2018 Inspection
Ernst & Young LLP

(Headquartered in New York, New York)

April 28, 2020

PCAOB
Public Company Accounting Oversight Board

<u>THIS IS A PUBLIC VERSION OF A PCAOB INSPECTION REPORT</u>

PORTIONS OF THE COMPLETE REPORT ARE OMITTED FROM THIS DOCUMENT IN ORDER TO COMPLY WITH SECTIONS 104(g)(2) AND 105(b)(5)(A) OF THE SARBANES-OXLEY ACT OF 2002

PCAOB RELEASE NO. 104-2020-009A
(Includes portions of Part II and Appendix A of the full report that were not included in PCAOB Release No. 104-2020-009)

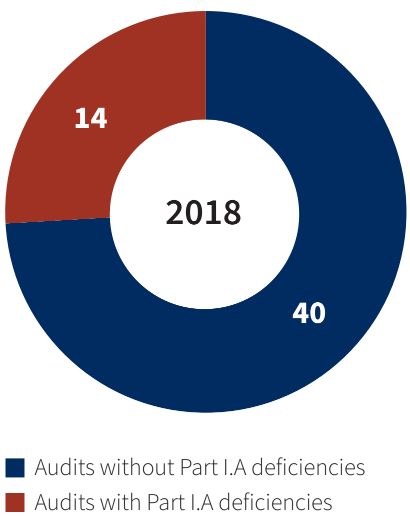
Executive Summary

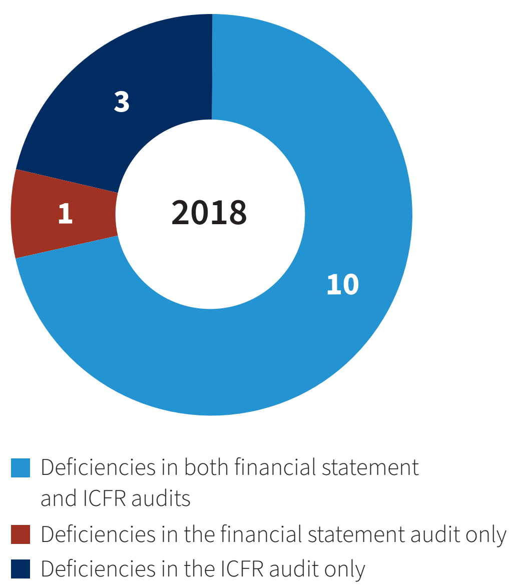
Our 2018 inspection report on Ernst & Young LLP provides information on our inspection to assess the firm's compliance with Public Company Accounting Oversight Board ("PCAOB") standards and rules and other applicable regulatory and professional requirements. This executive summary offers a high-level overview of: (1) Part I.A of the report, which discusses deficiencies ("Part I.A deficiencies") in certain issuer audits that were of such significance that we believe the firm, at the time it issued its audit report(s), had not obtained sufficient appropriate audit evidence to support its opinion on the issuer's financial statements and/or internal control over financial reporting ("ICFR"), and (2) Part I.B of the report, which discusses deficiencies that do not relate directly to the sufficiency or appropriateness of evidence the firm obtained to support its opinion(s) but nevertheless relate to instances of non-compliance with PCAOB standards or rules.

The fact that we have included a deficiency in this report — other than those deficiencies for audits with incorrect opinions on the financial statements and/or ICFR — does not necessarily mean that the issuer's financial statements are materially misstated or that undisclosed material weaknesses in ICFR exist. If a deficiency is included in Part I.A or Part I.B of this report, it does not necessarily mean that the firm has not addressed the deficiency.

Overview of the 2018 Deficiencies Included in Part I

Fourteen of the 54 issuer audits we reviewed in 2018 are included in Part I.A of this report due to the significance of the deficiencies identified. The identified deficiencies primarily related to the firm's testing of controls over and/or substantive testing of business combinations, inventory, and revenue and related accounts.





The most common Part I.A deficiencies in 2018 related to testing the design or operating effectiveness of controls selected for testing and in some cases, therefore, the overreliance on controls when performing substantive testing, and to evaluating significant assumptions or data that the issuer used in developing an estimate.

An additional deficiency identified during the 2018 inspection that does not relate directly to the sufficiency or appropriateness of evidence the firm obtained to support its opinion(s), which appears in Part I.B, related to audit committee communications.

Table of Contents

2018 Inspection

During the PCAOB's 2018 inspection of Ernst & Young LLP, we assessed the firm's compliance with laws, rules, and professional standards applicable to the audits of public companies.

We selected for review 54 audits of issuers with fiscal years generally ending in 2017. For each issuer audit selected, we reviewed a portion of the audit. We also evaluated elements of the firm's system of quality control.

What's Included in this Inspection Report

This report includes the following sections:

- **Overview of the 2018 Inspection and Historical Data by Inspection Year:** Information on our inspection, historical data, and common deficiencies.
- **Part I – Inspection Observations:**
  - **Part I.A:** Deficiencies that were of such significance that we believe the firm, at the time it issued its audit report(s), had not obtained sufficient appropriate audit evidence to support its opinion on the issuer's financial statements and/or ICFR.
  - **Part I.B:** Deficiencies that do not relate directly to the sufficiency or appropriateness of evidence the firm obtained to support its opinion(s) but nevertheless relate to instances of non-compliance with PCAOB standards or rules.
- **Part II – Observations Related to Quality Control:** Criticisms of, or potential defects in, the firm's system of quality control. Section 104(g)(2) of the Sarbanes-Oxley Act ("the Act") restricts us from publicly disclosing Part II deficiencies unless the firm does not address the criticisms or potential defects to the Board's satisfaction no later than 12 months after the issuance of this report.
- **Appendix A – Firm's Response to the Draft Inspection Report:** The firm's response to a draft of this report, excluding any portion granted confidential treatment.

2018 Inspection Approach

In selecting issuer audits for review, we use both risk-based and random methods of selection. We make most selections based on (1) our internal evaluation of audits we believe have a heightened risk of material misstatement, including those with challenging audit areas, and (2) other risk-based characteristics, including issuer and firm considerations. We select the remaining audits randomly to provide an element of unpredictability.

When we review an audit, we do not review every aspect of the audit. Rather, we generally focus our attention on audit areas we believe to be of greater complexity, areas of greater significance or with a heightened risk of material misstatement to the issuer's financial statements, and areas of recurring deficiencies. We may also select some audit areas for review in a manner designed to incorporate unpredictability.

Our selection of audits for review does not constitute a representative sample of the firm's total population of issuer audits. Additionally, our inspection findings are specific to the particular portions of the issuer audits reviewed. They are not an assessment of all of the firm's audit work nor of all of the audit procedures performed for the audits reviewed.

View the details on the scope of our inspections and our inspections procedures.

Overview of the 2018 Inspection and Historical Data by Inspection Year

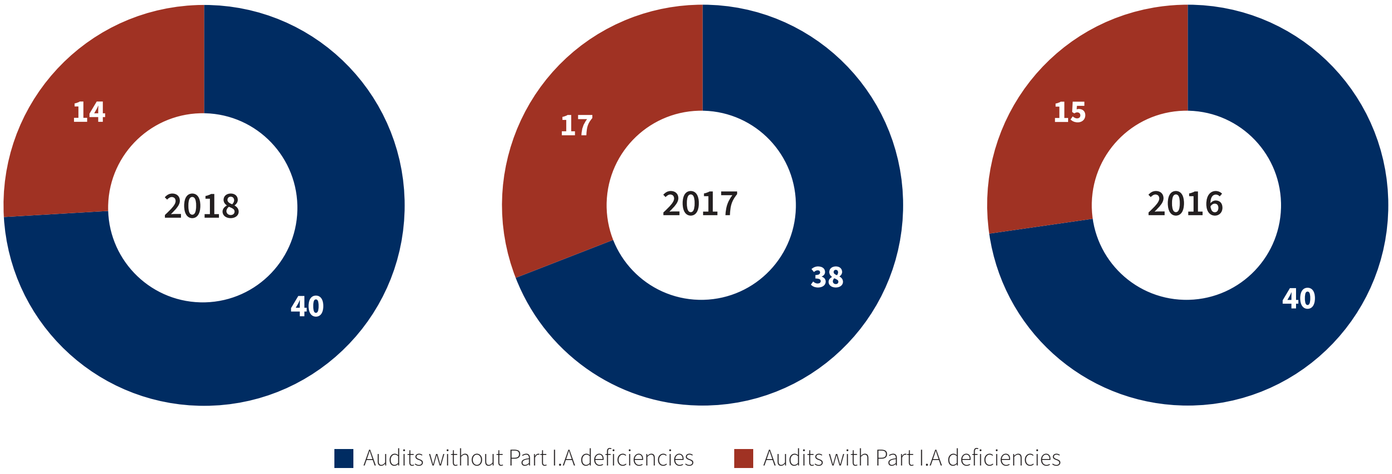
The following information provides an overview of our inspections in 2018 of the firm's issuer audits as well as data from the previous two inspections. We use a combination of risk-based and random methods to select audits for review and to identify areas on which we focus our inspection. Because our inspection process evolves over time, it can, and often does, focus on a different mix of audits and focus areas from year to year and firm to firm. As a result of this variation, we caution that our inspection results are not necessarily comparable over time or among firms.

Audits Reviewed

	2018	2017	2016
Total audits reviewed	54	55	55
Audits in which the firm was the principal auditor	54	54	55
Audits in which the firm was not the principal auditor	0	1	0
Integrated audits of financial statements and ICFR	53	53	53
Risk-based selections	44	45	45
Random selections	10	10	10

Part I.A Deficiencies in Audits Reviewed

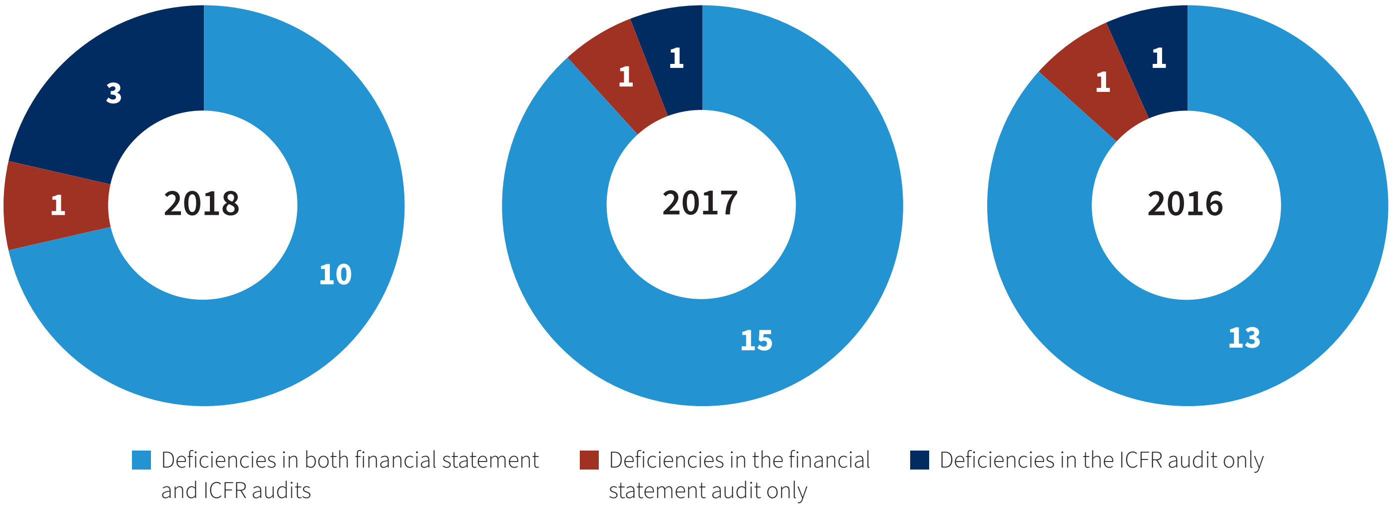
In 2018, all 14 audits appearing in Part I.A were selected for review using risk-based criteria. In 2017, 14 of the 17 audits appearing in Part I.A were selected for review using risk-based criteria. In 2016, 12 of the 15 audits appearing in Part I.A were selected for review using risk-based criteria.



If a deficiency is included in Part I.A of our report, it does not necessarily mean that the firm has not addressed the deficiency. In many cases, the firm has performed remedial actions after the issue was identified. Depending on the circumstances, remedial actions may include performing additional audit procedures, informing management of the issuer of the need for changes to the financial statements or reporting on ICFR, or taking steps to prevent reliance on prior audit reports. Our inspection normally includes a review, on a sample basis, of the adequacy of a firm's remedial actions, either with respect to previously identified deficiencies or deficiencies identified during that inspection. If a firm does not take appropriate actions to address deficiencies, we may criticize its system of quality control or pursue a disciplinary action.

The fact that we have included a deficiency in our report — other than those deficiencies for audits with incorrect opinions on the financial statements and/or ICFR — does not necessarily mean that the issuer's financial statements are materially misstated or that undisclosed material weaknesses in ICFR exist. It is often not possible for us to reach a conclusion on those points based on our inspection procedures and related findings because, for example, we have only the information that the auditor retained and the issuer's public disclosures. We do not have direct access to the issuer's management, underlying books and records, and other information.

Audits Affected by the Deficiencies Identified in Part I.A



In connection with our 2018 inspection procedures for one audit, the issuer revised its report on ICFR, and the firm modified its report on ICFR to include an additional material weakness. In connection with our 2017 inspection procedures for one audit, the issuer revised its report on ICFR, and the firm revised its opinion on the effectiveness of the issuer's ICFR to express an adverse opinion and reissued its report. In connection with our 2016 inspection procedures for two audits, the issuers revised their reports on ICFR, and the firm revised its opinions on the effectiveness of the issuers' ICFR to express an adverse opinion and reissued their reports.

The following tables and graphs summarize inspection-related information, by inspection year, for 2018 and the previous two inspections. We caution any comparison of the data provided without reading the descriptions of the underlying deficiencies in each respective inspection report.

Most Frequently Identified Part I.A Deficiencies

Deficiencies in audits of financial statements	Audits with Part I.A deficiencies		
	2018	2017	2016
Did not sufficiently evaluate significant assumptions or data that the issuer used in developing an estimate	6	6	9
Did not perform substantive procedures to obtain sufficient evidence as a result of overreliance on controls (due to deficiencies in testing controls)	6	6	5
Did not perform sufficient testing related to an account or significant portion of an account or to address an identified risk	4	4	2

Deficiencies in ICFR audits	Audits with Part I.A deficiencies		
	2018	2017	2016
Did not perform sufficient testing of the design and/or operating effectiveness of controls selected for testing	10	11	11
Did not identify and test any controls related to a significant account or relevant assertion	6	3	4
Did not identify and/or sufficiently test controls over the accuracy and completeness of data or reports	5	7	8

Audit Areas Most Frequently Reviewed

This table reflects the five focus areas we have selected most frequently for review in each inspection year (and the related Part I.A deficiencies). For the issuer audits selected for review, we selected these areas because they were generally significant to the issuer's financial statements, may have included complex issues for auditors, and/or involved complex judgments in (1) estimating and auditing the reported value of related accounts and disclosures and (2) implementing and auditing the related controls.

2018			2017			2016		
Audit area	Audits reviewed	Audits with Part I.A deficiencies	Audit area	Audits reviewed	Audits with Part I.A deficiencies	Audit area	Audits reviewed	Audits with Part I.A deficiencies
Revenue and related accounts	44	4	**Revenue and related accounts**	46	8	**Revenue and related accounts**	43	8
Inventory	28	5	**Inventory**	22	6	**Inventory**	25	5
Business combinations	19	6	**Goodwill and intangible assets**	18	1	**Goodwill and intangible assets**	25	1
Goodwill and intangible assets	12	1	**Business combinations**	16	3	**Long-lived assets**	15	4
Long-lived assets	12	1	**Long-lived assets**	14	0	**Business combinations**	14	2

Audit Areas with Frequent Part I.A Deficiencies

This table reflects the focus areas with the most frequently identified Part I.A deficiencies in each inspection year with the corresponding results for the other two years presented.

Audit area	2018		2017		2016	
	Audits with Part I.A deficiencies	Audits reviewed	Audits with Part I.A deficiencies	Audits reviewed	Audits with Part I.A deficiencies	Audits reviewed
Business combinations	6	19	3	16	2	14
Inventory	5	28	6	22	5	25
Revenue and related accounts	4	44	8	46	8	43
Allowance for loan losses	3	4	0	7	0	4
Investment securities	2	9	3	8	0	7
Long-lived assets	1	12	0	14	4	15

Business combinations: The deficiencies in 2018, 2017, and 2016 primarily related to evaluating the reasonableness of assumptions used by the issuer to determine the fair values of assets acquired and liabilities assumed. In addition, the deficiencies related to testing controls involving the issuer's review of assumptions used to value assets acquired and liabilities assumed.

Inventory: The deficiencies in 2018 primarily related to testing controls over the existence of inventory, including cycle-count controls. The deficiencies in 2017 and 2016 primarily related to the firm's substantive testing procedures of the existence of inventory, as well as testing controls over the existence of inventory and the accuracy and completeness of data used in the performance of the controls.

Revenue and related accounts: The deficiencies in 2018 primarily related to substantive testing of revenue recognition and testing controls over revenue, including controls over information technology systems associated with revenue. The deficiencies in 2017 and 2016 related to substantive testing of revenue recognition and testing controls over revenue, including controls over the accuracy and completeness of data used in the performance of the controls.

Allowance for loan losses: The deficiencies in 2018 related to substantive testing of the assumptions used by the issuer to estimate the allowance for loan losses and testing controls over the allowance for loan losses.

Investment securities: The deficiencies in 2018 and 2017 primarily related to testing the design effectiveness of controls over the valuation of investment securities.

Long-lived assets: The deficiencies in 2018 related to performing substantive procedures to test, and testing controls over, the existence of long-lived assets. The deficiencies in 2016 related to substantive testing, and testing relevant controls, over the potential impairment of long-lived assets.

Auditing Standards Associated with Identified Part I.A Deficiencies

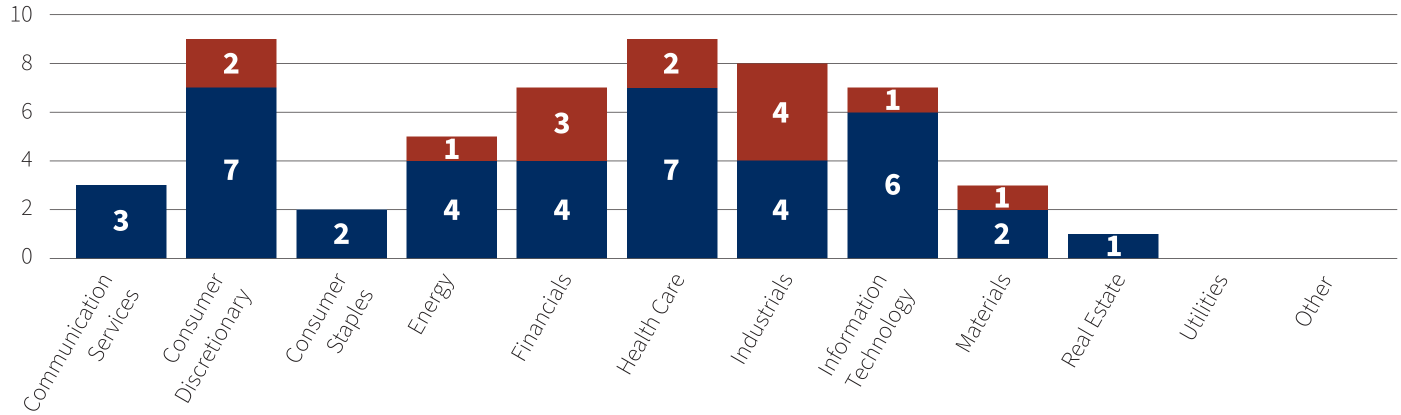
The following lists the auditing standards referenced in Part I.A of the 2018 and the previous two inspection reports and the number of times that the standard is cited in Part I.A.

PCAOB Auditing Standards	2018	2017	2016
AS 1105, *Audit Evidence*	4	3	2
AS 1210, *Using the Work of a Specialist*	0	1	0
AS 2101, *Audit Planning*	0	0	5
AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*	37	37	34
AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*	9	5	6
AS 2305, *Substantive Analytical Procedures*	0	2	5
AS 2315, *Audit Sampling*	5	5	4
AS 2501, *Auditing Accounting Estimates*	2	1	12
AS 2502, *Auditing Fair Value Measurements and Disclosures*	5	9	2
AS 2510, *Auditing Inventories*	1	3	2
AS 2810, *Evaluating Audit Results*	1	4	3

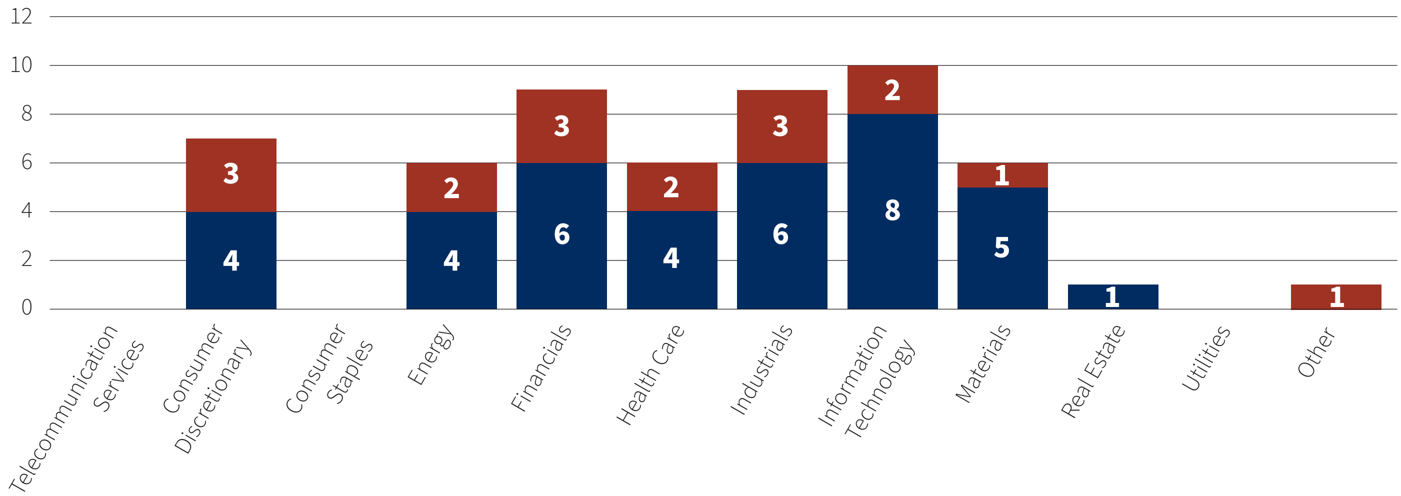
Inspection Results by Issuer Industry Sector

The majority of industry sector data is based on Global Industry Classification Standard ("GICS") data obtained from Standard & Poor's ("S&P"). In instances where GICS data for an issuer is not available from S&P, classifications are assigned based upon North American Industry Classification System data.

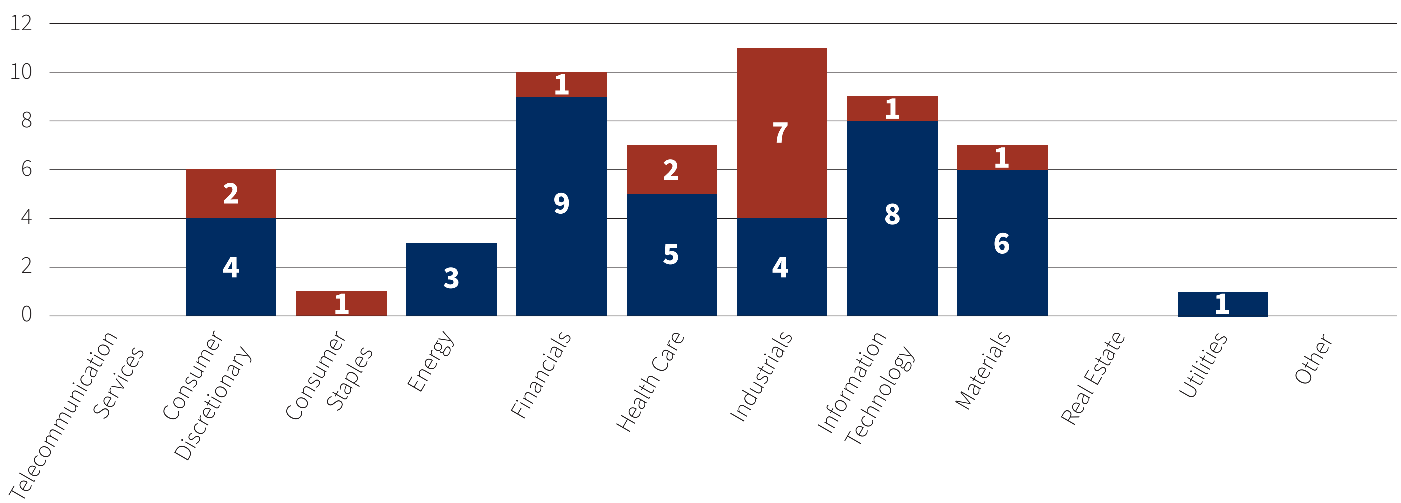
2018



2017



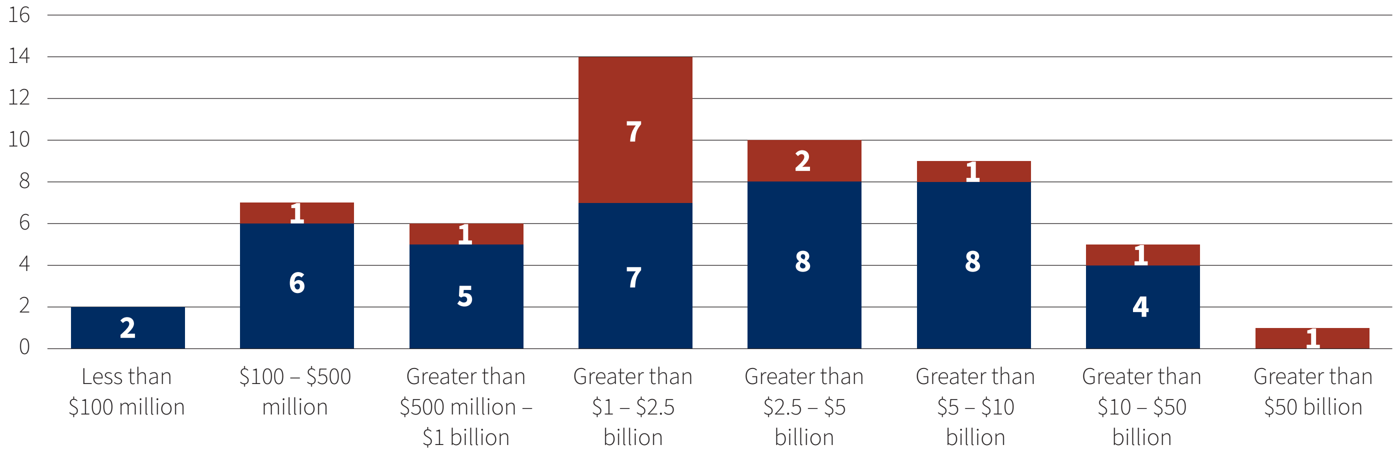
2016



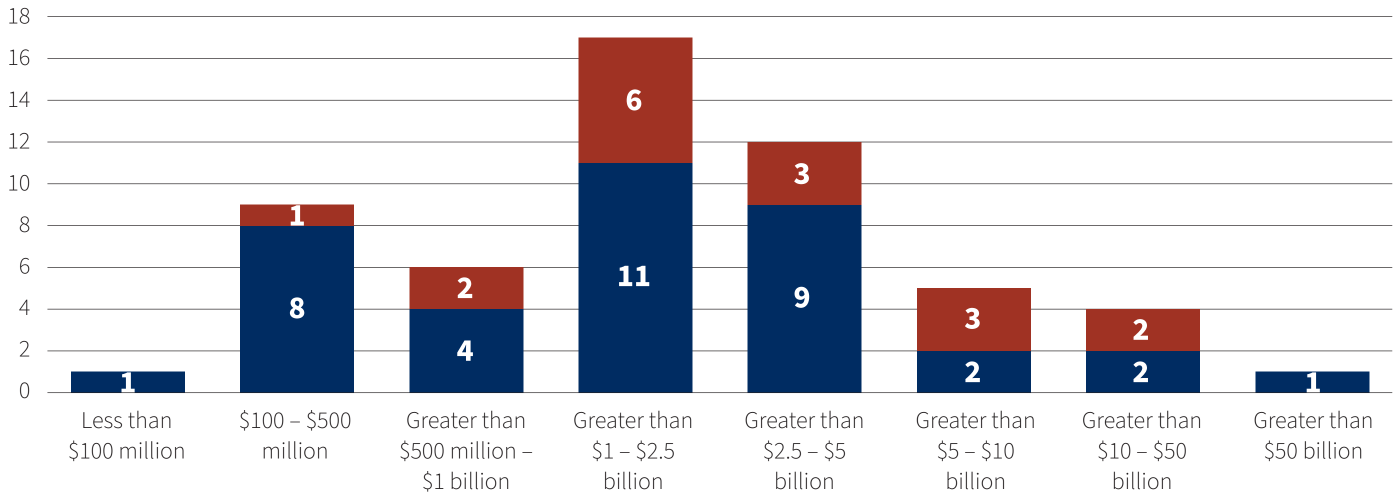
Audits without Part I.A deficiencies
Audits with Part I.A deficiencies

Inspection Results by Issuer Revenue Range

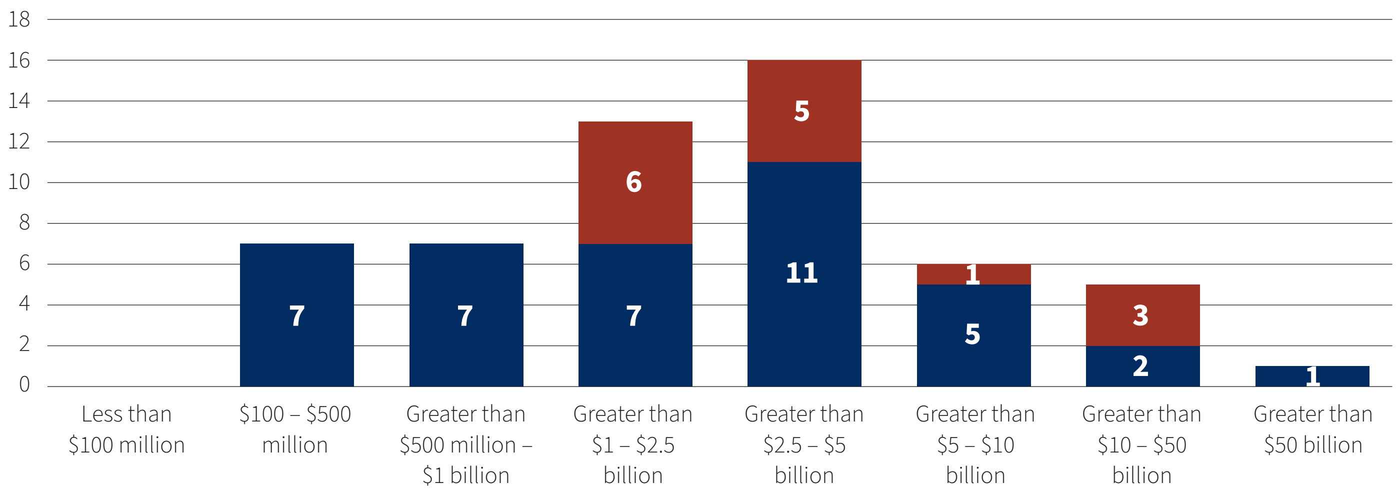
2018



2017



2016



Audits without Part I.A deficiencies   Audits with Part I.A deficiencies

Classification of Audits with Part I.A Deficiencies

Within Part I.A of this report, we classify each issuer audit in one of the categories discussed below based on the Part I.A deficiency or deficiencies identified in our review.

The sole purpose of this classification system is to group and present issuer audits by the number of Part I.A deficiencies we identified within the audit as well as to highlight audits with an incorrect opinion on the financial statements and/or ICFR.

Audits with an Incorrect Opinion on the Financial Statements and/or ICFR

This classification includes instances where an audit deficiency was identified in connection with our inspection and, as a result, an issuer's financial statements were determined to be materially misstated, and the issuer restated its financial statements. It also includes instances where an audit deficiency was identified in connection with our inspection and, as a result, an issuer's ICFR was determined to be ineffective, or there were additional material weaknesses that the firm did not identify, and the firm withdrew its opinion, or modified its report, on ICFR.

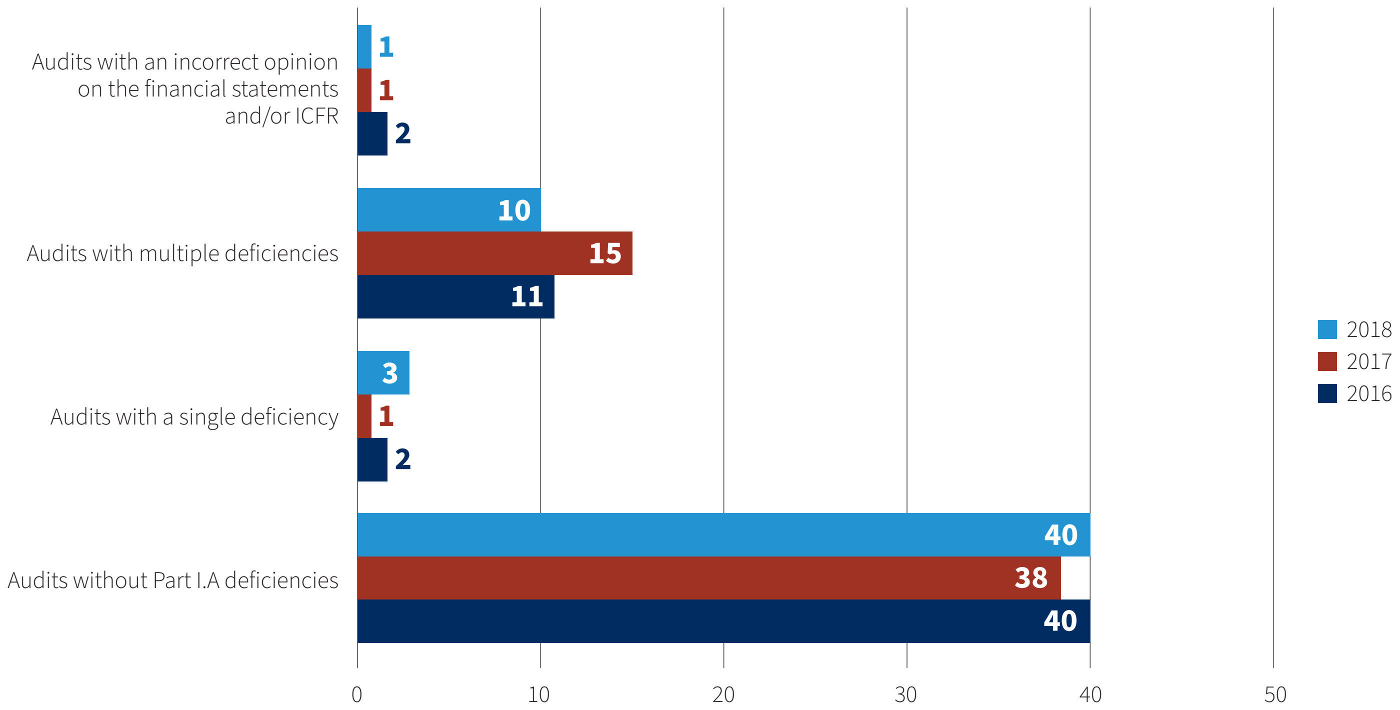
Audits with Multiple Deficiencies

This classification includes instances where multiple deficiencies were identified that related to a combination of one or more financial statement accounts, disclosures, and/or important controls in an ICFR audit.

Audits with a Single Deficiency

This classification includes instances where a single deficiency was identified that related to a financial statement account or disclosure or to an important control in an ICFR audit.

Number of Audits in Each Category



Part I: Inspection Observations

Part I.A of our report discusses deficiencies that were of such significance that we believe the firm, at the time it issued its audit report(s), had not obtained sufficient appropriate audit evidence to support its opinion on the issuer's financial statements and/or ICFR. Part I.B discusses deficiencies that do not relate directly to the sufficiency or appropriateness of evidence the firm obtained to support its opinion(s) but nevertheless relate to instances of non-compliance with PCAOB standards or rules. Consistent with the Act, it is the Board's assessment that nothing in Part I of this report deals with a criticism of or potential defect in the firm's quality control system. Any such criticisms or potential defects are discussed in Part II. Further, you should not infer from any Part I deficiency or combination of deficiencies that a quality control finding is identified in Part II.

Part I.A: Audits with Unsupported Opinions

This section of our report discusses the deficiencies identified, by specific issuer audit reviewed, in the audit work supporting the firm's opinion on the issuer's financial statements and/or ICFR.

We identify each issuer by a letter (e.g., Issuer A) and industry sector. Each deficiency could relate to several auditing standards, but we reference the PCAOB standard(s) that most directly relates to the requirement with which the firm did not comply.

Issuer audits are presented below within their respective deficiency classifications (as discussed previously). Within the classifications, we generally present the audits based on our assessment as to the relative significance of the identified deficiencies taking into account the significance of the financial statement accounts and/or disclosures affected, and/or the nature or extent of the deficiencies.

Audits with an Incorrect Opinion on the Financial Statements and/or ICFR

Issuer A – Materials

Type of audit and related areas affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to **Revenue**, **Inventory**, and **Trade Payables**.

Description of the deficiencies identified

With respect to **Revenue** and **Inventory** at three of the issuer's locations:

For one of the locations, the firm identified and tested a compensating control to address a control deficiency it identified related to access and the ability to make changes to the general ledger. This compensating control related to testing, reviewing, and approving changes prior to migration into the general ledger system. The firm did not evaluate the implications of one type of users' ability to modify certain information used in the operation of this control. (AS 2201.68)

For the other two locations, the firm selected for testing three access controls that consisted of reviews of whether access to the general ledger system was appropriately restricted based on the system profiles. The firm did not evaluate whether the access provided through these profiles was appropriate based on users' functional needs. (AS 2201.42 and .44)

As a result of our inspection, the firm performed additional procedures related to the deficiencies in controls over revenue and inventory discussed above and requested that the issuer reevaluate these controls. As a result of this reevaluation, the issuer identified a material weakness related to the aggregation of control deficiencies over the issuer's information technology ("IT") systems that had not been previously identified. The firm modified its report on the effectiveness of the issuer's ICFR to include this additional material weakness.

The firm relied on information in reports generated from these general ledger systems in performing its substantive procedures over revenue and inventory but did not test the completeness of the information in certain of these reports beyond comparing certain amounts in these reports to the general ledger systems. (AS 1105.10)

With respect to **Trade Payables**:

In addition to the control deficiencies discussed above, the firm identified control deficiencies in the issuer's controls over trade payables that it had selected for testing and concluded that these deficiencies, in the aggregate, represented a significant deficiency. The firm did not sufficiently evaluate whether the deficiencies represented a material weakness because the firm did not evaluate the magnitude of potential misstatements resulting from these control deficiencies. (AS 2201.62 and .63)

Audits with Multiple Deficiencies

Issuer B – Health Care

Type of audit and related areas affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to **Revenue**, **Accounts Receivable**, **Inventory**, and **Goodwill**.

Description of the deficiencies identified

With respect to **Revenue** at three of the issuer's business units:

For all three business units, the firm selected for testing an automated control over the pricing of revenue transactions within the revenue systems. Pricing for many cases was based on the issuer's costs. The firm did not evaluate whether this control was appropriately configured to operate over each scenario contained in customer contracts. (AS 2201.42 and .44) In addition, the firm did not identify and test any controls that addressed whether the revenue systems appropriately applied the item costs that were used to generate customer sales invoices. (AS 2201.39)

For one of the three business units, the firm selected a control that consisted of the manual resolution of exceptions identified through an automated process to determine whether daily sales had shipped. The firm did not (1) test the configuration of the automated control that identified exceptions and (2) identify and test the aspects of the control related to the manual steps that the control owners performed to resolve the identified exceptions. (AS 2201.42 and .44)

For another one of the three business units, the firm selected for testing controls that consisted of management's reviews of a sample of changes made to the pricing information within the revenue system. The firm did not evaluate whether the sample of changes subject to the reviews was sufficient to identify any misstatements that, in the aggregate, could be material. (AS 2201.42)

For all three business units, the firm's substantive procedures to test revenue consisted of testing samples of transactions. In performing its testing of the selected transactions, the firm did not evaluate whether the selling prices that the issuer used to record revenue agreed with the terms in the customer contracts. (AS 2301.08) In addition, the sample sizes the firm used were too small to provide sufficient appropriate audit evidence because these procedures were designed based on a level of control reliance that was not supported due to the deficiencies in the firm's control testing discussed above. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

With respect to **Revenue**, **Accounts Receivable**, and **Inventory** at certain of the issuer's business units:

The issuer initiated and processed transactions related to sales, accounts receivable, and inventory at numerous business units using various IT systems. With respect to controls for these business units, the firm selected for testing two entity-level controls that used information generated by the IT systems. The firm did not test IT general controls ("ITGCs") over the IT systems for these business units or test any other controls over the accuracy and completeness of the information that was generated by the systems and that the issuer used in the performance of the entity-level controls. (AS 2201.39)

The firm's reliance on the entity-level controls discussed above to reduce its substantive procedures was unsupported. As a result, its analytical procedures, which consisted of comparisons of certain current-year account balances to corresponding prior-period balances, to test revenue, accounts receivable, and inventory for these locations did not provide sufficient appropriate audit evidence. (AS 2301.08)

With respect to **Inventory** at two of the issuer's business units:

The firm did not identify and test any controls that addressed whether the inventory subsidiary ledgers for these business units accurately calculated inventory values using the correct item cost at year end. (AS 2201.39)

The firm did not identify and test any controls over the calculation of last-in, first-out values for one category of inventory. (AS 2201.39)

With respect to **Goodwill** for one of the issuer's reporting units:

The firm selected for testing a control that consisted of the issuer's review of the assumptions underlying the cash-flow forecasts used in the issuer's annual goodwill impairment assessment. The firm did not evaluate the review procedures that the control owners performed, including the criteria that the control owners used to identify items for follow up and whether those items were appropriately resolved. (AS 2201.42 and .44)

The firm performed certain substantive procedures to evaluate the significant assumptions underlying the cash-flow forecasts but did not obtain sufficient appropriate audit evidence regarding the issuer's ability to carry out its cost-saving strategies to achieve these forecasts. (AS 2502.26, .28, .31, and .36)

Issuer C – Industrials

Type of audit and related areas affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to **Revenue**; **Deferred Revenue**; **Asset Retirement Obligations**; **Capitalized Asset Retirement Costs**; and **Plant, Property, and Equipment**.

Description of the deficiencies identified

With respect to **Revenue**, **Deferred Revenue**, **Asset Retirement Obligations**, and **Capitalized Asset Retirement Costs**:

The issuer recognized one type of revenue and the associated deferred revenue using certain customer rates and service dates recorded in the revenue system. The issuer recognized a second type of revenue and determined the asset retirement obligations ("ARO") and asset retirement costs ("ARC") using certain measurement information that was recorded in the revenue system. The firm identified various control deficiencies related to controls over both types of revenue and the deferred revenue and identified and tested four compensating controls that it believed mitigated these deficiencies. The following deficiencies were identified:

- Two of the four compensating controls involved the review of certain revenue analyses. The firm did not evaluate the review procedures that the control owner performed to be able to conclude that the compensating controls mitigated identified control deficiencies. (AS 2201.68) In addition, the firm did not identify and test any controls over the accuracy and completeness of certain information, including the measurement information, which the issuer used in the performance of these two controls. (AS 2201.68)
- The other two compensating controls involved the issuer's comparisons of the terms used to calculate revenue for a selection of transactions to supporting documentation. The firm did not evaluate whether these two controls

sufficiently mitigated the identified control deficiencies, given that these controls addressed only small portions of both types of revenue and the deferred revenue. (AS 2201.68)

- The issuer identified errors in certain of the selected items it tested through the operation of one of the two compensating controls discussed directly above, but the firm did not evaluate the implications of these errors on its opinion on the issuer's financial statements. (AS 2810.03)

With respect to the firm's testing of various controls over the second type of revenue, the ARO, and the ARC, the firm did not identify and test any controls over the accuracy and completeness of certain information that was used in the operation of these controls. (AS 2201.39)

With respect to the firm's substantive testing of the second type of revenue, the ARO, and the ARC, the firm used certain measurement information in its testing but did not perform any procedures to test the accuracy of this information. (AS 1105.10)

With respect to **Plant, Property, and Equipment**:

The firm did not identify and test any controls over the existence of one type of movable equipment. (AS 2201.39)

The firm did not perform sufficient substantive procedures related to the existence of two types of movable equipment because the firm's procedures were limited to (1) tracing an issuer-prepared roll-forward schedule for this equipment to the general ledger and (2) vouching a sample of equipment additions during the year to supporting documentation. (AS 2301.08)

Issuer D – Financials

Type of audit and related areas affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to the **Allowance for Loan Losses ("ALL")**, a **Business Combination**, and **Investments**.

Description of the deficiencies identified

With respect to the **ALL**:

The issuer estimated the general reserve component of the ALL using the following significant assumptions: (1) loan segmentation, (2) probability of default ("PD"), (3) loss given default ("LGD"), and (4) loan risk ratings ("LRR"). The issuer used a model to derive the PD and LGD assumptions using current and historical loan data ("loan data") contained in two data warehouses. The following deficiencies were identified:

- The firm did not identify and test any controls that addressed the reasonableness of the loan segmentation, PD, and LGD assumptions. (AS 2201.39)

- The firm did not identify and test any controls over the accuracy of the loan data contained in the two data warehouses. (AS 2201.39)

- The firm selected for testing a control that included (1) the issuer's review of the LRRs assigned to loans meeting certain criteria and (2) procedures to monitor whether the LRRs for these loans were updated within the time frame established for the control. The firm did not evaluate the review procedures that the control owners performed, including the criteria that the control owners used to identify items for follow up and whether those items were appropriately resolved. (AS 2201.42 and .44) In addition, the firm did not test the aspect of this control that addressed the appropriateness of the time frame established for the control for requiring updates to the LRRs. (AS 2201.42 and .44)

- In its substantive testing of the ALL, the firm did not test the reasonableness of the loan segmentation, PD, and LGD assumptions. (AS 2501.11)

With respect to a **Business Combination**:

During the year, the issuer acquired a business. The firm selected for testing various controls over the accounting for the business combination, which included the issuer's reviews of the significant assumptions used in the valuation of certain assets acquired and liabilities assumed. In testing the aspects of these controls related to the review of these assumptions, the firm did not evaluate the review procedures that the control owners performed, including the criteria that the control owners used to identify items for follow up and whether those items were appropriately resolved. (AS 2201.42 and .44)

The sample sizes the firm used in certain of its substantive procedures to test certain assets acquired and liabilities assumed were too small to provide sufficient appropriate audit evidence because these procedures were designed based on a level of control reliance that was not supported due to the deficiencies in the firm's control testing discussed above. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

With respect to **Investments**:

The issuer recorded the fair value for available-for-sale ("AFS") and held-to-maturity ("HTM") debt securities based on the prices it received from an external pricing service. The firm selected for testing a control that consisted of the issuer's comparison, for a selection of securities from various security categories, of the prices it received from the external pricing service to prices it obtained from other sources and evaluation of any pricing differences that exceeded monetary thresholds. The firm did not evaluate whether the control was designed to address the risks of material misstatement presented by the different risk characteristics inherent in the population of securities in each category not subject to the control given the selection method applied. (AS 2201.42)

The sample sizes the firm used in certain of its substantive procedures to test the valuation of the AFS and HFM debt securities were too small to provide sufficient appropriate audit evidence because these procedures were designed based on a level of control reliance that was not supported due to the deficiency in the firm's control testing discussed above. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

Issuer E – Financials

Type of audit and related areas affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to the **ALL**, **Investments**, and a **Business Combination**.

Description of the deficiencies identified

With respect to the **ALL**:

The issuer developed the qualitative component of the general reserve of the ALL by assigning risk-rating factors, which it weighted using certain judgmental assumptions, to qualitative considerations such as delinquency trends, economic and business conditions, and other external factors used in its calculation. The following deficiencies were identified:

- With respect to controls over the qualitative component of the general reserve, the firm selected for testing controls that consisted of reviews of trends in various qualitative considerations the issuer used to determine the risk-rating factors. The firm did not identify and test any controls that addressed the appropriateness of the risk-rating factors and weightings that were assigned to each of the qualitative considerations. (AS 2201.39)
- With respect to its substantive procedures over the qualitative component of the general reserve, the firm did not evaluate the appropriateness of the risk-rating factors and weightings that were assigned to each of the qualitative considerations. (AS 2501.11)

With respect to **Investments**:

The issuer recorded the fair value for AFS securities based on the prices it received from an external pricing service. The firm selected for testing a control that consisted of (1) comparing the recorded fair values to prices obtained from another pricing service for a sample of securities selected from certain categories of securities and (2) the analysis of pricing differences that exceeded an established threshold. The firm did not evaluate whether the control was designed to address the risks of material misstatement presented by the population of securities not subject to the control given the selection method applied by the issuer and the different valuation methods used by the issuer's external pricing services to value the securities. (AS 2201.42)

The sample sizes the firm used in certain of its substantive procedures to test the valuation of the AFS securities were too small to provide sufficient appropriate audit evidence because these procedures were designed based on a level of control reliance that was not supported due to the deficiency in the firm's control testing discussed above. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

With respect to a **Business Combination**:

During the year, the issuer acquired a business. The firm selected for testing a control over the valuation of certain acquired loans that consisted of the issuer's review of the significant assumptions that the issuer used in the valuation of these loans, including the discount rate. The firm did not evaluate the specific review procedures the control owner performed to review two important components the issuer used to determine the discount rate. (AS 2201.42 and .44)

Issuer F – Consumer Discretionary

Type of audit and related areas affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to **Revenue** and **Inventory**.

Description of the deficiencies identified

With respect to **Revenue**:

For certain revenue, the issuer's system initiated revenue recognition upon the issuer's review and input of shipment information into the system. The following deficiencies were identified:

- The firm selected for testing an automated control over this revenue that was designed to record revenue once the shipment information was manually entered into the issuer's system. The firm did not test the configuration of the automated control or perform other procedures to obtain sufficient appropriate audit evidence that the automated control was operating as designed. (AS 2201.42 and .44) In addition, the firm did not identify and test any controls over the issuer's review of the shipment information that was manually entered into the issuer's system. (AS 2201.39)
- The sample sizes the firm used in certain of its substantive procedures to test this revenue were too small to provide sufficient appropriate audit evidence because these procedures were designed based on a level of control reliance that was not supported due to the deficiencies in the firm's control testing discussed above. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

With respect to **Inventory**:

The issuer performed daily cycle counts of inventory but designed its counts to exclude a portion of inventory from the daily cycle counts. In evaluating the design of the cycle-count control, the firm did not assess the effect of the issuer excluding this portion of inventory on the control's ability to effectively prevent or detect a material misstatement. (AS 2201.42)

Issuer G – Health Care

Type of audit and related area affected

In our review, we identified deficiencies in the financial statement audit related, in part, to a **Business Combination**.

Description of the deficiencies identified

During the year, the issuer entered into transactions, including an acquisition, which resulted in the recording of the fair value of investments. The firm selected for testing investments that met specific criteria. The firm did not perform any substantive procedures to test the portion of investments that did not meet these criteria. (AS 1105.27)

The firm did not perform procedures, beyond inquiry, to evaluate significant differences it identified when performing certain comparisons to test the reasonableness of certain assumptions underlying the cash-flow forecasts that the issuer used to determine the fair value of the investments discussed above. (AS 2502.26, .28, .31, and .36) In addition, the firm did not test the accuracy and completeness of certain data used in one of the comparisons. (AS 1105.10)

Issuer H – Information Technology

Type of audit and related area affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to **Inventory**.

Description of the deficiencies identified

Certain inventory held by the issuer in several locations was subject to cycle counts. The following deficiencies were identified:

- The firm did not identify and test any controls over the issuer's monitoring of the results of the cycle counts to assess whether its perpetual inventory records were reliable. (AS 2201.39)
- For inventory at certain of these locations, the firm identified deficiencies in certain controls over the issuer's cycle-count program related to whether sufficient inventory items were counted with sufficient frequency in accordance with the issuer's cycle-count program. The firm identified and tested compensating controls that it believed mitigated these deficiencies. The firm did not identify that these compensating controls did not address whether sufficient inventory items were counted with sufficient frequency in accordance with the issuer's cycle-count program. (AS 2201.68)
- For another one of these locations, the issuer used an inventory management system in performing its cycle counts. The firm did not identify and test controls over the accuracy and completeness of the cycle-count selection reports generated by this system and used by the issuer in the performance of the cycle counts at this location. (AS 2201.39)
- Due to the deficiencies discussed above, the firm's testing of controls did not provide sufficient appropriate audit evidence that the cycle-count procedures the issuer used for this inventory were sufficiently reliable to produce results substantially the same as those that would have been obtained by a count of all items each year. (AS 2510.11)

Issuer I – Energy

Type of audit and related area affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to a **Business Combination**.

Description of the deficiencies identified

During the year, the issuer acquired a business. The firm selected for testing controls over the accounting for the business combination, which included the issuer's reviews of the data and significant assumptions that the issuer used in the valuation of certain obligations assumed in this acquisition. The firm did not evaluate the review procedures that the control owners performed, including the criteria that the control owners used to identify items for follow up and whether those items were appropriately resolved. (AS 2201.42 and .44)

In its substantive testing, the firm did not evaluate the reasonableness of the significant assumptions underlying the fair values of the obligations assumed. (AS 2502.26 and .28) In addition, the firm did not test the accuracy and completeness of data used to determine the fair values of these obligations assumed. (AS 2502.26, .28, and .39)

Issuer J – Industrials

Type of audit and related area affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to a **Business Combination**.

Description of the deficiencies identified

During the year, the issuer acquired a business. The firm selected for testing a control that included the issuer's review of the significant assumptions used in the valuation of the intangible assets acquired in this transaction. The firm did not evaluate the review procedures that the control owners performed, including the criteria that the control owners used to identify items for follow up and whether those items were appropriately resolved. (AS 2201.42 and .44)

The firm performed substantive procedures to evaluate the significant assumptions underlying the forecasts the issuer used in the valuation of the acquired intangible assets but did not obtain sufficient appropriate audit evidence related to the issuer’s ability to carry out its cost-saving strategies to achieve these forecasts. (AS 2502.26, .28, .31, and .36)

Issuer K – Industrials

Type of audit and related area affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to **Inventory**.

Description of the deficiencies identified

The firm’s testing of controls for inventory held at certain locations consisted primarily of testing an entity-level control that involved the issuer's reviews of regional and component-level income statements and balance sheets. The firm did not evaluate the review procedures that the control owner performed, including the criteria that the control owner used to identify items for follow up and whether those items were appropriately resolved, with respect to the component-level financial information. (AS 2201.42 and .44)

Based on the firm’s reliance on this entity-level control, which was not supported due to the deficiency discussed above, the firm limited its substantive procedures to test this inventory to various analytical procedures. These analytical procedures, as designed, provided little or no substantive evidence. (AS 2301.08)

Audits with a Single Deficiency

Issuer L – Financials

Type of audit and related area affected

In our review, we identified a deficiency in the ICFR audit related to the **ALL**.

Description of the deficiency identified

For loans that the issuer assessed collectively for impairment, the issuer estimated the ALL using a model that consisted of quantitative and qualitative components. The issuer developed the qualitative component of the ALL by applying certain qualitative factors to each of its classes of loans. The firm selected for testing a control that consisted of a committee's review of the ALL, including the qualitative factors. The firm did not evaluate the review procedures that the control owners performed to evaluate the qualitative factors, including the criteria that the control owners used to identify items for follow up and whether those items were appropriately resolved. (AS 2201.42 and .44)

Issuer M – Industrials

Type of audit and related area affected

In our review, we identified a deficiency in the ICFR audit related to the **Period-End Financial Reporting Process**.

Description of the deficiency identified

The issuer used data generated by an IT system, including data related to revenue and inventory, in the financial statement consolidation process. The firm selected for testing a control over the financial statement consolidation process but did not identify and test any controls over the accuracy and completeness of the data and reports generated by this system and used in the operation of the control. (AS 2201.39)

Issuer N – Consumer Discretionary

Type of audit and related area affected

In our review, we identified a deficiency in the ICFR audit related to a **Business Combination**.

Description of the deficiency identified

During the year, the issuer acquired a business. The firm selected for testing a control over the accounting for this business combination, which included the issuer's review of the significant assumptions, including forecasted revenue and EBITDA margins that the issuer used in the valuation of the acquired intangible assets. The firm did not evaluate the review procedures that the control owners performed to assess the reasonableness of the forecasted revenue and EBITDA margins, including the criteria that the control owners used to identify items for follow up and whether those items were appropriately resolved. (AS 2201.42 and .44)

Part I.B: Other Instances of Non-Compliance with PCAOB Standards or Rules

This section of our report discusses any deficiencies we identified that do not relate directly to the sufficiency or appropriateness of evidence the firm obtained to support its opinion(s) but nevertheless relate to instances of non-compliance with PCAOB standards or rules. When we review an audit, we do not review every aspect of the audit. As a result, the area below was not reviewed on every audit inspected.

We identified the following deficiency:

In two of 16 audits reviewed, the firm did not document its communications to the issuer's audit committee of changes to significant risks initially identified (and communicated to the audit committee) and the reasons for such changes. In these instances, the firm was non-compliant with AS 1301, *Communications with Audit Committees*.

Part II: Observations Related To Quality Control

Part II of our report discusses criticisms of, and potential defects in, the firm's system of quality control.

Deficiencies are included in Part II if an analysis of the inspection results, including the results of the reviews of individual audits, indicates that the firm's system of quality control does not provide reasonable assurance that firm personnel will comply with applicable professional standards and requirements. Generally, the report's description of quality control criticisms is based on observations from our inspection procedures.

Any changes or improvements to its system of quality control that the firm may have brought to the Board's attention may not be reflected in this report, but are taken into account during the Board's assessment of whether the firm has satisfactorily addressed the quality control criticisms or defects no later than 12 months after the issuance of this report.

Criticisms of, and potential defects in, the firm's system of quality control, to the extent any are identified, are nonpublic when the reports are issued. If a firm does not address to the Board's satisfaction any criticism of, or potential defect in, the firm's system of quality control within 12 months after the issuance of our report, any such deficiency will be made public.

Policies for Financial Holdings Disclosures

The inspection results indicate that the firm's system of quality control does not provide reasonable assurance that the firm and its personnel will comply with the firm's policies and procedures with respect to independence-related regulatory requirements. (QC 20.04, .09, and .10)

The firm conducts periodic audits of a sample of its personnel to monitor compliance with certain of its independence policies. In the audits conducted during the period ended March 31, 2018, the firm identified that 33 percent of the partners and 46 percent of the managers who were audited had not reported, as of the dates of their confirmations of compliance with firm policy, financial relationships that were required to be reported in accordance with the firm's policies. These high rates of non-compliance with the firm's policies, which are designed to provide compliance with applicable independence regulatory requirements, provide cause for concern, especially considering that these individuals are required to certify on a quarterly basis that they have complied with the firm's independence policies and procedures.

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Appendix A: Firm's Response to the Draft Inspection Report

Pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(a), the firm provided a written response to a draft of this report. Pursuant to section 104(f) of the Act and PCAOB Rule 4007(b), the firm's response, excluding any portion granted confidential treatment, is attached hereto and made part of this final inspection report.

The Board does not make public any of a firm's comments that address a nonpublic portion of the report unless a firm specifically requests otherwise. In some cases, the result may be that none of a firm's response is made publicly available.

In addition, pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(b), if a firm requests, and the Board grants, confidential treatment for any of the firm's comments on a draft report, the Board does not include those comments in the final report. The Board routinely grants confidential treatment, if requested, for any portion of a firm's response that addresses any point in the draft that the Board omits from, or any inaccurate statement in the draft that the Board corrects in, the final report.

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Building a better working world

April 3, 2020

Mr. George Botic
Director
Division of Registration and Inspections
Public Company Accounting Oversight Board
1666 K Street NW
Washington, D.C. 20006-2803

Re: Response to Part I of the Draft Report on the 2018 Inspection of Ernst & Young LLP

Dear Mr. Botic:

Ernst & Young LLP is pleased to provide its response to Part I of the Public Company Accounting Oversight Board's (the "PCAOB") Draft Report on the 2018 Inspection of Ernst & Young LLP (the "Report").

The PCAOB has played an important role in strengthening audit quality since its formation in 2002. Through the inspection process, the PCAOB continues to help us and the profession identify areas for further attention where we can enhance our system of quality controls. We respect and benefit from this process as it aids us in fulfilling our responsibilities to investors, other stakeholders and the capital markets in general.

We have thoroughly evaluated the matters described in Part I of the Report and have taken appropriate actions to address the findings in accordance with AS 2901, Consideration of Omitted Procedures After the Report Date, and AS 2905, Subsequent Discovery of Facts Existing at the Date of the Auditor's Report.

We appreciate the opportunity to provide our response to the Report and look forward to continuing to work with the PCAOB on matters of interest to our public company auditing practice.

Respectfully submitted,

Kelly J. Grier
US Chair and Managing Partner

John L. King
US Vice Chair of Assurance

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Building a better working world

April 3, 2020

Mr. George Botic
Director
Division of Registration and Inspections
Public Company Accounting Oversight Board
1666 K Street NW
Washington, D.C. 20006-2803

Re: Response to Part II of the Draft Report on the 2018 Inspection of Ernst & Young LLP

Dear Mr. Botic:

Ernst & Young LLP is pleased to provide its response to Part II of the Public Company Accounting Oversight Board's (the "PCAOB") Draft Report on the 2018 Inspection of Ernst & Young LLP (the "Report").[1]

Our overriding objective is to continuously improve our auditing and quality control processes, and we are committed to working with you and your staff over the 12-month period following the issuance of the final report to address the matters described in Part II of the final inspection report. We have made it a priority to interact constructively with the inspection staff on remediation plans and follow-up actions, and this dialogue has resulted in our implementing changes to advance audit quality.

We respect the PCAOB's inspection process and believe it assists us in identifying areas where we can continue to improve audit quality. We value the PCAOB inspection process, and we take comments received from the Board and inspection staff seriously.

Respectfully submitted,

Kelly J. Grier
US Chair and Managing Partner

John L. King
US Vice Chair of Assurance

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[1] Section 104(g)(2) of the Sarbanes-Oxley Act requires that "no portions of the inspection report that deal with criticisms of or potential defects in the quality control systems of the firm under inspection shall be made public if those criticisms or defects are addressed by the firm, to the satisfaction of the Board, not later than 12 months after the date of the inspection report." Accordingly, we understand that our comments on Part II of the Draft Report remain non-public as long as Part II of the Report itself is non-public.

PRIVILEGED AND CONFIDENTIAL/SUBJECT TO SECTIONS 104(g)(2) AND 105(b)(5) OF THE SARBANES-OXLEY ACT AND REGULATIONS THEREUNDER.