2019 Inspection Ernst & Young LLP

(Headquartered in New York, New York)

December 17, 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. 104-2021-006A
(Includes portions of Part II and Appendix A of the full report that were not included in PCAOB Release No. 104-2021-006)

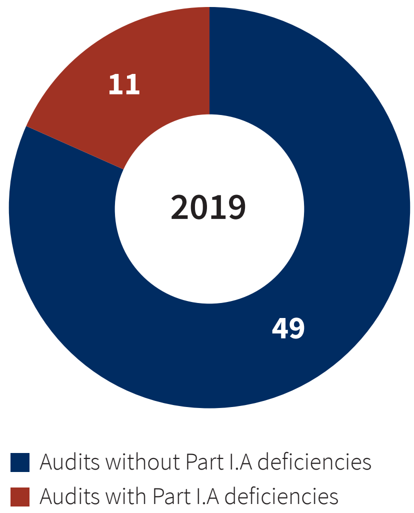
Executive Summary

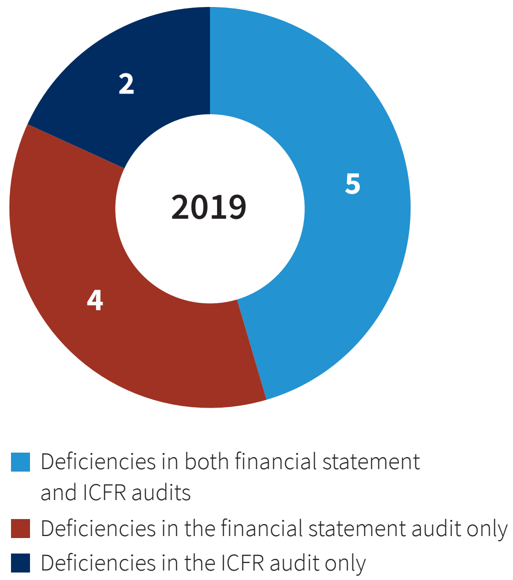
Our 2019 inspection report on Ernst & Young LLP provides information on our inspection to assess the firm's compliance with Public Company Accounting Oversight Board ("PCAOB") standards and rules and other applicable regulatory and professional requirements. This executive summary offers a high-level 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 2019 Deficiencies Included in Part I

Eleven of the 60 issuer audits we reviewed in 2019 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 revenue and related accounts, business combinations, and long-lived assets.





The most common Part I.A deficiencies in 2019 related to testing the design or operating effectiveness of controls selected for testing, substantively testing the accuracy and completeness of data or reports, and testing controls over the accuracy and completeness of data or reports.

Other deficiencies identified during the 2019 inspection that do not relate directly to the sufficiency or appropriateness of evidence the firm obtained to support its opinion(s), which appear in Part I.B, related to an audit report on ICFR, Form AP, and audit committee communications.

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2019 Inspection

During the PCAOB's 2019 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 60 audits of issuers with fiscal years generally ending in 2018. 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 2019 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.

2019 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 also select audits randomly to provide an element of unpredictability. In 2019, we established a target team to perform inspection procedures in areas of current audit risk and emerging topics. For our target team selections, our review focuses primarily on evaluating the firm's procedures related to that risk or topic.

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.

In 2019, our target team reviews focused, in part, on planning and execution of multi-location audits, including risk assessment, principal auditor considerations, and communications between the principal auditor and the other auditor. We also evaluated the firm's determination and communication of critical audit matters ("CAM"), in particular to understand the policies and procedures firms put in place to support and monitor the effective implementation of CAM requirements and how audit teams implemented CAM requirements.[1]

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.

1 Refer to Staff Update and Preview of 2019 Inspection Observations and Critical Audit Matters Spotlight for observations from the target team reviews. Instances of non-compliance with PCAOB standards and rules identified during the target team reviews are included in Part I.A or Part I.B of this report.

Overview of the 2019 Inspection and Historical Data by Inspection Year

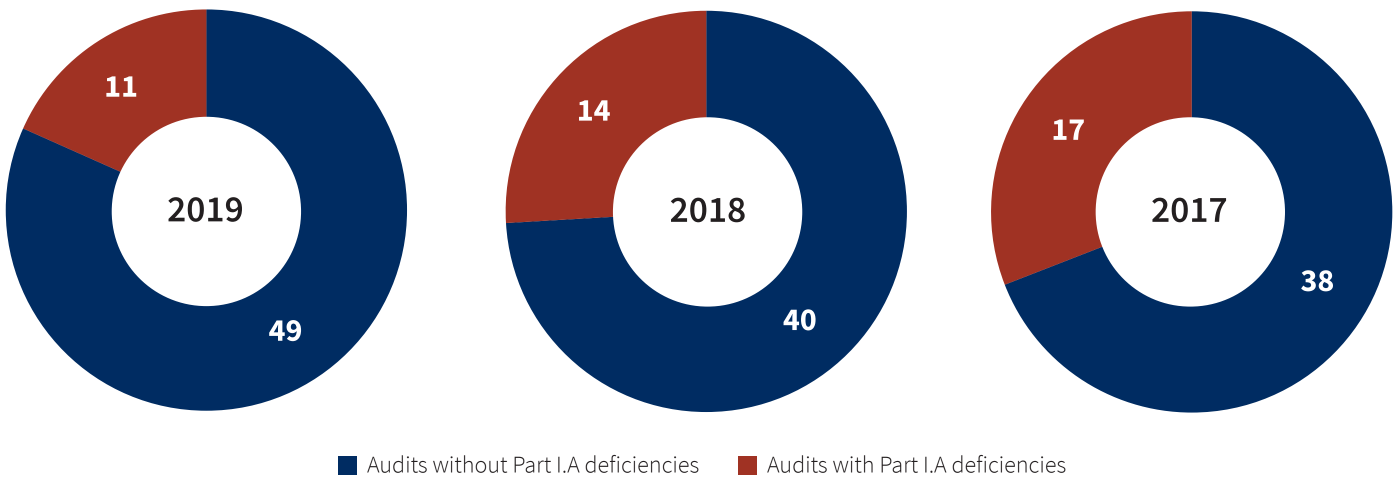
The following information provides an overview of our 2019 inspection as well as data from the previous two inspections. We use a combination of risk-based and random methods to select audits for review and to identify areas on which we focus our review. Because our inspection process evolves over time, it can, and often does, focus on a different mix of audits and audit 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

	2019	2018	2017
Total audits reviewed	60	54	55
Audits in which the firm was the principal auditor	58	54	54
Audits in which the firm was not the principal auditor	2	0	1
Integrated audits of financial statements and ICFR	54	53	53
Risk-based selections	41	44	45
Random selections	14	10	10
Target team selections	5	0	0

Part I.A Deficiencies in Audits Reviewed

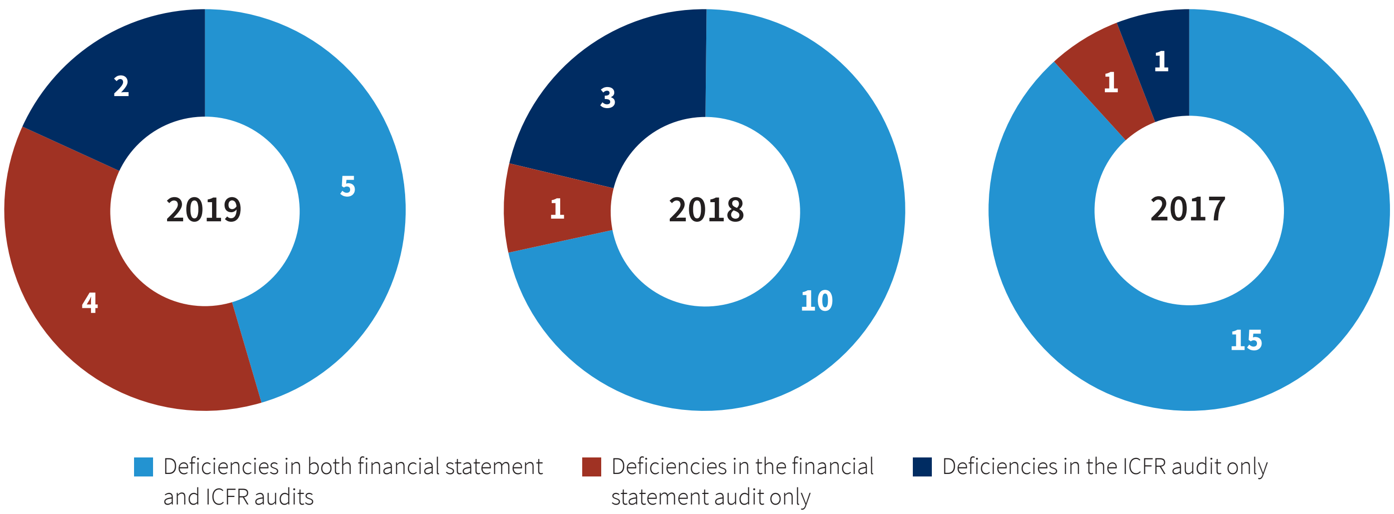
In 2019, ten of the 11 audits appearing in Part I.A were selected for review using risk-based criteria. In 2018, all 14 audits appearing in Part I.A were selected for review using risk-based criteria. In 2017, 14 of the 17 audits appearing in Part I.A were selected for review using risk-based criteria.



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 the current 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 2019 inspection procedures for two audits, the issuers revised their reports on ICFR, and the firm revised its opinions on the effectiveness of the issuer's ICFR to express adverse opinions and reissued its reports. 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.

The following tables and graphs summarize inspection-related information, by inspection year, for 2019 and the previous two inspections. We caution against making 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		
	2019	2018	2017
Did not perform sufficient testing of the accuracy and completeness of data and reports used in the firm's substantive testing	5	3	4
Did not sufficiently evaluate significant assumptions or data that the issuer used in developing an estimate	3	6	6
Did not perform sufficient testing related to an account or significant portion of an account or to address an identified risk	3	4	4

Deficiencies in ICFR audits	Audits with Part I.A deficiencies		
	2019	2018	2017
Did not perform sufficient testing of the design and/or operating effectiveness of controls selected for testing	6	10	11
Did not identify and/or sufficiently test controls over the accuracy and completeness of data and reports that the issuer used in the operation of controls	3	5	7
Did not identify and test any controls related to a significant account or relevant assertion	3	6	3

Audit Areas Most Frequently Reviewed

This table reflects the five audit 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.

2019			2018			2017		
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	39	7	**Revenue and related accounts**	44	4	**Revenue and related accounts**	46	8
Business combinations	18	2	**Inventory**	28	5	**Inventory**	22	6
Investment securities	13	1	**Business combinations**	19	6	**Goodwill and intangible assets**	18	1
Inventory	12	0	**Goodwill and intangible assets**	12	1	**Business combinations**	16	3
Goodwill and intangible assets	9	0	**Long-lived assets**	12	1	**Long-lived assets**	14	0

Audit Areas with Frequent Part I.A Deficiencies

This table reflects the audit 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	2019		2018		2017	
	Audits with Part I.A deficiencies	Audits reviewed	Audits with Part I.A deficiencies	Audits reviewed	Audits with Part I.A deficiencies	Audits reviewed
Revenue and related accounts	7	39	4	44	8	46
Business combinations	2	18	6	19	3	16
Long-lived assets	2	7	1	12	0	14
Allowance for loan losses	1	7	3	4	0	7
Investment securities	1	13	2	9	3	8

Revenue and related accounts: The deficiencies in 2019 and 2018 primarily related to substantive testing of, and testing controls over, revenue, including controls over information technology systems associated with revenue. The deficiencies in 2017 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.

Business combinations: The deficiencies in 2019, 2018, and 2017 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.

Long-lived assets: The deficiencies in 2019 primarily related to substantive testing of property, plant, and equipment and testing controls over various types of long-lived assets, including controls over information technology systems associated with long-lived assets. The deficiencies in 2018 related to performing substantive procedures to test, and testing controls over, the existence of long-lived assets.

Allowance for loan losses: The deficiencies in 2019 related to testing controls over the 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 2019 related to substantive testing of, and testing controls over, the categorization of investment securities. The deficiencies in 2018 and 2017 primarily related to testing the design effectiveness of controls over the valuation of investment securities.

Auditing Standards Associated with Identified Part I.A Deficiencies

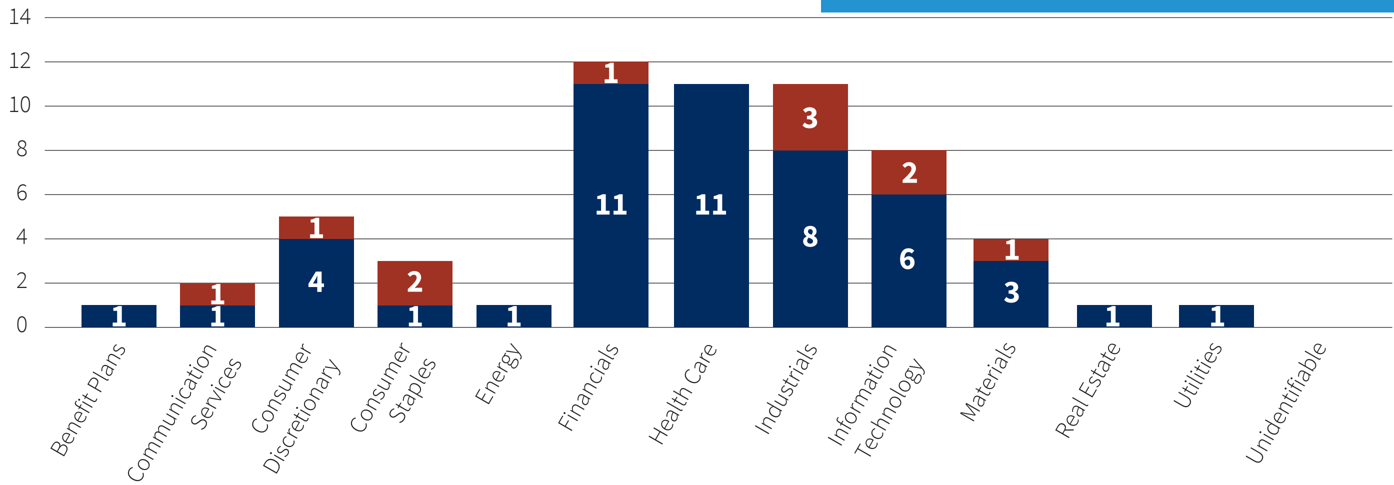
The following lists the auditing standards referenced in Part I.A of the 2019 and the previous two inspection reports and the number of times that the standard is cited in Part I.A.

PCAOB Auditing Standards	2019	2018	2017
AS 1105, *Audit Evidence*	7	4	3
AS 1210, *Using the Work of a Specialist*	0	0	1
AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*	20	37	37
AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*	3	9	5
AS 2305, *Substantive Analytical Procedures*	0	0	2
AS 2310, *The Confirmation Process*	1	0	0
AS 2315, *Audit Sampling*	1	5	5
AS 2501, *Auditing Accounting Estimates*	2	2	1
AS 2502, *Auditing Fair Value Measurements and Disclosures*	4	5	9
AS 2510, *Auditing Inventories*	0	1	3
AS 2605, *Consideration of the Internal Audit Function*	1	0	0
AS 2810, *Evaluating Audit Results*	0	1	4

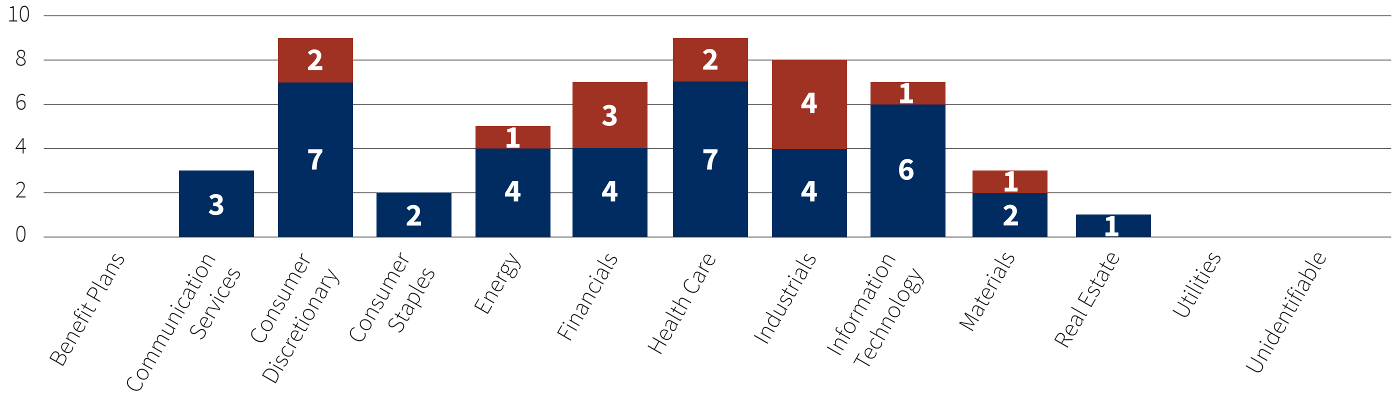
Inspection Results by Issuer Industry Sector

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. In instances where classifying an issuer using its industry sector could make an issuer identifiable, we have instead classified such issuer(s) as "unidentified."

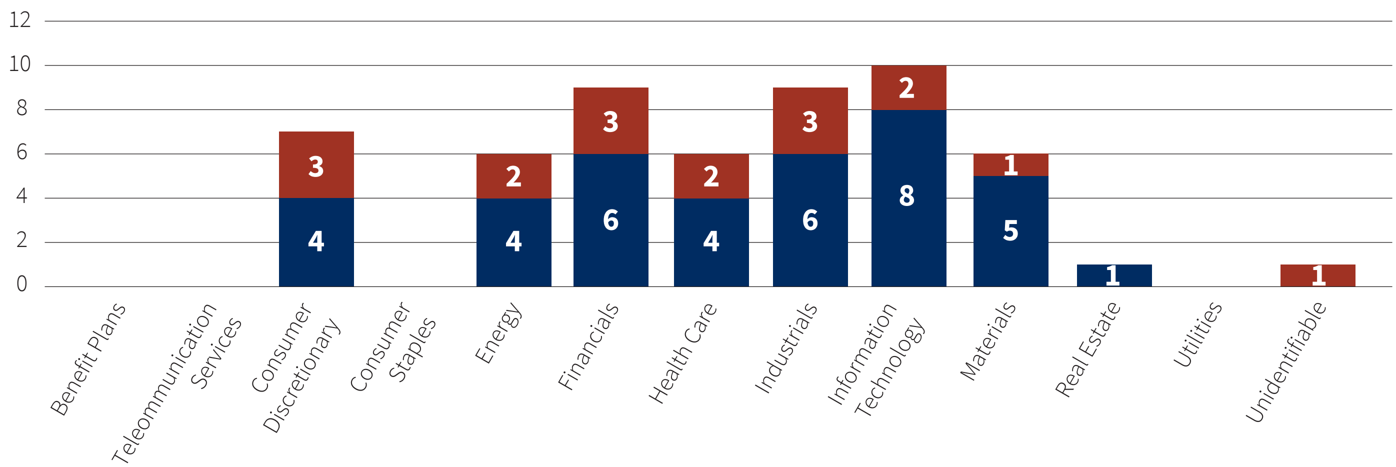
2019



2018



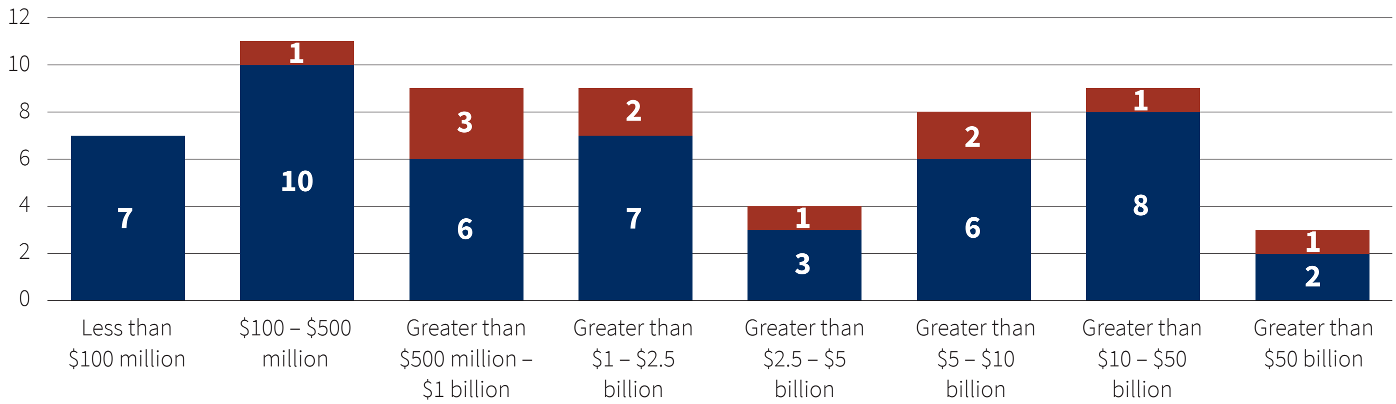
2017



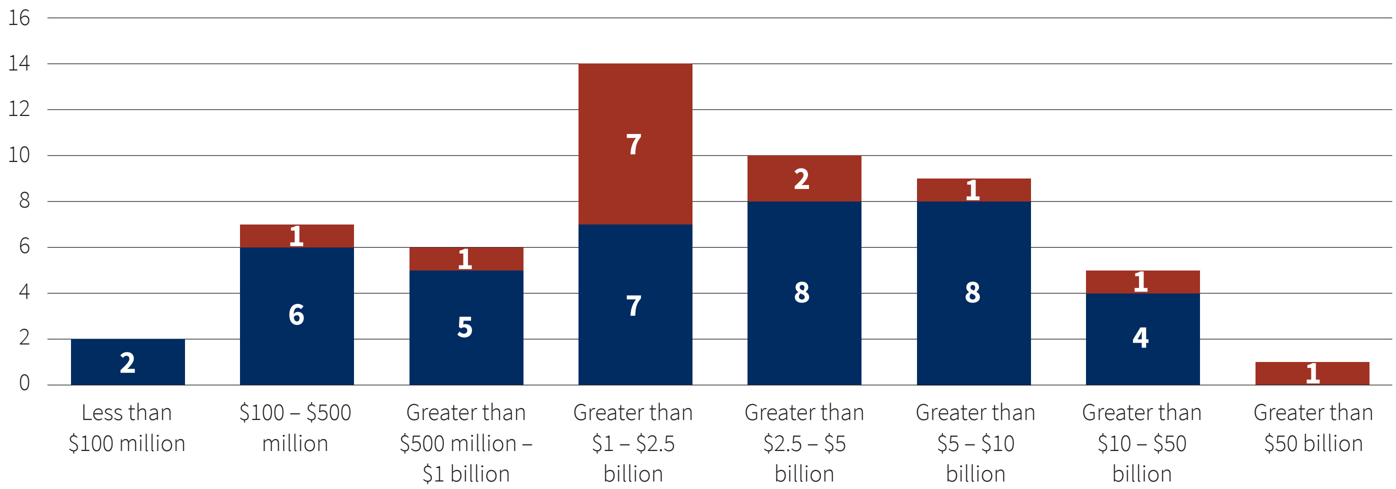
Audits without Part I.A deficiencies | Audits with Part I.A deficiencies

Inspection Results by Issuer Revenue Range

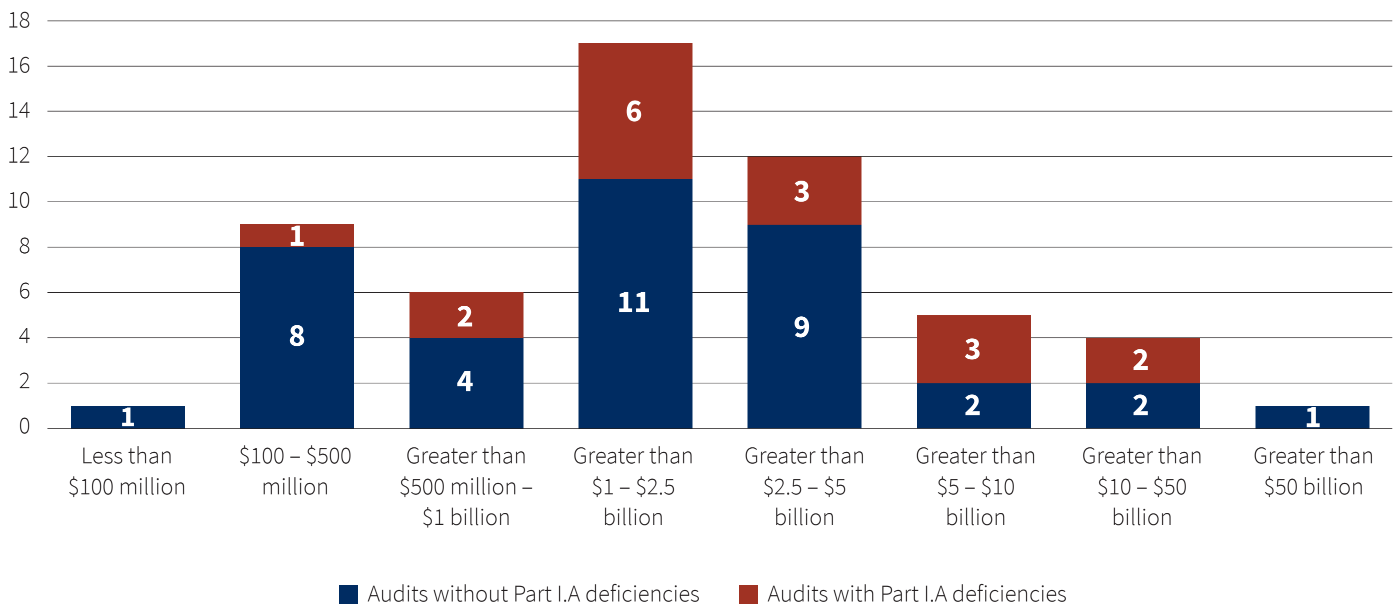
2019



2018



2017



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 a 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 a 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. This classification does not include instances where, unrelated to our review, an issuer restated its financial statements and/or an issuer's ICFR was determined to be ineffective. Any deficiencies identified in connection with our reviews of these audits would be included in the audits with multiple deficiencies or audits with a single deficiency classification below.

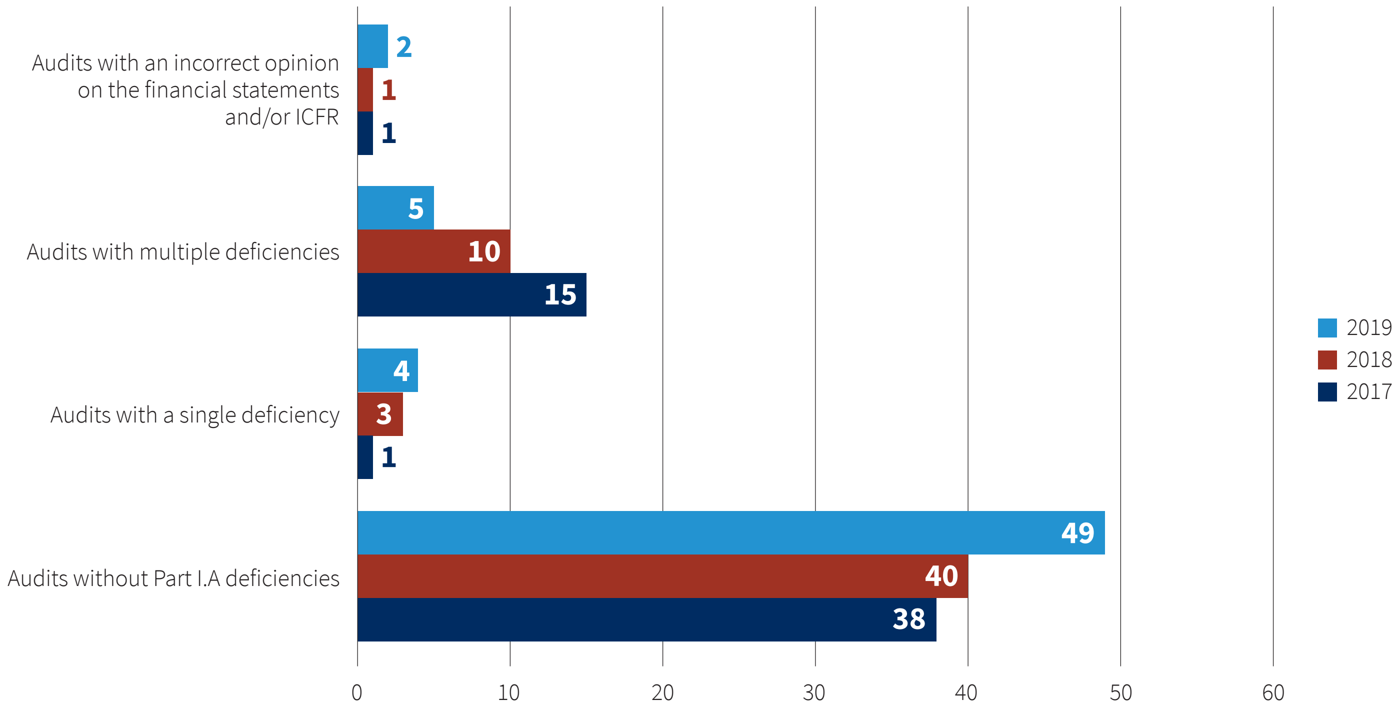
Audits with Multiple Deficiencies

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 – Information Technology

Type of audit and related areas affected

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

Description of the deficiencies identified

With respect to one type of **Revenue**:

The firm did not identify and test any controls over this revenue. (AS 2201.39)

The firm did not perform any substantive procedures to test this revenue. (AS 2301.08)

With respect to two other types of **Revenue** and **Deferred Revenue**:

The firm selected for testing controls over these two types of revenue and the related deferred revenue. The firm did not identify and test any controls over the accuracy and completeness of certain information that the control owners used in the performance of these controls. (AS 2201.39)

The firm did not perform substantive procedures to test, or (as discussed above) test controls over, the accuracy and completeness of certain information used in its substantive testing of this revenue and deferred revenue. (AS 1105.10)

In connection with our review, the issuer reevaluated its controls and concluded that a material weakness existed that had not been previously identified. The issuer subsequently revised its report on ICFR to reflect this material weakness, and the firm modified its opinion on the effectiveness of the issuer's ICFR to express an adverse opinion and reissued its report.

Issuer B – Information Technology

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 review of the assumptions underlying the cash-flow forecasts used in the valuation of the acquired intangible assets. The firm did not evaluate the review procedures that the control owners performed, including the procedures to identify items for follow up and the procedures to determine whether those items were appropriately resolved. (AS 2201.42 and .44)

In connection with our review, the issuer reevaluated its controls over accounting for business combinations and concluded that a material weakness existed that had not been previously identified. The issuer subsequently revised its report on ICFR to reflect this material weakness, and the firm revised its opinion on the effectiveness of the issuer's ICFR to express an adverse opinion and reissued its report.

The firm's approach for substantively testing the valuation of the acquired intangible assets was to review and test management's process. The firm performed 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 acquired intangible assets. The firm did not perform procedures, beyond inquiring of management, to evaluate the differences it identified in these comparisons. (AS 2502.26, .28, .31, and .36) In addition, the firm did not perform procedures, beyond inquiring of management, to evaluate the reasonableness of certain other assumptions underlying these cash-flow forecasts. (AS 2502.26, .28, .31, and .36)

Audits with Multiple Deficiencies

Issuer C – Communication Services

Type of audit and related areas affected

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

Description of the deficiencies identified

The issuer used multiple information-technology ("IT") systems to initiate, process, and record transactions related to certain revenue and property, plant, and equipment. The firm tested information technology general controls ("ITGCs") for these IT systems. The following deficiencies were identified:

- The firm selected for testing controls over managing developer-level access to these IT systems. The firm did not evaluate the procedures that the control owners performed to determine whether developers had the ability to migrate changes to production. (AS 2201.42 and .44)
- The issuer used various change management processes for these IT systems, including multiple tools to manage and migrate changes into the production environments. The firm's sampling approach for testing ITGCs related to change management and segregation of duties was inappropriate because it was based on an unsupported assumption that the population of ITGCs was homogeneous. (AS 2201.46)

- The firm did not test, or in the alternative, test any controls over, the accuracy and completeness of the system-generated reports that it used to select its sample for testing controls over change management. (AS 1105.10)
- The firm tested certain automated and IT-dependent manual controls that used data from these IT systems. As a result of the deficiencies in the firm's testing of ITGCs discussed above, the firm's testing of these automated and IT-dependent manual controls was not sufficient. (AS 2201.46)
- The firm used information that was produced by these IT systems in performing certain of its substantive procedures to test revenue, property, plant, and equipment, and related manual journal entries, but did not have a basis to rely on this information due to the deficiencies in the firm's testing of ITGCs discussed above. The firm did not test, or in the alternative, test any other controls over, the accuracy and completeness of this information. (AS 1105.10)

With respect to **Revenue**:

The issuer processed revenue for one of its business units using two billing systems. The firm selected for testing various automated controls related to the revenue recorded by both systems. The firm did not test the configuration of the automated controls or perform other procedures that would have provided sufficient appropriate audit evidence that the automated controls were designed and operating effectively. (AS 2201.42, .44, and .B9)

The sample sizes the firm used in certain of its substantive procedures to test 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 deficiencies in the firm's testing of ITGCs discussed and the deficiency in the firm's control testing related to certain revenue discussed above. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

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

The issuer incurred costs related to property, plant, and equipment, including costs of internally-developed software; certain of these costs were expensed and others were capitalized. The firm did not identify and test any controls that addressed whether (1) the non-software costs incurred for individual projects and (2) costs of internally-developed software were appropriately expensed or capitalized. (AS 2201.39)

The issuer assigned estimated useful lives to each type of property, plant, and equipment. The following deficiencies were identified:

- The firm selected for testing a control that consisted of the issuer's review of the estimated useful lives. The firm did not evaluate the review procedures that the control owners performed, including the procedures to identify items for follow up and the procedures to determine whether those items were appropriately resolved. (AS 2201.42 and .44)
- The firm did not perform sufficient substantive procedures to evaluate the reasonableness of the estimated useful lives because its procedures were limited to reading the useful life study prepared by an external specialist in a previous year and inspecting the issuer's depreciation schedule. (AS 2501.11)

The issuer's policy was to group all of its property, plant, and equipment when evaluating the assets for possible impairment because the cash flows were largely interdependent. The following deficiencies were identified:

- The firm selected for testing a control over the impairment of property, plant, and equipment, which included the determination of its asset groupings. The firm did not test, beyond inquiry, the aspect of the control that addressed the appropriateness of the issuer's conclusion that it had one asset group. (AS 2201.42 and .44)
- In concluding that the issuer's impairment assessment was reasonable, the firm did not sufficiently evaluate whether the issuer's identification of one asset group was appropriate because the firm's procedures were limited to reading the issuer's memorandum documenting its conclusion that there was no impairment of property, plant, and equipment. (AS 2501.11)

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")**, **Investments**, and **Deposit Liabilities**.

Description of the deficiencies identified

With respect to the **ALL** for loans that the issuer assessed collectively for impairment:

The firm selected for testing controls that included a committee's review of certain assumptions used to estimate this ALL. The firm did not evaluate the review procedures that the control owners performed, including the procedures to identify items for follow up and the procedures to determine whether those items were appropriately resolved. (AS 2201.42 and .44)

The firm selected for testing a control that consisted of the issuer's review of the assigned loan grades, which included a review by senior management of the assigned loan grades for certain loans. The loan grades were an important factor in estimating this ALL. The firm did not perform procedures to test the aspect of the control related to senior management's review of the assigned loan grades beyond inspecting loan files for sign-off as evidence of review. (AS 2201.42 and .44)

With respect to the **ALL** for loans that the issuer assessed individually for impairment:

The firm selected for testing a control that consisted of the issuer's review of loans that exceeded a loan grade threshold and the review of the impairment calculations for individually impaired loans. The firm did not evaluate the specific review procedures that the control owners performed to assess the reasonableness of certain inputs and assumptions underlying the impairment calculations for individually impaired loans. (AS 2201.42 and .44)

The firm selected for testing a control that consisted of the issuer's review of appraisals used to determine the fair value of the underlying collateral for collateral-dependent loans that it had determined to be individually impaired. The firm used only the work of the issuer's internal audit as evidence of the operating effectiveness of the control. This approach did not provide sufficient appropriate audit evidence that the control was operating as designed because of the amount of subjectivity involved in reviewing the appraised collateral values. (AS 2201.19; AS 2605.20 and .21)

With respect to **Investments**:

The firm selected for testing a control that included the issuer's review of the categorization of the available-for-sale and trading securities within the fair value hierarchy as set forth in FASB ASC Topic 820, *Fair Value Measurement*. The firm did not perform procedures to test the aspect of the control related to assessing the appropriateness of the categorization of these securities within the fair value hierarchy. (AS 2201.42 and .44)

The firm did not perform any substantive procedures to evaluate the appropriateness of the issuer's categorization of these securities within the fair value hierarchy. (AS 2502.43)

With respect to **Deposit Liabilities**:

During the year, the issuer acquired a business. The firm's procedures to test the acquired deposit liabilities included sending positive confirmation requests for deposit accounts over an established threshold. For the positive confirmations that were not returned, the firm did not perform alternative procedures that provided sufficient appropriate audit evidence that the recorded amounts of the acquired deposit liabilities were accurate as of the confirmation date. (AS 2310.31)

Issuer E – Industrials

Type of audit affected and related area

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 that consisted of the issuer's review of the cash-flow forecasts used in the valuation of certain acquired intangible assets. The firm did not evaluate the specific review procedures that the control owners performed to assess the reasonableness of a revenue assumption underlying the cash-flow forecasts. (AS 2201.42 and .44)

The firm's approach for substantively testing the valuation of certain acquired intangible assets was to review and test management's process. The firm did not perform procedures, beyond inquiring of management, to evaluate the reasonableness of a revenue assumption underlying the cash-flow forecasts for any of the periods beyond the first two years of the 20-year forecast period. (AS 2502.26, .28, .31, and .36)

Issuer F – Industrials

Type of audit and related areas affected

In our review, we identified deficiencies in the ICFR audit related to **Revenue** and **Long-lived Assets**.

Description of the deficiencies identified

The issuer used multiple IT systems to initiate, process, and record transactions related to certain revenue and long-lived assets. The following deficiencies were identified:

- The firm tested ITGCs for these IT systems. The firm selected for testing controls over change management that consisted of (1) the review and testing of planned changes to the IT systems and (2) approval of these changes prior to implementation into the production environment. The firm did not evaluate the specific procedures that the control owners performed to identify, evaluate the appropriateness of, and approve certain changes made to the IT systems. (AS 2201.42 and .44) In addition, the firm did not test or in the alternative, test controls over, the completeness of the population of changes that were processed internally by the issuer's IT personnel and that the firm used in its testing of the controls over change management. (AS 1105.10)
- The firm tested certain automated and IT-dependent manual controls over certain revenue and long-lived assets that used information from these IT systems. As a result of the deficiencies in the firm's testing of ITGCs discussed above, the firm's testing of these automated and IT-dependent manual controls was not sufficient because these controls used information generated by these IT systems. (AS 2201.46)

Issuer G – Industrials

Type of audit and related area affected

In our review, we identified deficiencies in the ICFR audit related to **Revenue**.

Description of the deficiencies identified

The firm selected for testing a control that consisted of the review of the issuer's accounting for certain revenue arrangements for conformity with GAAP. The firm did not identify and test any controls over the completeness of certain information that the control owners used in the performance of this control. (AS 2201.39)

The firm selected for testing a manual control that consisted of the review of pricing in all new and modified contracts. The sample that the firm used to test this control was too small to provide sufficient appropriate audit evidence that the control was operating effectively because it limited the sample to one contract modification. (AS 2201.44)

Audits with a Single Deficiency

Issuer H – Consumer Staples

Type of audit and related area affected

In our review, we identified a deficiency in the financial statement audit related to **Revenue**.

Description of the deficiency identified

The firm's approach for substantively testing certain revenue consisted primarily of performing a software-assisted analysis, which included performing procedures to test the accuracy of information used in this analysis. The software-assisted analysis was designed to test the relationships among revenue, accounts receivable, and cash that the issuer recorded through journal entries. The firm, however, did not perform procedures to test the appropriateness of the cash data used in this analysis. (AS 1105.10)

Issuer I – Consumer Staples

Type of audit and related area affected

In our review, we identified a deficiency in the financial statement audit related to **Revenue**.

Description of the deficiency identified

The firm's approach for substantively testing certain revenue consisted primarily of performing a software-assisted analysis, which included performing procedures to test the accuracy of information used in this analysis. The software-assisted analysis was designed to test the relationships between revenue and cash that the issuer recorded through journal entries. The firm, however, did not perform procedures to test the appropriateness of the cash data used in this analysis. (AS 1105.10)

Issuer J – Consumer Discretionary

Type of audit and related area affected

In our review of an audit in which the firm played a role but was not the principal auditor, we identified a deficiency in connection with the firm's role in the financial statement audit related to **Revenue**.

Description of the deficiency identified

The firm's approach for substantively testing certain revenue consisted primarily of performing a software-assisted analysis, which included performing procedures to test the accuracy of information used in this analysis. The software-assisted analysis was designed to test the relationships among revenue, accounts receivable, and cash that the issuer recorded through journal entries. The firm did not perform sufficient procedures to test the appropriateness of certain information used in this analysis because it did not perform procedures to test whether the cash receipts were relevant to the revenue being tested. (AS 1105.10)

Issuer K – Materials

Type of audit and related area affected

In our review, we identified a deficiency in the financial statement audit related to **Pension Assets**.

Description of the deficiency identified

The issuer reported its pension plan assets at fair value. The firm did not perform any substantive procedures to test the valuation of certain of the issuer's pension plan assets it had planned to test. (AS 2301.08)

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 areas below were not necessarily reviewed on every audit. In some cases, we assess the firm's compliance with specific PCAOB standards or rules on other audits that were not otherwise selected for review and may include instances of non-compliance below.

The deficiencies below are presented in numerical order based on the PCAOB standard or rule with which the firm did not comply. We identified the following deficiencies:

- In two of 14 audits reviewed, the firm was the principal auditor but did not obtain, and review and retain, letters of representation from management that its foreign affiliates had obtained for certain of the issuer's non-U.S. components. In these instances, the firm was non-compliant with AS 1205, *Part of the Audit Performed by Other Independent Auditors*.
- In one of 18 audits reviewed, the firm did not include in its report on ICFR a disclosure regarding the exclusion of acquired businesses from the scope of both management's assessment and the firm's audit of ICFR. In this instance, the firm was non-compliant with AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.
- In one of 13 audits reviewed, the firm's report on Form AP omitted information related to the participation in the audit by certain other accounting firms. In this instance, the firm was non-compliant with PCAOB Rule 3211, *Auditor Reporting of Certain Audit Participants*.
- In one of 10 audits reviewed, the firm's required written communications to the audit committee were insufficient as the firm did not include a description of the nature and scope of certain tax services. In this instance, the firm was non-compliant with PCAOB Rule 3524, *Audit Committee Pre-approval of Certain Tax Services*.

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.

Supervision of the Audit

The inspection results indicate that the firm's system of quality control does not provide reasonable assurance that the supervisory activities, including reviews of audit work, performed by the firm's engagement partners will meet the requirements of AS 1201. (QC 20.03 and .17)

In 11 audits,[2] 10 of which are included in Part I.A,[3] and one of which is included in Part I.B,[4] the inspection team identified one or more deficiencies that the engagement partner should have identified and appropriately addressed but did not. In two of these audits,[5] the engagement team had identified a significant risk, including in one case a fraud risk, in the area in which a deficiency was identified.

* * * *

Internal Inspection Program

The inspection results indicate that the firm's system of quality control related to monitoring does not provide reasonable assurance that the firm's internal inspection program is suitably designed and is being effectively applied. (QC 20.20)

The firm's internal inspection program is one of the firm's mechanisms to assess compliance with firm policies, procedures, and applicable professional and regulatory standards. The PCAOB reviewed five issuer audits[6] that had also been inspected under the firm's internal inspection program. In two of these audits where the same areas were reviewed,[7] the PCAOB identified Part I.A deficiencies that were not detected by the internal inspectors.

2 Issuers A, B, C, D, E, G, H, I, J, K, and L

3 Issuers A, B, C, D, E, G, H, I, J, and K

4 Issuer L

5 Issuers D and E

6 Issuers E, H, L, M, and N

7 Issuers E and H

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, 2019, the firm identified that * * * * 32 percent of the managers who were audited had not reported 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.

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

December 2, 2020

Re: Response to Part I of the Draft Report on the 2019 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 (PCAOB) Draft Report on the 2019 Inspection of Ernst & Young LLP (the Report).

The PCAOB continues to play an important role in strengthening audit quality, and we support its efforts to innovate and explore new ways to prevent audit deficiencies, which include increasing its focus on a firm's system of quality control, establishing target teams and communicating leading practices. We respect and value this innovation because it is helping us and the profession enhance audit quality for the benefit of investors, other stakeholders and the capital markets in general. In addition, our ongoing dialogue with the PCAOB inspection team, through both the inspection and reporting processes, helps us identify areas where we can enhance our auditing and quality control processes.

Performing high-quality audits with independence, integrity and professional skepticism is at the heart of our responsibilities as auditors. While we are facing significant uncertainties in our working world and society in general right now, our commitment to audit quality remains constant.

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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December 2, 2020

Re: Response to Part II of the Draft Report on the 2019 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 (PCAOB) Draft Report on the 2019 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 Report. We make it a priority to interact constructively with the inspection staff on remediation plans and follow-up actions, and, as a result of this dialogue, we have implemented changes to advance audit quality.

We value the PCAOB inspection process, and we take comments received from the PCAOB and inspection staff seriously.

Respectfully submitted,

Kelly J. Grier
US Chair and Managing Partner

John L. King
US Vice Chair of Assurance

[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 nonpublic as long as Part II of the Report itself is nonpublic.