment used to be the unimaginable future.”

Possible - “might” happen (future knowledge) **Probable** - “likely to” happen (current trends)

Plausible - “could” happen (current knowledge) **Preferable** - “want to” happen (value judgements)



Key Risks Detail

1. Credit/ACH

Risk Description

Risk of financial loss due to client defaults, dependencies on banking partner lines of credit, NACHA rules/regulations, unsecured credit and reliance on ACH as vehicle for collection and recovery

Primary Organization Owner(s) - Risk Management

Risk Type - (K) Known

Primary Indicators

Bad debt write-offs, National Economic Indicators, ACH return activity, regional/industry factors, credit agency reporting CEI/DSO indicators

Mitigation Strategies

- Branch and client transaction thresholds
- Credit bureau monitoring; consumer and commercial credit review
- Credit policies, including secured funding and security deposits
- Monitoring for credit deterioration, industry/economic data and bankruptcy
- Allowance for doubtful accounts (reserve)
- Fraud industry coalition

Trending - Small businesses continue to hold course even though threat of a double-dip recession is starting to look more plausible. Access to credit continues to be elusive for many struggling businesses as evident by the SBA adding “extra support” to lenders to boost loan approvals; however, SBA-backed loans make up only a small portion of over all business loans market. Balance sheets have improved as businesses continue to deleverage due to caution about the future economic outlook and legislative landscape.

Results - While soft credit risk exposure has nearly doubled over the past several years to over \$266 billion dollars, credit losses are down 82% from approximately \$11 million to just \$2.0 million last year.

2. Regulatory Compliance

Risk Description

Maintaining compliance for all products and services with applicable federal, state and local statutes, laws and regulations; ensuring timeliness and accuracy of regulatory change on Paychex platforms

Primary Organization Owner(s) – Risk Management

Risk Type - U1 (Unknown)

Primary Indicators

Regulatory activity, laws enacted, warranties/penalties, lawsuits, enforcement activity, regulatory inquiries

Mitigation Strategies

- Monitoring enforcement trends, relevant publications and industry news
- Strong regulatory agency relationships
- Active participation in Payroll Consortium
- Ongoing review and audit of compliance
- Increased training for applicable personnel
- Change management control process

Trending - Increasing pre-election pressures on the administration and Congress around lingering economic weakness and the debt ceiling may result in ad-hoc measures requiring compressed implementation timeframes. Debt ceiling legislation does not include a payroll tax reduction, but a push for an extension of the current employee payroll tax reduction through 2012. The Obama jobs proposal contains aspects which, if enacted, could present operational and systemic challenges, with a reduced implementation period.

Results - Despite the extraordinary environment of accelerated legislative changes under the Obama administration heightened by the recent recession, Paychex has been able to execute required changes with minimal to no adverse impact.

ERM Dashboards

Providing the Board and senior management with greater risk transparency

Compliance with risk policies and regulations

- Exposures vs. policy limits
- Regulatory compliance

Earnings-at-risk

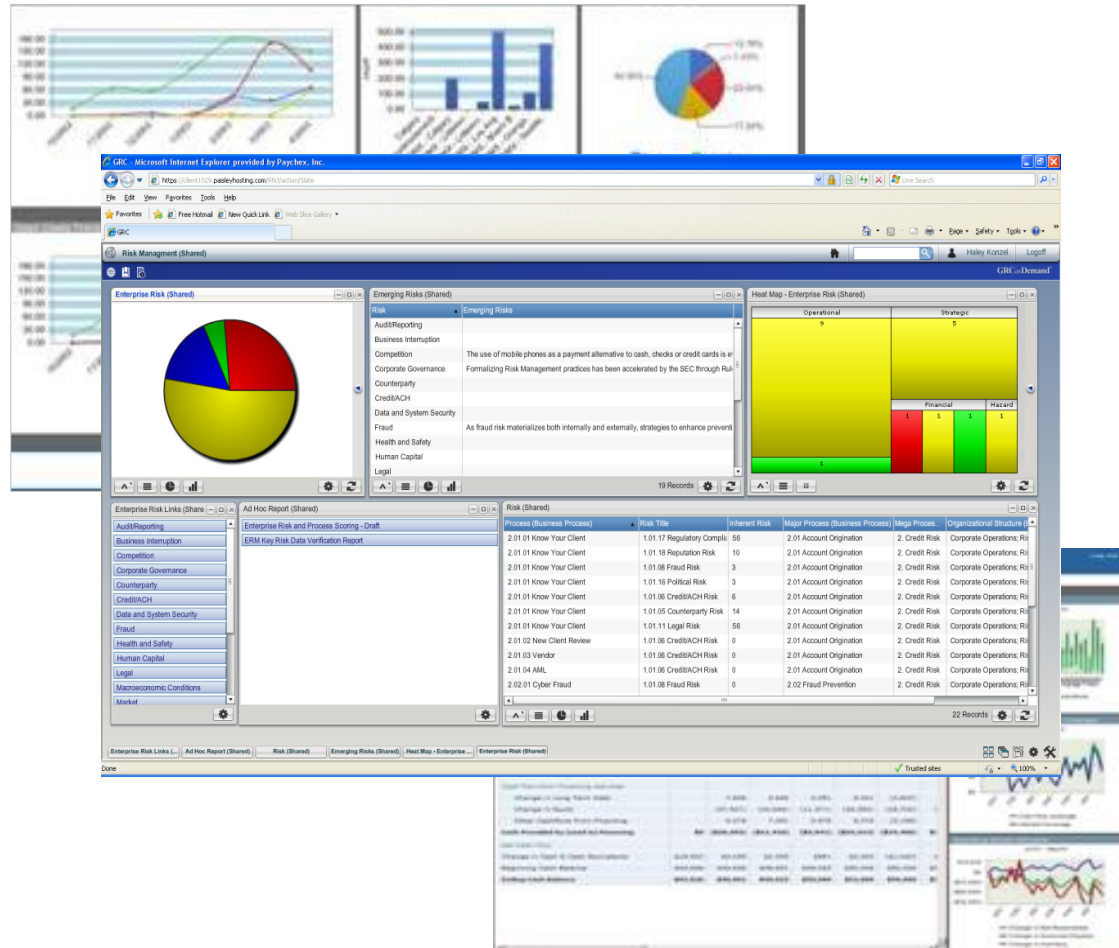
- Major internal drivers
- Key external variables

Risk/return performance tracking

- Business units
- Customer segments
- Products

Real time risk reporting

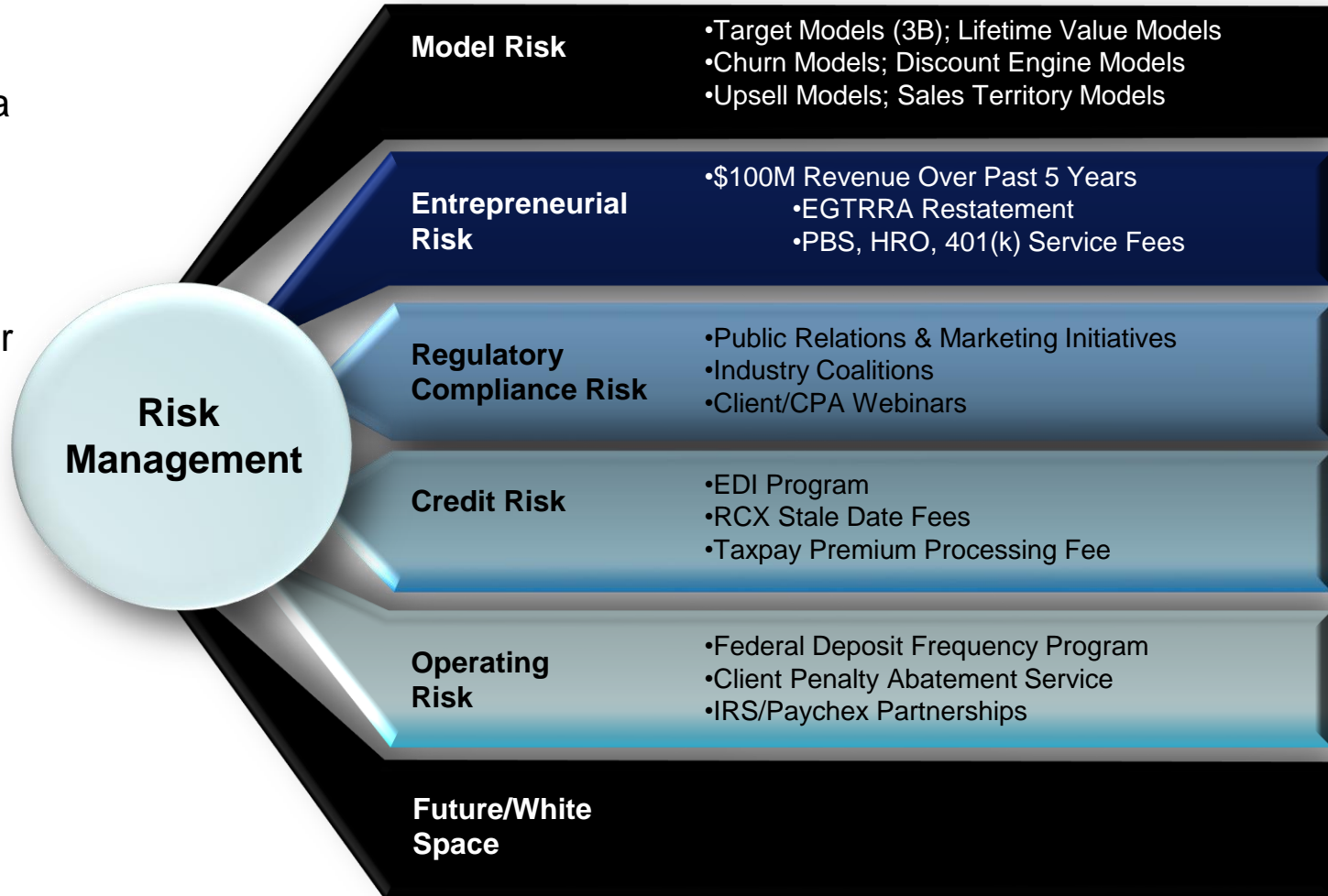
- One touch visibility
- Drill down capabilities
- 24x7 escalation
- Early warning signals



Value Preservation to Value Creation

The discipline of risk management has evolved from strictly a value preservation-based focus to a balanced focus between protecting assets and creating or enhancing value.

A flexible and dynamic risk management discipline is uniquely positioned to quickly adapt to change and identify opportunistic risk to create new streams of revenue and increase value



Questions

Thank you!

Frank Fiorille

ffiorille@paychex.com

585-336-7310

1175 John St.
West Henrietta, NY 14586