

# Application for Independent Compliance Auditor

To Assess Herbalife's Compliance with Court Order

August 29, 2016

## Contact:

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# What the Court Order Requires

- The Order¹ provides for an ICA to assess and report on implementation of reforms in the following general areas of Herbalife's U.S. business:
  - Tracking of retail sales
  - o Distinguishing between business opportunity participants and discount buyers
  - o Observing limitations on compensation based on personal product consumption
  - o Calculation and payment of multi-level compensation
  - o Specified training requirements

<sup>&</sup>lt;sup>1</sup> STIPULATED ORDER FOR PERMANENT INJUNCTION AND MONETARY DAMAGES, Case 2:16-cv-05217-BRO-GJS (United States District Court for the Central District of California)



# **Executive Summary**

In order to ensure Herbalife's compliance with the key provisions of the Order, we recommend that the Independent Compliance Auditor ("ICA") function as independent auditor with an audit committee framework.

The project must also support outcomes that advance the legal standards and best interests of the people of the United States while providing guidance for the direct selling industry.

To carry out the project, the following system will provide the necessary oversight and reporting:



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## Personnel

## Meet the Firms

The members of the proposed ICA team are founders, owners and partners of respected professional organizations. The support staffs also reflect the values and characteristics of their respective firms.

ServiceQuest® servicequest.com

- Founded in 1993 to provide consulting, executive coaching and training systems for direct selling companies
- Served more than 600 companies: from start-ups to global giants strategy, advisory, coaching, operations
- Recipient of the 2009 DSA Partnership Award for career work in customer service and policy administration

Dan Jensen Consulting danjensen-consulting.com

- 34-year career as software engineer, compensation plan analyst and executive trainer
- Served more than 800 companies in compensation plan design, modeling and best practices
- Recipient of the 1997 & 2007 DSA Partnership Award for industry contributions in compensation plans

Squire & Company, PC squire.com

- A full-service CPA firm with a 40-year history and a specialized department dedicated to direct selling
- Depth and experience in advisory, audit and assurance backed by breadth in staff and resources
- Unique technology group to support the compliance audit demands for data mining and analysis



## Meet the Team

The ICA team brings seasoned and prominent professionals from their respective areas of expertise in direct selling.

Through years of working together and collaboration, the team members have forged efficient working methods, effective communications practices, and a foundation of trust. The benefit to Herbalife and FTC is a group that is immediately ready to start.

Led by team leader Terrel Transtrum, the ICA team offers years of experience and wisdom to help FTC and Herbalife accomplish expected outcomes by fulfilling the disciplines of independent compliance auditing. Terrel Transtrum and Dan Jensen are recipients of the prestigious DSA Partnership Award, recognizing their extensive work and contributions to the direct selling profession.

Meet the team starting on the next page, and read more about their detailed qualifications and prior experience in the section that follows, titled, "Qualifications & Bios."





Terrel Transtrum, ESQ ICA Team Leader

As the founder and CEO of ServiceQuest, Terrel Transtrum leads a team of highly experienced direct selling experts to provide boardroom and C-level strategy, executive coaching and mentoring, and service operations support to guide all areas of a direct-selling enterprise.

Terrel's vision and enthusiasm for the profound impact of the Herbalife & FTC settlement on direct selling, combined with his vast experience in policy administration, teams, and training will bring the needed leadership to the compliance project.



Shane Edwards, CPA
ICA Senior Auditor

Shane's career as an auditor has expanded into organizational and process design with many direct selling organizations, creating a unique skill set for designing the methodology to support the compliance auditing responsibilities.

His primary duties as a member of the ICA team will be to lead all aspects of the audit planning, process and control identification, sampling, performance, analysis and reporting processes.



**Dan Jensen**ICA Compensation Specialist

Dan is known in international circles as the foremost "go to" guy for companies seeking best-of-breed expertise in compensation design, modeling and analysis. He possesses the necessary experience and insights to advise the team.

Anticipating new territory and challenges in interpreting, assessing and reporting multilevel compensation, retail sales, rewardable transactions, purchaser identities and thresholds for multi-level compensation, Dan will serve as a compensation specialist and resource.



Britt Raybould ICA Project Director

Britt is a strategist, writer and editor.

After seven years in corporate marketing she launched her own firm in 2007 and now oversees operations as COO with the Best Practices Alliance, a membership organization co-founded by ServiceQuest.

She will guide the planning, execution and reporting elements of this project. In addition to coordinating meetings and communications between the ICA team and external parties (Herbalife and FTC) she will facilitate communications among members of the ICA team.





Ray Chipman, CPA, CIA ICA Supervising Auditor

Ray's career has focused on the financial statements and commission auditing of many directing selling organizations.

His primary duties as a member of the ICA team will be to manage the audit team, including their work to identify the relevant processes, and related key controls, required to fulfill the audit function. Ray will also oversee the team that performs the sampling, testing, analysis and reporting.



Noah Myers Data Analyst

Noah began his career working for a Big Four firm in IT General Control Audits and Service Organization Control (SOC) reporting.

His primary role as a member of the ICA team will be to obtain, organize and analyze large data sets to aid in the planning, performance and reporting of the audit procedures.



**David Archibald , CPA**ICA Technology Specialist

Dave's career has encompassed auditing and advising direct selling clients on technology. Dave was also the controller for a large direct selling organization.

His primary duties as a member of the ICA team will be to oversee all aspects of the IT auditing process, including IT risk assessment, process analysis, controls identification and compliance testing.



**Stephen Olsen, CPA**Senior Auditor

Stephen has focused his career on leading the teams that perform the actual financial statement and commission audit work and related reporting for direct selling organizations.

Stephen's primary role as a member of the ICA team will be to lead the team of audit professionals that perform the work and related reporting.



## **Qualifications & Bios**



#### Terrel F Transtrum, ESQ

As a respected advisor to MLM and Party Plan companies, Terrel has impacted the lives of customer service reps, executives, and hundreds of thousands of distributors in more than 600 companies through training, mentoring, designing, and implementing best practices for MLM and Home Party companies.

As the founder and CEO of ServiceQuest, he has led a team of highly experienced direct

selling experts to provide boardroom & C-level strategy, coaching and mentoring to assure strength in all areas of a direct-selling enterprise. From start-up and diversification efforts to major corporate transformation, the group is known for their willingness to work in the trenches in order to understand and execute.

Terrel's career in MLM began with Melaleuca (the scientific name for tea tree oil is *melaleuca alternifolia*), where he served for 5 years and was in charge of customer service operations during the company's growth cycle from \$6 million in annual sales to over \$220 million. He then served as VP of Operations for Quorum International during the time the company grew from \$4 million monthly to \$22 million per month.

Since then he has coached owners, CEOs and presidents, front-line staff and janitors, with an intense focus on implementing growth strategies, policy administration, training systems, distributor service and retention strategies, and executive development through training, coaching and mentoring.

#### **Education & Certifications**

- B.S. Accounting (BYU 1983)
- J.D. (University of Idaho 1986)
- LL.M. Taxation (University of Miami 1987)
- Idaho State Bar Association, License #3637
- Registered to practice before IRS, Licensed in US Tax Court
- Expert witness (Ostrom vs World Ventures, LA NO. 12-213-JJB-RLB)

## Notable Publications & Keynote Presentations

- The Bankruptcy Tax Act of 1980 (21 Idaho Law Review [vii] 1985)
- DSHEA A Practical Guide for Policy Administration (2011)
- Entrepreneurs in 30 Days (DSA 2012 Annual Meeting)
- Policy Compliance Certification Course (2009-2016)
- LaunchSmart! Comprehensive Startup Guide (2014)

## **Current Activities & References**

- CEO ServiceQuest supporting staff with multiple clients
- Direct Selling Association (DSA), 15-year member
- LuLaRoe (women's apparel) Chief Advisor; Mark Stidham CEO
- Best Practices Alliance, Co-founder and Chairman
- World Ventures, Expert Witness; Chris Ralston Lead Litigator
- See Expert Witness Opinion in APPENDIX
- Also see "Prior Experience and References" section below





## Shane Edwards, CPA

Providing Auditing, CFO and Controller Services for Private and Publicly Traded Companies, Shane also specializes in NetSuite Implementation Project Management, Buy/Sell Transaction Support, Business Strategy Design and Implementation, Executive and Manager Mentoring, and Organizational and Process Redesign.

## Profile

- Helps organization understand and fulfill the responsibilities of the CFO office (both privately owned and publicly traded companies)
- Manages the implementation of NetSuite to insure achievement of key stakeholder objectives
- Assists management in the recognition and elimination of the barriers to excellence that exist in organizations, and provides a strategic framework to move organizations to the next level
- Implements Organization, Process and Infrastructure redesign, which aligns an organization's strategy to tangible mechanisms
- Advises management and owners in the Financing, Buying and Selling of a business
- Provides Executive and Manager Mentoring to founders, executives, and middle manages to expedite personal and professional development

## Profile (cont.)

- Organizes and executes audits for key clients
- Leads the Squire's Technology and Life Science Industry Service Group
- Elected to Squire's executive committee, which has responsibility to run the firm
- Previously served as the manufacturing and distribution practice area leader for the Utah offices of Grant Thornton. Shane also has direct industry experience as the former corporate chief accountant for Kennecott Corporation

#### **Education & Certifications**

- B.S., Brigham Young University
- MAcc, Brigham Young University
- Certified Public Accountant and Certified Internal Auditor

## **Affiliations**

- American Institute of Certified Public Accountants, member
- Institute of Internal Auditors, member
- Utah Association of Certified Public Accountants, member
- Advisory Committee member for Utah Valley University Accounting Education Department
- Member of BioUtah and Association for Corporate Growth





#### Daniel O. Jensen

Dan has built a 34-Year career as a direct selling professional, working with more than 800 direct-selling companies. Dan is known and respected globally for his expertise and discipline in compensation plan policies, analysis and design.

He has consulted with companies on compensation plans, incentive plans, recognition strategy, business plans, compensation policies, and technology, modeling and best practices.

#### Profile

- Direct selling executive trainer, field leader trainer, and public speaker
- Featured speaker at DSA conferences and other industry groups
- As a software engineer, founded Jenkon Software in 1978 retired in 1999
- Recipient of the DSA Partnership award in 1997 (Jenkon) and 2007 (Dan Jensen Consulting)—the only person to receive this prestigious award twice

## Compensation Analysis & Modeling

- Using historical data or test data, Dan's team conducts sophisticated modeling and reporting. Dan's group typically uses its own software and modeling engine for independent and "clean" modeling.
- Areas of modeling expertise include retail profit and payouts, bonuses on rewardable transactions, qualified recipients of bonuses, including trained recipients, threshold requirements and profiles (profitable retail sales, preferred customer sales, etc.) volume seller bonuses, MLM overrides and bonuses, bonuses tied to recruiting and/or required purchases such as start-up packages.
- Full audit trail to validate all calculations and results
- Extensive output reports in Excel format (and other formats where required)
- International cross border sponsoring supported
- Full version control to track compensation plan changes and refinements



## **Britt Raybould**

Britt is a strategist, writer and editor. After seven years in corporate marketing she launched her own firm in 2007 and now oversees operations as COO with the Best Practices Alliance, a membership organization co-founded by ServiceQuest.

She will guide the planning, execution and reporting elements of this project. In addition to coordinating meetings and communications between the ICA team and external parties (Herbalife and FTC) she will facilitate communications among members of the ICA team.

## Education

- B.A. English (Boise State University 2001)
  - Degree emphasis in Technical Communications
- Master of Professional Communication (MPC)
  - o Westminster College 2003

## Profile

I specialize in connecting with the audience.

As a uniquely experienced communications specialist who understands how transformative changes are made in any direction, I professionally review findings and statistics and auditors' notes and help to capitalize on the hard work done behind the scenes. The work product that creates tremendous value is not worth much if it isn't communicated well.

From overall readability and flow, consistency of style for credibility and language usage for message effectiveness in positioning the ICA Team's written works for presentation and publication, my work engages readers and reviewers with effectively communicated content.

My clients, often strategy experts and SMEs themselves, enjoy our relationship that centers on our shared purpose of moving their objectives forward.

Oh, and the answer is "no," I have not reviewed nor edited this specific proposal. This is Terrel's work, but I will work with him and the team to create the reporting protocols, standards and flow, while shifting attention to proofreading, connecting work product and research with conclusion. And I will create the visuals that will help you understand what we are saying.





## Ray Chipman, CPA, CIA

Providing Auditing, and Internal control services, Ray also specializes in Organizational and Process Redesign.

## Profile

- Experience working with organizations implementing Risk
   Management processes—especially when those processes relate to internal control over financial reporting
- Enjoys working with management, the audit committee and/or chief audit executive to ensure that the Internal Audit function is meeting the needs of the organization
- Facilitates Business Process Redesign to identify areas of improvement and related risks
- Manages audit teams to provide assurance on financial information
- Coordinates international audit and advisory work with our international association of accounting and legal firms

## **Education & Certifications**

- B.S., Brigham Young University
- MBA, Utah State University
- Certified Public Accountant and Certified Internal Auditor

## Affiliations

- American Institute of Certified Public Accountants, member
- Institute of Internal Auditors, member
- Utah Association of Certified Public Accountants, member
- Board member of the Utah Venture Entrepreneur Forum
- Member of the Direct-Selling Management Association of Utah, a not-for-profit that supports direct-selling organizations headquartered in Utah





# David Archibald, CPA Providing IT Consulting and Auditing

## **Education & Certifications**

- B.S., Brigham Young University
- Certified Public Accountant
- Certified in Microsoft Dynamics GP and SQL Server
- Certified in Scribe software

## Affiliations

- American Institute of Certified Public Accountants, member
- Utah Association of Certified Public Accountants, member

## Profile

- Helps organization understand fully utilize technology to implement business objectives.
- Supports audit process by providing risk assessment and IT audit procedures on financial statements and commission based audits.
- Implements Organization, Process and Infrastructure redesign, which aligns an organization's strategy to tangible IT infrastructure.
- Previously served as the controller for large direct selling organization.





## Noah Meyer

Providing IT and SOC Auditing, implements technology ERP solutions, utilizes technology to capture and analyze large quantities of data to provide business intelligence to management.

## Profile

- Helps organization understand how to extract and utilize the data encased in databases.
- Implements Microsoft Dynamics and NetSuite ERP technology solutions
- Previously worked at a Big Four firm and conducted public company IT General Control Audits and Service Organization Control (SOC) Reporting engagements

## **Education & Certifications**

- B.S., Brigham Young University
- MAcc, Brigham Young University

## Affiliations and Accomplishments

- Co-authored research paper in major academic accounting journal
- Pitched ideas that led to initiation of two new research projects
- Taught and helped rework course curriculum for SAS statistical programming classes
- Wrote program to automate the collection of academic publication citation counts





Stephen Olsen, CPA
Providing Auditing Services

## **Education & Certifications**

- B.S., Utah Valley University
- MAcc, University of Utah
- Certified Public Accountant

## Affiliations

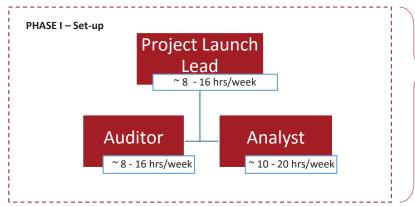
- American Institute of Certified Public Accountants, member
- Utah Association of Certified Public Accountants, member

## Profile

- Leads the development of the audit planning and oversees the execution of audit procedures and resulting reporting.
- Leads the planning, performance and reporting of financial statements and commission auditing of direct selling organizations

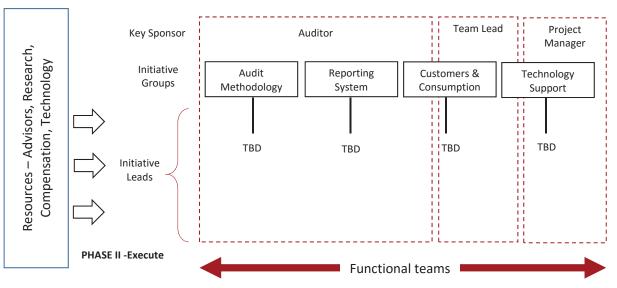


## The proposed organization structure will support the overall implementation of key initiatives



## Project Launch Team / PLT

- PLT will identify relevant processes and key controls to test
- They also assist the functional teams in technology support, compensation feature modeling, launch preparation, program launch
- Conduct initial process walk-throughs with primary focus on statistically valid samples for observations



Assign a sponsor to lead initiative group

- The sponsor is fully responsible for planning and execution
- Initiative leads will lead execution of all assigned initiatives on a day-to-day basis

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	Individual Availability & Time Dedicated to Project
Terrel Transtrum	<ul> <li>During Phase I Implementation (3 months): 12-16 Hours weekly (25%)</li> <li>Phase II / Ongoing (after 3 months): 10 Hours weekly (15%)</li> <li>Travel: twice monthly to Herbalife (3 months); once monthly to Herbalife (after 3 months)</li> </ul>
Shane Edwards	<ul> <li>During Implementation (3 months): 60 Hours weekly (100%)</li> <li>Post-launch &amp; Ongoing (after 3 months): 10 Hours weekly</li> <li>Travel: four times monthly to Herbalife (3 months); twice monthly to Herbalife (after 3 months)</li> </ul>
Dan Jensen	<ul> <li>During Implementation (3 months): 5 Hours weekly (12.5%)</li> <li>Post-launch &amp; Ongoing (after 3 months): 5 – 8 Hours weekly (12.5% to 20%) first year</li> <li>Travel: once quarterly to Herbalife</li> </ul>
Britt Raybould	<ul> <li>During Implementation (3 months): 4 Hours weekly (10%)</li> <li>Post-launch &amp; Ongoing (after 3 months): 4 Hours weekly (10%)</li> <li>Travel: once quarterly to Herbalife</li> </ul>
Support Staff	<ul> <li>During Implementation (3 months): 1,830 hours total (100%)</li> <li>Post-launch &amp; Ongoing (after 3 months): 1,270 hours total (40%)</li> <li>Travel: 40 trips to Herbalife (3 months); 20 trips to Herbalife (after 3 months)</li> </ul>



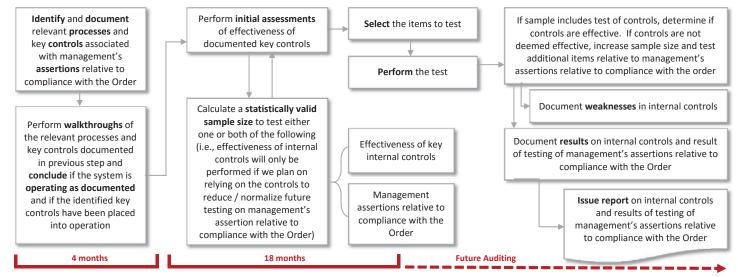
# **Methodology and Proposed Activities**

## The Basic Methodology

A dual-test **foundation** will guide the Scope of Work:

- 1. Identify relevant processes and determine the effectiveness of controls
- 2. Test compliance of the systems against the assertions of management

The audit methodology will consist of these elements, AICPA standards, flow and timeline:





## **Proposed Activities**

# Obtaining Information

- **From Management:** Obtain and review documentation relating to processes, internal control environment and key control procedures associated with management's assertions relevant to compliance with the Order.
- From Independent auditors: Review independent auditor's audit documentation that supports their opinion on Herbal Life's internal controls over financial reporting, focusing on processes and control procedures relevant to compliance with the Order. Also review the same auditor testing of the order entry, commission calculation and commission payment cycles.
- From In-house and Outside Technology Employees and Vendors: Obtain and review documentation relating to the technology used to process information as part of the business cycles associated with the Order.
- From Accounting and Commissions Departments: Detailed transactional data for all transactions associated with compliance with the Order
- From Governmental Agencies: Obtain and review documentation, as allowed by law, that lead to the creation of the list of management assertions outlined in the Order

# Analyzing Information

Assess risk of non-compliance with assertions, perform tests of controls, re-asses risk, obtain population of all relevant transactions, determine compliance testing sample size, select sample and perform testing for compliance with management assertions outlined in the Order.

# Reporting Information

Our quarterly (and for later years, semi-annual) reports will assess and communicate the results of our testing of management's assertions over internal controls and compliance, as follows:

- Management's assertions concerning the effectiveness of key control procedures relevant to compliance with the Order
- Management's assertions concerning compliance with the Order

Our reports will also communicate general observations and proposed areas for improvement.

## Frequency & Cycles

Our work will be regularly performed over the seven year period, with a significant ramp-up during the first six months. Our reports will be issued quarterly, beginning with the three months ended March 31, 2017, which will be issued no later than May 31, 2017. Beginning with the report for the three month period ended June 30, 2017, we will issue our reports no later than 45 days following the end of the quarter.



## **Project Funnel**

The Independent Compliance Audit

# From Court Order

**Identify Relevant Processes** 

Verified Compliance

# Technology Systems & Constraints

Successful execution of compliance monitoring will require a unique technology depth to support

# Clarify Standards

Test the Controls

Test

# The pathway to long-term compliance

Remedial measures for Herbalife and for Herbalife distributors when exceptions are discovered

# Exceptions 100% Adherence Rate

Target: Compliance

# How effective are the controls?

Are the processes and controls properly documented?

# Are the samples statistically valid?

## Dual Test:

- 1. Effectiveness of controls
- 2. Compliance with assertions of Herbalife management

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# Unknowns (to be discovered / defined during project launch)

Area	Key Questions	What needs to be done?
Retail Sales	<ul> <li>How is retail sales information being collected and does it meet the agreed standards?</li> <li>How is Herbalife calculating profitable retail sales and does it meet agreed standards?</li> <li>Is Herbalife monitoring and verifying profitable retail sales?</li> <li>Is Herbalife adhering to requirement that claimed profitable retail sales do not exceed participant's total product purchases less personal consumption?</li> </ul>	<ul> <li>Obtain clarity from FTC and Herbalife on standards and definitions</li> <li>Determine applicable standards and review processes and controls for adherence</li> <li>Determine specifically what we will report (including statistical validity) in order to demonstrate findings of or questions about compliance</li> </ul>
Preferred Customers	<ul> <li>Is Herbalife correctly differentiating between preferred customers and business opportunity participants?</li> <li>How are transitioning preferred customers classified and what occurs to change discounts / benefits accruing to business opportunity participants?</li> <li>Is Herbalife accurately calculating preferred customer sales in a participant's downline?</li> </ul>	<ul> <li>Evaluate reclassifications, and the method by which these are accomplished and documented and test whether preferred customers only consume (not re-sell, recruit, or receive commissions)</li> <li>Determine early on what method exists (for example, point-of-sale) for distributors to process a customer sale</li> <li>Determine technique and adequacy of Herbalife monitoring sales to preferred customers to ensure validity</li> </ul>
Personal Consumption	<ul> <li>Is Herbalife accurately calculating rewardable personal consumption in a downline per requirement?</li> <li>Determine whether / how Herbalife ensures that product purchases (rewardable personal consumption) are in fact purchased for the participant's own or household use.</li> </ul>	<ul> <li>Evaluate the methodology and process followed by Herbalife, including exception reports and controls</li> <li>Set up the review / interview methodology and statistical standards for verifying with participants, and a means by which to validate responses</li> </ul>



Area	Key Questions	What needs to be done?
Multi-level Compensation	<ul> <li>Establish the order and routine by which the sequence of multi-level compensation is determined, including qualified transactions, relevant sales volumes, and the matrix of participants involved</li> <li>Obtain clarity on whether non-required start-up packages are used or anticipated, while verifying that no "headhunter fee" or recruiter compensation is paid.</li> </ul>	<ul> <li>Work through the multi-level compensation scenarios set forth in the Order and derive a matrix for analysis and ultimate testing</li> <li>Implement distributor compliance training and certification and the internal system for managing compliance along with policy administration</li> </ul>
Annual Multi- level Compensation	<ul> <li>Determine whether Herbalife is accurately calculating net rewardable sales and total net sales, limiting the sum of multi-level compensation payments if so required</li> <li>How is Herbalife enforcing the prohibition against participants leasing or purchasing a physical location unless they have met all relevant requirements?</li> </ul>	<ul> <li>Find the programming and triggers that govern / limit compensation payments, starting with an evaluation of the distributor commission reports</li> <li>Evaluate the physical location requirements and corresponding processes for training and clearing a participant for such program</li> </ul>



# Detailed Activity Plan

					Task Duration		
Task ID#	Task Name	Lead	Task Status	Next Stage	(Days)	Start Date	Complete Date
A1	Indentify and document processes and controls		In Progress	Choose One	180	10/1/16	3/30/1
	Set up process documentation teams	Herbalife	In Progress	Choose One			
	Kickoff meeting with process teams	Herbalife and ICA	In Progress	Choose One			
	Documenting of processes and controls	Herbalife and ICA	In Progress	Choose One			
	Write management's assertion for controls	Herbalife	In Progress	Choose One			
	Write management's assertion for compliance	Herbalife	In Progress	Choose One			
	Complete process documentation	Herbalife	In Progress	Choose One			
	Complete control documentation	Herbalife	In Progress	Choose One			
	Analysis of effectivenss of design of controls	Herbalife	In Progress	Choose One			
42	Walkthroughs		In Progress	Choose One	30	1/1/17	1/31/
	Retail sales	Herbalife and ICA	In Progress	Choose One			
	Preferred customers	Herbalife and ICA	In Progress	Choose One			
	Personal consumption by Business Opportunity Participants	Herbalife and ICA	In Progress	Choose One			
	Paying Multi-Level Commission	Herbalife and ICA	In Progress	Choose One			
	Annual U.S. Multi-Level Compensation	Herbalife and ICA	In Progress	Choose One			
	Lmitations on Leased or Purchased Business Locations	Herbalife and ICA	In Progress	Choose One			
A3	Initial assessment of design effectiveness		In Progress	Choose One	30	10/31/16	11/30/1
	Assess key controls	ICA	In Progress	Choose One			
	Document any weaknesses in design	ICA	In Progress	Choose One			
	Update key controls as needed for appropriate coverage	Herbalife	In Progress	Choose One			
	Update key control document	Herbalife and ICA	In Progress	Choose One			
	Statistical analysis	ICA	In Progress	Choose One	60	12/1/16	1/30/1
	Selection of items to test	ICA	In Progress	Choose One	58	2/1/17	3/31/1
	Perform tests of controls and compliance		In Progress	Choose One	60	2/1/17	4/2/1
	Document results of items tested	ICA	In Progress	Choose One			
	Report on failed items	ICA	In Progress	Choose One			
	Remediate for failed items	Herbalife	In Progress	Choose One			
	Re-performance of test for items that failed	ICA	In Progress	Choose One			
	Determine effectiveness of controls and compliance		In Progress	Choose One	30	3/31/17	4/30/1
	Conclude on comliance with the Order	ICA	In Progress	Choose One			
	Conclude on effectiveness of controls	ICA	In Progress	Choose One			
	Issue initial report on controls and compliance	ICA	In Progress	Choose One	60	4/1/17	5/31/1
	Management and support functions	TFT / DJ / BR					



## **Estimated Hours**

NOTE: The ICA Team recommends that the project include significant review and audit of internal controls in the first 3-month phase, including policy work, setting the stage for streamlined testing and compliance review in the periods that follow. Otherwise, the proposal can be adjusted down to reflect only compliance auditing. We have assumed this important first step in our estimated hours and budget.

## Phase I (3 months)

					Task Duration												Professional	Support	
	Task Name	Lead	Task Status	Next Stage			Complete Date		Britt	Dan	-	Shane	Ray	David	Noah	Stephen	Staff	Staff	Total
A1	Indentify and document processes and controls		In Progress	Choose One	180	10/1/16	3/30/17	156		65	40	320	150	40	80	80	80	20	103
	Set up process documentation teams	Herbalife	In Progress	Choose One															
	Kickoff meeting with process teams	Herbalife and ICA	In Progress	Choose One															
	Documenting of processes and controls	Herbalife and ICA	In Progress	Choose One															
	Write management's assertion for controls	Herbalife	In Progress	Choose One															
	Write management's assertion for compliance	Herbalife	In Progress	Choose One															
-	Complete process documentation	Herbalife	In Progress	Choose One															
ŝ.	Complete control documentation	Herbalife	In Progress	Choose One															
	Analysis of effectivenss of design of controls	Herbalife	In Progress	Choose One															
A2	Walkthroughs		In Progress	Choose One	30	1/1/17	1/31/17					160	80	40	80	80	80	20	54
	Retail sales	Herbalife and ICA	In Progress	Choose One															
	Preferred customers	Herbalife and ICA	In Progress	Choose One	1					_									
	Personal consumption by Business Opportunity Participants	Herbalife and ICA	In Progress	Choose One	1														
8	Paying Multi-Level Commission	Herbalife and ICA	In Progress	Choose One	1														
	Annual U.S. Multi-Level Compensation	Herbalife and ICA	In Progress	Choose One	1														
	Lmitations on Leased or Purchased Business Locations	Herbalife and ICA	In Progress	Choose One	1														
A3	Initial assessment of design effectiveness		In Progress	Choose One	30	10/31/16	11/30/16					80	80	10	25	25	25	20	265
9	Assess key controls	ICA	In Progress	Choose One		66 11													
	Document any weaknesses in design	ICA	In Progress	Choose One	1														
	Update key controls as needed for appropriate coverage	Herbalife	In Progress	Choose One	1														
	Update key control document	Herbalife and ICA	In Progress	Choose One	1														
	Statistical analysis	ICA	In Progress	Choose One	60	12/1/16	1/30/17					30	5	5	0		0	20	- 61
in the	Selection of items to test	ICA	In Progress	Choose One	58	2/1/17	3/31/17					10	25	20	40	40	40	20	19
-	Perform tests of controls and compliance		In Progress	Choose One	60	2/1/17	4/2/17					20	20	10	80	80	80	20	310
	Document results of items tested	ICA	In Progress	Choose One															
	Report on failed items	ICA	In Progress	Choose One	1														
	Remediate for failed items	Herbalife	In Progress	Choose One	1														
	Re-performance of test for items that failed	ICA	In Progress	Choose One	1														
8	Determine effectiveness of controls and compliance		In Progress	Choose One	30	3/31/17	4/30/17					30	30	5	10	10	10	20	111
	Conclude on comiliance with the Order	ICA	In Progress	Choose One		- Contraction of the Contraction													
1	Conclude on effectiveness of controls	ICA	In Progress	Choose One															
	Issue initial report on controls and compliance	ICA	In Progress	Choose One	60	4/1/17	5/31/17					100	100	5	20	20	20	60	32
	Management and support functions	TFT / DJ / BR				- 1-1-1-1	-	156		65	40								26



## Phase II and ongoing (after 3 months)

Task ID#	Task Name	Lead	Task Status	Next Stage	Shane	Ray	David	Noah	Stephen	Professional Staff	Support Staff	Total
A1	Indentify and document processes and controls		In Progress	Choose One	30	40	20	30	30	50	5	205
	Set up process documentation teams	Herbalife	In Progress	Choose One								
	Kickoff meeting with process teams	Herbalife and ICA	In Progress	Choose One								
	Documenting of processes and controls	Herbalife and ICA	In Progress	Choose One								
	Write management's assertion for controls	Herbalife	In Progress	Choose One								
	Write management's assertion for compliance	Herbalife	In Progress	Choose One								
	Complete process documentation	Herbalife	In Progress	Choose One								
	Complete control documentation	Herbalife	In Progress	Choose One								
	Analysis of effectivenss of design of controls	Herbalife	In Progress	Choose One								
A2	Walkthroughs		In Progress	Choose One	30	30	30	60	60	80	5	295
	Retail sales	Herbalife and ICA	In Progress	Choose One								
	Preferred customers	Herbalife and ICA	In Progress	Choose One								
	Personal consumption by Business Opportunity Participants	Herbalife and ICA	In Progress	Choose One								
	Paying Multi-Level Commission	Herbalife and ICA	In Progress	Choose One								
	Annual U.S. Multi-Level Compensation	Herbalife and ICA	In Progress	Choose One								
	Lmitations on Leased or Purchased Business Locations	Herbalife and ICA	In Progress	Choose One								
A3	Assessment of design effectiveness		In Progress	Choose One	10	40	10	25	25	25	20	155
	Assess key controls	ICA	In Progress	Choose One								
	Document any weaknesses in design	ICA	In Progress	Choose One								
	Update key controls as needed for appropriate coverage	Herbalife	In Progress	Choose One								
	Update key control document	Herbalife and ICA	In Progress	Choose One								
	Statistical analysis	ICA	In Progress	Choose One	10	5	5	0	0	0	20	40
	Selection of items to test	ICA	In Progress	Choose One	5	25	20	40	40	40	20	190
	Perform tests of controls and compliance		In Progress	Choose One	5	20	10	80	80	80	20	295
	Document results of items tested	ICA	In Progress	Choose One								
	Report on failed items	ICA	In Progress	Choose One								
	Remediate for failed items	Herbalife	In Progress	Choose One								
	Re-performance of test for items that failed	ICA	In Progress	Choose One								
	Determine effectiveness of controls and compliance		In Progress	Choose One	5	20	5	10	10	10	20	80
	Conclude on comliance with the Order	ICA	In Progress	Choose One								
	Conclude on effectiveness of controls	ICA	In Progress	Choose One								
	Issue initial report on controls and compliance	ICA	In Progress	Choose One	30	30	5	10	20	20	20	135
	Management and support	TFT / DJ / BR			130 / 35 / 15							



## **Resource Requirements**

- Given the magnitude of the project and its potential impact on future implementation and auditing requirements that may follow, the ICA Team will leverage a combination of internal and external resources for successful and timely execution.
- Total cost impact of repurposing Herbalife resources in the first 18 months will need to be gauged in relationship to the expected results of the project. This proposal does not take into account the resources that Herbalife will provide (if any) in order for the ICA Team to perform such activities as the following:
  - o Identify relevant processes, including access to Herbalife's enterprise software
  - o Identify key controls in the relevant processes through interviews and testing
  - o Addressing expected constraints in the technology system in order to find the necessary data / information
  - o Programming inquiries and/or data gathering tools and techniques for new practices and definitions to be installed by Herbalife
  - Assistance and access for testing
- To ensure timely execution of identified initiatives, the ICA Team will need to be in close contact with Herbalife / FTC officials to obtain timely guidance and approvals on certain policy and/or working definitions that will affect monitoring and audit conclusions. Thus, the available resources from Herbalife and/or FTC are not contemplated in this proposal, but will be required. To illustrate, examples of the types of guidance and policy approval that will be required from Herbalife and FTC resources might include the following:
  - o How retail sales are currently measured (if measured) and/or whether new measurement techniques / tools will need to be created and implemented
  - What precisely will define purchaser identity, how will identity transitions be identified (i.e., from retail consumer to preferred customer, or from preferred customer to distributor), or which aspects, specifically, of multi-level compensation are prohibited based on identity of the purchaser? Will there be an acceptable window / period for defining change in status and treatment (for example, one commission cycle)?
  - o Will a start-up package bonus be permitted if the start-up package is not a required package? More specifically, if Herbalife offers optional product packages, will the sellers / distributors who sell the packages to a qualified purchaser (non-distributor) be permitted to receive corresponding bonuses? If Herbalife enhances its programs as knowledge and understanding evolve, what will be the procedure (and who will be authorized) for obtaining approvals for refinements? What role will the ICA Team fulfill in defining and subsequently auditing adherence?
  - Who will approve training content to ensure that it meets the requirements that Herbalife and FTC have agreed upon vis-à-vis the stipulation?



## **Resource Requirements**

## ICA Team Resources

Function	Resources <sup>2</sup>	Resources <sup>2</sup> Initiatives			Required Start Date
Executive	ICA Team Leader	General Management of ICA Project	Start of Project <sup>3</sup>	1	TBD
	Audit Executive	Management and Execution of the Auditing System and Activities	Start of Project	1	TBD
Audit	<ul> <li>Process documentation</li> <li>Walk-throughs</li> <li>Assessments and tests</li> <li>Field testing leased locations</li> <li>Field testing profitable retail sales, etc.</li> </ul>		Within 90 days of launch <sup>4</sup>	1 - 3	TBD
	Analyst / Data Manager	Rep acquisition by region	Determined by desired pace	1	TBD
Technology &	Compensation Plan Resource	<ul> <li>Advise on definitions and modeling refinements</li> <li>Assist in data review and problem search</li> </ul>	Within 60 days of launch	1	TBD
Specialized Support	Statistics Expert	Guide the determination of statistically valid samples; participate in data analysis	Within 60 days of launch	1	TBD
	Technology Expert	Assist in bridging anticipated technology constraints and support data mining	Within 30 days of launch	1	TBD
Reporting Project & Report Coordinate project and reporting		Start of Project	1	TBD	

 $<sup>^{\</sup>rm 2}$  These will be filled by the ICA Team.

<sup>&</sup>lt;sup>3</sup> The model allows for executive leadership from Terrel Transtrum and ServiceQuest starting at launch and extending until the ICA system is stable, with the long-range plan to continue; Transtrum is currently age 58 and conceivably will oversee the project from start to finish in 7 years. <sup>4</sup> The primary source for audit support will be from Squire & Co. CPAs.



# Resource Requirements

## External Resources

Function	Resources	Initiatives	Comment
Distributor Training & Support	Training System and Content Design Services	Develop and deliver required training programs and certification / tracking	
	IT Consulting Services	Technology systems implementation, integration, and support of new requirements	
Technology  MLM Compensation Software Revisions		To reflect refinements in definitions and compensation (non-rewardable transactions, "look-back" for new participants, retail customer purchases / Point-of-sale, compliance training completion & certification, etc.)	
Legal	Distributor agreeme		
Language Translators / Interpreters		The vast reach of Herbalife causes us to believe that we will need to use language skills to reach distributors who do not speak English	

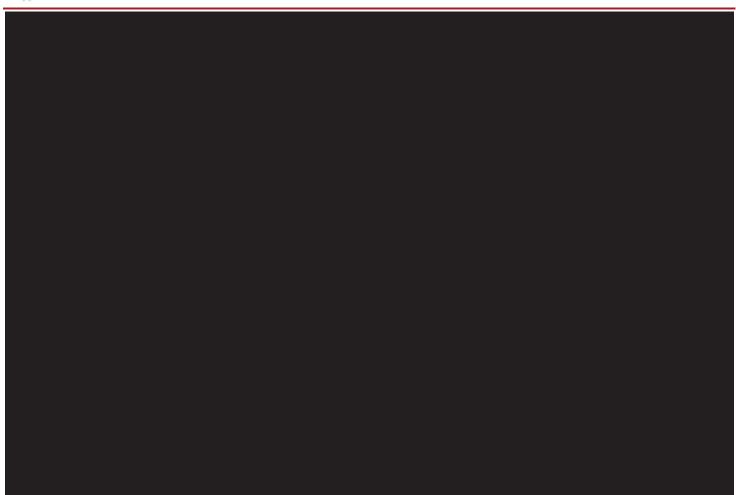
NOTE: "External resources" anticipates that the project will require access to, and assistance from, resources from Herbalife and FTC. Cost of external resources will be driven by the scope of involvement of external entities. These estimates are identified here but are not included in the budget. This will be a point of discussion and decision.



# Estimated Costs & Project Budget









## Potential Conflicts of Interest or Bias

The nature of the work performed by members of our proposed ICA Team places us very close to the owners and executives of many direct selling companies. This is also what will make us ideal candidates for this important function, we have developed our street smarts over many years, and we have maintained the confidence and loyalty of our clients by collectively holding ourselves to the highest standards of professional conduct.

By virtue of being regulated by governing bodies such as the state bar association and accountancy boards, we adhere to the commitments and expectations of these regulators. Additionally, a closer look at the decades of clients and relationships will reveal our collective clean reputations for confidentiality and good judgment, and for prudence and discernment.

Potential Conflicts of Interest or Bias – Collective

Collectively, there exists a potential for bias in favor of direct selling companies since these have been the primary sources of our professions and livelihoods. However, it is also our collective opinion that the clarity brought to the Herbalife matter will serve many other direct selling companies in the future, and we embrace and respect the process and outcome by which this important milestone has been achieved. To keep ourselves in check, we will rely heavily on our mutual accountability to each other as professionals, and strict adherence to methodology, testing processes and reporting. We understand the stakes, not only for Herbalife, but also for direct selling companies who will monitor and learn from the important new phase of the Herbalife / FTC stipulated settlement. Because it is a role we will be engaged to perform, we will do so with utmost diligence and objectivity.

Potential Conflicts of Interest or Bias - Individual



#### Terrel Transtrum

- ServiceQuest performed a specific research and advisory project for Herbalife approximately 15 years ago. The scope of work was to interview Herbalife distributors when they received their starter kits, in order to determine which items in the starter kits were being set aside. The goal of the project was to determine which items in the starter kit were outdated, and which should remain after listening carefully to distributors. The project and final report with recommendations occurred over the period of approximately 120 days, and it included English-speaking and Spanish-speaking interviews. It was successfully concluded, with Herbalife implementing our key recommendations based on findings and unique discoveries we made during the project. We have not performed any services for Herbalife since that time and do not believe that this prior relationship with Herbalife will impede our ability to perform at the highest, most objective and independent level.
- Because of the level of interest in this matter from around the circles in direct selling, combined with our visibility to
  many in direct selling, we will need to create an appropriate wall of confidentiality around our work. With guidance
  from Herbalife and FTC, we wish to identify the parameters within which we may guide our clients and speak to the
  practices that will help companies who desire to understand how they may perform more in line with emerging
  interpretations and implications of the regulations. We do not perceive a problem but will carefully adhere to the
  requests of Herbalife and FTC.

Shane Edwards, Ray Chipman, David Archibald, Noah Myer, Stephen Olsen

• No Conflicts or bias beyond what is described above regarding collective bias.

## Dan Jensen & Britt Raybould

No Conflicts or bias beyond what is described above regarding collective bias.

# **APPENDIX**

- Report Template for Illustration of Expected Work Product
- Prior Project Experience and References



# Independent Compliance Auditor's Assessment and Report on Herbalife's compliance with and implementation of a Judicially-enforceable Stipulated Order

and

Report on Related Controls Placed in Operation and Tests of Operating Effectiveness

For the Period from January 1, 2017 to March 31, 2017



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# **SECTION I**

# **INDEPENDENT COMPLIANCE AUDITOR'S REPORT**

## **HERBALIFE**



#### INDEPENDENT COMPLIANCE AUDITOR'S REPORT

To the Management of Herbalife and the FTC

Scope

We have assessed the accompanying Management description of controls related to Herbalife's (HERBALIFE or the Company) compliance with and implementation of the judicially-enforceable Stipulated Order for Permanent Injunction and Monetary Judgment (the Order) throughout the period January 1, 2017 to March 31, 2017 (the "description") and the suitability of the design and operating effectiveness of controls to achieve the related control objectives stated in the description; including Management's compliance with the Order throughout the period January 1, 2017 to March 31, 2017

## HERBALIFE's Responsibilities

HERBALIFE has provided an assertion about the fairness of the presentation of the description and suitability of the design and operating effectiveness of the controls to achieve the related control objectives stated in the description. HERBALIFE is responsible for preparing the description and for the assertion, including the completeness, accuracy, and method of presentation of the description and the assertion, specifying the control objectives and stating them in the description, identifying the risks that threaten the achievement of the control objectives, selecting the criteria, and designing, implementing, and documenting controls to achieve the related control objectives stated in the description.

## Compliance Auditor's Responsibilities

Our responsibility is to asses and report on HERBALIFE's compliance with and implementation of the Order as outlined in the description; including an assessment of the controls in place, and compliance with the Order. This engagement was conducted in accordance with consulting standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of those parties specified in the report. Consequently, we make no representation regarding the sufficiency of the procedures either for the purpose for which this report has been requested or for any other purpose.

Our analysis of the description of HERBALIFE's system and the suitability of the design and operating effectiveness of the Company's controls to achieve the related control objectives stated in the description involves performing procedures to obtain evidence about the fairness of the presentation of the description and the suitability of the design and operating effectiveness of those controls to achieve the related control objectives as stated in the description. Our procedures included assessing the risks that the description is not fairly presented and that the controls were not suitably designed or operating effectively to achieve the related control objectives stated in the description, including HERBALIFE's compliance with the Order. Our procedures also included testing the operating effectiveness of those controls that we consider necessary to the related control objectives stated in the description. An engagement of this type also includes evaluating the overall presentation of the description and the suitability of the control

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objectives stated therein, and the suitability of the criteria specified by the Company and described in Section V.

#### Inherent Limitations

Because of their nature, controls at HERBALIFE may not prevent, or detect and correct, all errors or omissions in processing or reporting transactions.

## ICA Report Findings

Based on our analysis of HERBALIFE's assertion in Section II and III:

a.	the description fairly presents the significant processes of the Company related to compliance with the Order that were designed and implemented throughout the period January 1, 2017 to March 31, 2017, except as follows:
b.	the key controls related to the control objectives stated in the description were suitably designed to provide reasonable assurance that the control objectives related to compliance with the Order would be achieved if the controls operated effectively throughout the period January 1, 2017 to March 31, 2017, except as follows:
c.	the key controls tested, if operating effectively, were those necessary to provide reasonable assurance that the control objectives related to compliance with the Order stated in the description were achieved and operated effectively throughout the period January 1, 2017 to march 31, 2017, except as follows:
d.	For those items tested, HERBALIFE complied with the Order for the period January 1, 2017 to March 31, 2017, except as follows:
crii	ption of Tests of Controls and Compliance

Description of Tests of Controls and Compliance

The specific controls tested and the nature, timing, and results of those tests are listed in Section V.

The specific test of compliance and results of those tests are listed in Section VI.

## Restricted Use

This report, including the description of tests of controls and compliance, and results thereof in Section V and VI, is intended solely for the information and use of HERBALIFE, and the FTC. This report is not intended to be and should not be used by anyone other than these specified parties. Non-specified users may not rely on the report and do not acquire any rights against Squire & Company, PC as a result of such access. Further, Squire & Company, PC does not assume any duties or obligations to any nonspecified user who obtains this report and/or has access to it.

May 31, 2017 Orem, Utah

> **APPENDIX** Page 3



# Prior Project Experience and References – Terrel Transtrum

# Summary

Please Note: Because our client products are confidential we will provide samples through confidential channels. Thank you.

Project Title	Description		Contact Information
Expert Witness Research and Opinion  The expert witness report is confidential and not available to circulate but lead litigator Chris Ralston has invited proposal reviewers to contact him directly.	Client: World Ventures  Situation: Lawsuit brought by a company had not fulfilled its diadminister policies preventing "cross sponsoring" or moving a downline organization.  Outcome: Distributor plaintiff a third ruling against him through third ruling against him through Relevance: As lead expert with research of company policies a company vis-à-vis distributor so procedures to assure consistent The key was combining compre of policy nuances with review a assisting counsel and company	Christopher K. Ralston, ESQ Lead Litigator for World Ventures Phelps Dunbar LLP 365 Canal Street, Suite 2000 New Orleans, LA 70130 Direct: 504-584-9358 Fax: 504-568-9130 Email: chris.ralston@phelps.com  Janet Weil, ESQ General Counsel, World Ventures 5100 Tennyson Parkway Plano, TX 75024 Phone: 972-805-5100 Email: jweil@wvholdings.com	
	Refer	ences	
Frank VanderSloot, CEO Melaleuca, Inc. 4609 W 65 <sup>th</sup> S Idaho Falls, ID 83402 Phone: <u>208-522-0700</u>		Mark Stidham, CEO LuLaRoe, LLC 830 Parkridge Ave Corona, CA 92879 Direct: 949-230-2457 Email: mark@lularoe	-
Jason Hansen Complete Merchant Solute 815 West University Park Orem, UT 84058 Direct: 801-458-8328 Email: jhansen@cmsonlin	way	Spencer Reese, ESQ Reese, Poyfair & Rich 1275 East Fort Union Cottonwood Heights Phone: 801-981-828 Email: sreese@rprlay	Boulevard, Suite 115 , UT 84047 <u>1</u>

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