

Report on
2004 Inspection of Ernst & Young LLP

Issued by the
Public Company Accounting Oversight Board

November 17, 2005

THIS IS A PUBLIC VERSION OF A PCAOB INSPECTION REPORT

**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**

Preface to Reports Concerning Annually Inspected Firms

The Sarbanes-Oxley Act of 2002 requires the Public Company Accounting Oversight Board ("the Board") to conduct an annual inspection of each registered public accounting firm that regularly provides audit reports for more than 100 issuers. The Board's report on any such inspection includes this preface to provide context for information in the public portion of the report.

A Board inspection includes, among other things, a review of selected audits. If the Board inspection team identifies deficiencies in those audits, it alerts the firm to the deficiencies during the inspection process. Deficiencies that exceed a certain significance threshold are also summarized in the public portion of the Board's inspection report. The Board encourages readers to bear in mind two points concerning those reported deficiencies.

First, inclusion in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. Under PCAOB standards, a firm must take appropriate action to assess the importance of the deficiency to the firm's present ability to support its previously expressed audit opinions. Depending upon the circumstances, compliance with these standards may require the firm to perform additional audit procedures, or to inform a client of the need for changes to its financial statements, or to take steps to prevent reliance on previously expressed audit opinions. A Board inspection does not typically include review of a firm's actions to address deficiencies identified in that inspection, but the Board expects that firms are attempting to take appropriate action, and firms frequently represent that they have taken, are taking, or will take action. If, through subsequent inspections or other processes, the Board determines that the firm failed to take appropriate action, that failure may be grounds for a Board disciplinary sanction.

Second, the Board cautions against drawing conclusions about the comparative merits of these firms based on the number of reported deficiencies in any given year. The total number of audits reviewed is a small portion of the total audits performed by these firms, and the frequency of deficiencies identified does not necessarily represent the frequency of deficiencies throughout the firm's practice. Moreover, if the Board discovers a potential weakness during an inspection, the Board may revise its inspection plan to target additional audits that may be affected by that weakness, and this may increase the number of deficiencies reported for that firm in that year. Such weaknesses may emerge in varying degrees at different firms in different years.

Notes Concerning this Report

1. Portions of this report may describe deficiencies or potential deficiencies in the systems, policies, procedures, practices, or conduct of the firm that is the subject of this report. The express inclusion of certain deficiencies and potential deficiencies, however, should not be construed to support any negative inference that any other aspect of the firm's systems, policies, procedures, practices, or conduct is approved or condoned by the Board or judged by the Board to comply with laws, rules, and professional standards.
2. Any references in this report to violations or potential violations of law, rules, or professional standards should be understood in the supervisory context in which this report was prepared. Any such references are not a result of an adversarial adjudicative process and do not constitute conclusive findings of fact or of violations for purposes of imposing legal liability. Similarly, any description herein of a firm's cooperation in addressing issues constructively should not be construed, and is not construed by the Board, as an admission, for purposes of potential legal liability, of any violation.
3. Board inspections encompass, among other things, whether the firm has failed to identify departures from Generally Accepted Accounting Principles ("GAAP") in its audits of financial statements. This report's descriptions of any such auditing failures necessarily involve descriptions of the related GAAP departures. The Board, however, has no authority to prescribe the form or content of an issuer's financial statements. That authority, and the authority to make binding determinations concerning an issuer's compliance with GAAP, rests with the Securities and Exchange Commission ("SEC" or "Commission"). Any description, in this report, of perceived departures from GAAP should not be understood as an indication that the Commission has considered or made any determination regarding these GAAP issues unless otherwise expressly stated.

2004 INSPECTION OF ERNST & YOUNG LLP

In 2004, the Public Company Accounting Oversight Board ("PCAOB" or "Board") conducted an inspection of Ernst & Young LLP ("E&Y" or "the Firm"). The Board is today issuing this report of that inspection in accordance with the requirements of the Sarbanes-Oxley Act of 2002 ("the Act").

The Board is making portions of the report publicly available. Specifically, the Board is releasing to the public Part I of the report, Appendix B, and portions of Appendix C. Appendix B provides an overview of the inspection process. Appendix C consists of the Firm's comments, if any, on a draft of the report.^{1/}

The Board has elsewhere described in detail its approach to making inspection-related information publicly available consistent with legal restrictions.^{2/} A substantial portion of the Board's criticisms of a firm (specifically criticisms of the firm's quality control system), and the Board's dialogue with the firm about those criticisms, occurs out of public view, unless the firm fails to make progress to the Board's satisfaction in addressing those criticisms. In addition, the Board generally does not disclose otherwise nonpublic information, learned through inspections, about the firm or its clients. Accordingly, information in those categories generally does not appear in the publicly available portion of an inspection report.

^{1/} The Board does not make public any of a firm's comments that address a nonpublic portion of the report. 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 at all. The Board notes that it routinely grants confidential treatment, if requested, for any of a firm's comments that identify factually inaccurate statements in the draft that the Board corrects in the final report.

^{2/} See Statement Concerning the Issuance of Inspection Reports, PCAOB Release No. 104-2004-001 (August 26, 2004).

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's inspection staff ("the inspection team") performed an inspection of E&Y from July 2004 to December 2004. The inspection team performed field work at E&Y's national office ("National Office") and at 16 of its 86 practice offices. In addition, the inspection team observed the performance of E&Y's internal inspection program at two practice offices. Appendix B to this report provides a description of the procedures the inspection team performed.

Board inspections are designed to identify and address weaknesses and deficiencies related to how a firm conducts audits. To achieve that goal, Board inspections include reviews of certain aspects of selected audits performed by the firm and reviews of other matters related to the firm's quality control system. Appendix B to this report provides a description of the steps the inspection team took with respect to the review of audit engagements and the review of the seven functional areas related to quality control.

In the course of reviewing aspects of selected audits, an inspection may identify ways in which a particular audit is deficient, including failures by the firm to identify, or to address appropriately, respects in which an issuer's financial statements do not present fairly the financial position, results of operations, or cash flows of the issuer in conformity with GAAP.^{3/} It is not the purpose of an inspection, however, to review all of a firm's audits or to identify every respect in which a reviewed audit is deficient. Accordingly, a Board inspection report should not be understood to provide any assurance that the firm's audits, or its issuer clients' financial statements, are free of any deficiencies not specifically described in an inspection report.

^{3/} When it comes to the Board's attention that an issuer's financial statements appear not to present fairly, in a material respect, the financial position, results of operations, or cash flows of the issuer in conformity with GAAP, the Board reports that information to the SEC, which has jurisdiction to determine proper accounting in issuers' financial statements.

A. Review of Audit Engagements

The scope of the inspection procedures performed included reviews of aspects of selected audits performed by the Firm. Those audits and aspects were selected according to the Board's criteria, and the Firm was not allowed an opportunity to limit or influence the selection process.

In reviewing the audits, the inspection team identified matters that it considered to be audit deficiencies. Those deficiencies included failures by the Firm to identify or appropriately address errors in the issuer's application of GAAP, including, in some cases, errors that appeared likely to be material to the issuer's financial statements. The deficiencies also included failures by the Firm to perform, or to perform sufficiently, certain necessary audit procedures.

When audit deficiencies are identified after the date of the audit report, PCAOB standards require a firm to take appropriate actions to assess the importance of the deficiencies to the firm's present ability to support its previously expressed opinions,^{4/} and failure to take such actions could be a basis for Board disciplinary sanctions. In response to the inspection team's identification of deficiencies, the Firm, in some cases, performed additional procedures or supplemented its work papers. In some instances in which the inspection team identified GAAP departures, follow-up between the Firm and the issuer led to a change in the issuer's accounting or disclosure practices or led to representations related to prospective changes.^{5/}

In some cases, the deficiencies identified were of such significance that it appeared to the inspection team that the Firm had not, at the time it issued its audit report, obtained sufficient competent evidential matter to support its opinion on the issuer's financial statements. In some of those audits, that conclusion followed from the

^{4/} See AU 390, *Consideration of Omitted Procedures After the Report Date*, and AU 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* (both included among the PCAOB's interim auditing standards, pursuant to PCAOB Rule 3200T).

^{5/} The Board inspection process generally did not include review of such additional procedures or documentation, or of such revised accounting, although future Board inspections of the Firm may, as appropriate, include further review of any of these matters.

omission, or insufficient performance, of a single procedure, while other audits included more than one such failure. The deficiencies that reached this degree of significance are described below (without identifying the issuers).^{6/} The deficiencies are discussed here on an audit-by-audit basis, with the exception of certain types of deficiencies that were observed to recur in multiple audits and are therefore grouped together.

Issuer A

In this audit, the Firm failed to identify a departure from GAAP that it should have identified and addressed before issuing its audit report.^{7/} The issuer accounted for a lease as an operating lease, despite the presence of conditions that made such accounting inappropriate under Statement of Financial Accounting Standards ("SFAS") No. 13, *Accounting for Leases*. As a result, the asset and the debt attributable to the leased property were not reflected in the issuer's 2003 balance sheet, as they should have been.

Issuer B

In this audit, the Firm failed to identify a departure from GAAP that it should have identified and addressed before issuing its audit report.^{8/} The issuer disclosed in the notes to its financial statements two reportable segments despite the presence of information that indicated the issuer was organized in more than two reportable segments as defined by SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*. The improper aggregation of reporting segments resulted in the offsetting of operating profits at one segment with losses at another.

^{6/} The discussion in this report of any deficiency observed in a particular audit reflects information reported to the Board by the inspection team and does not reflect any determination by the Board as to whether the Firm has engaged in any conduct for which it could be sanctioned through the Board's disciplinary process.

^{7/} This issuer has restated its 2003 balance sheet in its 2004 Form 10-K to make changes relating to the matter described here.

^{8/} The issuer revised its segment reporting in the financial statement disclosures included in its 2004 Form 10-K to make changes associated with the matter described here.

Issuer C

In this audit, the Firm failed in several respects to obtain sufficient competent evidential matter to support its audit opinion –

The issuer recorded revenue, approximating 15 percent of its pre-tax income, related to a fee received in conjunction with the issuance of a letter of credit on behalf of a customer with whom it was negotiating a significant construction contract. The Firm failed to obtain sufficient evidence, through confirmations with the customer or otherwise, regarding the substance of the agreements entered into between the issuer and the customer. In light of the circumstances surrounding the agreements, such evidence was necessary in order to evaluate the appropriateness of the issuer's recognition of fee revenue from the issuance of the letter of credit.

The Firm proposed a judgmental audit adjustment (which the issuer recorded) to increase the issuer's reserve for excess and obsolete inventory, even though the Firm's work papers did not include documentation supporting percentages used to estimate this reserve. After the Firm proposed this audit adjustment, the issuer's chief executive officer proposed an adjustment to increase the value of inventory received in a bankruptcy settlement, which was contrary to the issuer's earlier conclusion that the bankruptcy settlement accounting would result in no gain or loss. This adjustment was equal to and offset the excess and obsolete inventory adjustment described above. The Firm failed to assess, or failed to include evidence in the work papers that it assessed, whether the offsetting adjustments described above and another set of offsetting year-end adjustments relating to the accounting for major construction contracts (which in total approximated 24 percent of the issuer's pre-tax income) indicated a bias in management's estimates that could result in material misstatement of the financial statements, and/or a need for the Firm to reevaluate planned audit procedures.

Finally, the work papers contain no evidence that the Firm assessed the appropriateness of an addition to goodwill that the issuer recorded – subsequent to its initial accounting for an acquisition – to adjust the purchase accounting for a contingency in a contract assumed as part of the acquisition.

Auditing the Allowance for Loan Losses (Four Issuers)

The inspection team identified deficiencies in the Firm's testing of the allowance for loan losses ("ALL") in the audits of four banks. The unallocated component of the

ALL for three of these banks represented 13, 24 and 37 percent of the respective bank's total ALL. In each of these audits, the Firm failed to obtain sufficient evidence, or failed to include sufficient evidence in its work papers, that the unallocated component of the allowance represented a supportable estimate of probable losses inherent in the issuer's loan portfolio. The Firm's documented testing specific to this aspect of the banks' ALL was limited to certain high level analytical procedures that were not substantive tests and, while the Firm had performed various procedures related to the ALL generally and to the other components of the ALL, the work papers did not contain any evaluation of how the results of these procedures affected the Firm's assessment of the unallocated component of the ALL.

In the fourth audit, the Firm was aware of indications of deficiencies in the operating effectiveness of the issuer's controls over the allowance for loan losses. Particularly in light of the highly judgmental nature of the area, the Firm's knowledge of such indications rendered its assessment of the control risk with respect to the allowance for loan losses as "minimum" inappropriate. (Issuers D, E, F, and G)

Issuer H

In this audit, the Firm failed to perform, or failed to include in the work papers evidence that it performed, sufficient analysis to assess the appropriateness of the issuer's classification of a divested business as a discontinued operation. In connection with the divestiture, the issuer entered into certain agreements with the acquirer which called into question whether the operations and cash flows of the divested business would be eliminated from the ongoing operations of the issuer, and thus whether presentation of the divested business as a discontinued operation was appropriate.

B. Review of Quality Control System

In addition to evaluating the quality of the audit work performed on specific audits, the inspection included review of certain of the Firm's practices, policies and procedures related to audit quality. This review addressed practices, policies, and procedures concerning audit performance and the following seven functional areas (1) tone at the top; (2) practices for partner evaluation, compensation, promotion, assignment of responsibilities and disciplinary actions; (3) independence implications of non-audit services; business ventures, alliances and arrangements; and commissions and contingent fees; (4) client acceptance and retention; (5) the Firm's internal inspection program; (6) practices for establishment and communication of audit policies,

procedures and methodologies, including training; and (7) the supervision by U.S. audit engagement teams of the work performed by foreign affiliates on foreign operations of U.S. audit clients. Any defects in, or criticisms of, the Firm's quality control system, are discussed in the nonpublic portion of this report and will remain nonpublic unless the Firm fails to address them to the Board's satisfaction within 12 months of the date of this report.

END OF PART I

PART II, PART III, AND APPENDIX A OF THIS REPORT ARE NONPUBLIC
AND ARE OMITTED FROM THIS PUBLIC DOCUMENT

APPENDIX B

THE INSPECTION PROCESS

The inspection process was designed and performed to provide a basis for assessing the degree of compliance of E&Y with applicable requirements and standards related to auditing issuers. This process included reviews of components of selected issuer audit engagements completed by E&Y. These reviews were intended both to identify deficiencies, if any, in the conduct of those audits and to determine whether the results of these audits indicated deficiencies in the design or operation of the Firm's system of quality controls over audits. In addition, the inspection included reviews of the design and, in some cases, the application of procedures related to certain functional areas of E&Y that could be expected to influence audit quality.

1. Review of Selected Audit Engagements

The inspection team reviewed aspects of selected audits performed by E&Y. The inspection team chose the engagements according to the Board's criteria. E&Y was not allowed an opportunity to limit or influence the engagement selection process or any other aspect of the review.

For each audit engagement selected, the inspection team reviewed the issuer's financial statements and certain SEC filings. The inspection team selected certain higher-risk areas for review and, at the practice offices, inspected the engagement team's work papers and interviewed engagement personnel regarding those areas. The areas subject to review included, but were not limited to, revenues, reserves or estimated liabilities, derivatives, income taxes, related party transactions, supervision of work performed by foreign affiliates, assessment of risk by the audit team, and testing and documentation of internal controls by the audit team. The inspection team also analyzed potential adjustments to the issuer's financial statements that had been identified during the audit but not recorded in the financial statements. For some of the engagements, the inspection team reviewed written communications between E&Y and the issuer's audit committee. With respect to certain engagements, the inspection team also interviewed the chairperson of the issuer's audit committee.

When the inspection team identified a potential issue, it discussed the issue with members of the audit engagement team. If the inspection team was unable to resolve the issue through this discussion and any review of additional work papers or other

documentation, the inspection team ordinarily requested the engagement team to consult, as necessary, with the Firm's national PPDs.

2. Review of Seven Functional Areas

The inspection team conducted the procedures related to the review of the seven functional areas primarily at E&Y's national office. With respect to six of the functional areas, the inspection team also conducted procedures at certain of the Firm's practice offices. These procedures built on the foundation that was laid during the Board's limited inspection during 2003. The inspection team performed these procedures both to identify possible defects in E&Y's system of quality controls and to update the Board's knowledge of the Firm's policies and procedures in the seven functional areas. A more detailed description of the scope with respect to each of the seven functional areas follows.

a. Review of Partner Evaluation, Compensation, Promotion and Assignment of Partner Responsibilities and Discipline

The inspection team reviewed the Firm's policies and procedures related to partner evaluation; partner compensation; nomination and admission of new partners; and discipline, assignment of duties and termination of partners. The inspection procedures were designed to provide a basis for an assessment of whether the design of these processes, as documented and communicated, could be expected to encourage an appropriate emphasis on audit quality and technical competence, as compared to marketing or other activities of the Firm.

The inspection team interviewed members of E&Y's leadership at its National Office, as well as members of leadership and audit partners in practice offices, regarding these topics. In addition, the inspection team analyzed schedules provided by E&Y that detailed information on each partner, including the partner's location, recent evaluation history, and compensation history. The inspection team also reviewed a sample of partners' personnel files, including files of newly admitted partners, partners who resigned or took early retirement, and partners who received bonus compensation.

b. Review of Independence Policies

The objectives of the inspection procedures in this area included evaluating E&Y's policies and procedures relating to its compliance with independence

requirements with respect to the provision of non-audit services to issuer clients; Firm participation in business ventures, alliances, and arrangements; contingent fee arrangements; and the provision of services pursuant to Section 404 of the Act. To accomplish these objectives, the inspection team reviewed E&Y's policies, procedures, guidance, and training materials pertaining to these independence matters. The inspection team also reviewed E&Y's internal inspection program as it relates to monitoring compliance with E&Y independence policies and procedures; examined the Firm's independence consultation process, which included reviewing a sample of independence consultations; and reviewed information concerning E&Y's existing business ventures, alliances and arrangements, as well as the Firm's process for establishing such enterprises. The inspection team also interviewed numerous National Office and practice office personnel regarding E&Y independence policies, practices and procedures.

For each of the engagements selected for review, the inspection team reviewed relevant information to identify any non-audit services performed for the issuer, including whether any of the services involved contingent fee arrangements, as well as any business ventures, alliances, or arrangements with the issuer; and to determine whether the fees for the services provided are classified appropriately in the issuer's most recent proxy statement. In addition, the inspection team read and evaluated the most recent letter issued pursuant to Independence Standards Board ("ISB") Standard No. 1, *Independence Discussions with Audit Committees*.

c. Review of Client Acceptance and Retention Policies

The primary objectives of the inspection procedures in this area were to evaluate whether the Firm's client acceptance and retention policies and procedures reasonably assure that it is not associated with issuers whose management lacks integrity, that it undertakes only engagements within its professional competence, and that it appropriately considers the risks involved in accepting and retaining clients in the particular circumstances. Toward those objectives, the inspection team reviewed E&Y's policies, procedures and forms related to client acceptance and continuance; evaluated documentation related to new clients and to clients that had recently changed auditors from E&Y; and interviewed members of the Firm's leadership.

At the practice offices, the inspection team selected a sample from the engagements it reviewed and, for that sample, evaluated whether the client continuance documentation was completed and approved in accordance with Firm policies;

interviewed the audit partners and managers on these engagements concerning the reasons for continuing to serve the issuer, the approval process, and whether specific risk mitigation steps were performed and documented in response to any identified risks; and assessed whether the audit planning documentation incorporated the specific actions, if any, developed in response to any identified risks.

d. Review of Internal Inspection Program

The objectives of the inspection procedures in this area were to evaluate the effectiveness of E&Y's annual internal inspection program in enhancing audit quality, as well as to assess the Firm's compliance with the quality control standards adopted by the Board. To meet those objectives, the inspection team reviewed policies, procedures, guidance and forms at E&Y's National Office related to its internal inspection program, documentation of the results of the current year's inspection program, and steps taken by the Firm in response to those results. The inspection team also interviewed E&Y's leadership concerning the process and effectiveness of its internal inspection program.

The inspection team reviewed and tested the conduct of the internal inspection program by performing field work in eight practice offices where the Firm conducted internal inspections. These procedures included evaluating the qualifications of the Firm's inspectors, reading the inspectors' comments, and interviewing both area leadership and selected audit personnel concerning the internal inspection program. In addition, for a sample of the engagements that the internal inspectors had reviewed at these practice offices, the inspection team reviewed documentation of the internal inspectors' review of the engagements, reviewed certain aspects of the audit work papers, and discussed with E&Y any significant differences in the results of the inspection team's review and that of the Firm's internal inspectors.

e. Review of Practices for Establishment and Communication of Audit Policies, Procedures and Methodologies, Including Training

The objectives of the inspection procedures in this area were to update the inspection team's understanding of the Firm's processes for establishing and communicating audit policies, procedures and methodologies, including training; to evaluate whether the design of these processes could be expected to promote audit quality and enhance compliance; and to evaluate changes in audit policy the Firm has made since the 2003 limited inspection.

Toward those objectives, the inspection team reviewed documentation relating to the Firm's method for developing policies and procedures, as well as internal guidance and/or training materials distributed to audit personnel with respect to recent changes in requirements and to selected specific areas. The inspection team also evaluated the effectiveness of the design of E&Y's processes for monitoring developments that could affect the Firm's audit policies, procedures and methodologies.

f. Review of Policies Related to Foreign Affiliates

The inspection team performed procedures in this area to evaluate the processes E&Y uses to ensure that audit work performed by its foreign affiliates on the foreign operations of U.S. issuers is effective and in accordance with standards established by the Board. The inspection team did not inspect the audit work of foreign affiliates; rather, the inspection procedures in this area were limited to the supervision and control exercised by the U.S. engagement team over such work.

To accomplish this objective, the inspection team reviewed E&Y's policies and procedures related to its supervision and control of work performed by foreign affiliates on the foreign operations of U.S. issuer clients; analyzed audit guidance related to planning and administering multi-location engagements; and reviewed available information relating to the most recent foreign affiliated firms' internal inspections. In addition, the inspection team interviewed members of the Firm's leadership with responsibility for oversight of the work performed by foreign affiliates on foreign operations of U.S. issuer clients. Finally, with respect to a sample of engagements selected from the engagements chosen for review, the inspection team reviewed the U.S. engagement team's supervision and control procedures concerning the audit work performed by the Firm's foreign affiliates.

g. Review of Tone at the Top

The primary objective of the review of E&Y's "tone at the top" was to assess whether actions and communications by the Firm's leadership demonstrate a commitment to audit quality and compliance with the Act, the rules of the Board, the rules of the Securities and Exchange Commission, and PCAOB standards in connection with the Firm's performance of audits, issuance of audit reports, and related matters involving issuers. Toward that end, the inspection team reviewed and analyzed information at E&Y's National Office. Such information included E&Y's code of conduct; documents relating to measuring and monitoring audit quality; descriptions of the duties

of, and relationships between and among, E&Y's staff and leadership; results of surveys of staff and clients; public company audit proposals; internal and external communications from management; descriptions of the Firm's financial structure and business plan; and agendas and minutes of the Firm's board of directors. In addition, the inspection team interviewed 24 members of E&Y's leadership team.

The inspection team conducted interviews at the Firm's practice offices to obtain perspectives on communications from the Firm's leadership relating to audit quality and tone at the top. The inspection team interviewed members of the leadership at each of these offices, as well as certain audit partners and senior managers assigned to engagements that were reviewed. In addition, the inspection team conducted focus group meetings in eight of those offices to assess the participants' understanding of, among other things, the messages conveyed by the national office, practice office leadership and their supervisors, and how such messages might affect their actions on audits, as well as to hear their perspectives on the tone at the top. These meetings were conducted with separate groups of audit senior managers and managers and audit senior accountants and staff. In one location, a separate focus group was conducted with information technology audit senior accountants and staff.

APPENDIX C

RESPONSE OF THE FIRM TO DRAFT INSPECTION REPORT

Pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(a), the Board provided the Firm an opportunity to review and comment on a draft of this report. The Firm provided a written response.

Pursuant to section 104(f) of the Act 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 of a firm's comments that identify factually inaccurate statements, in the draft, that the Board corrects in the final report.

Pursuant to section 104(f) of the Act and PCAOB Rule 4007(b), the Firm's response, minus any portion granted confidential treatment, is attached hereto and made part of this final inspection report. In any version of this report that the Board makes publicly available, any portions of the Firm's response that address nonpublic portions of the report are omitted.



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October 28, 2005

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Response to Report on 2004
Inspection of Ernst & Young LLP

Dear Mr. Diacont:

We are pleased to provide our response to the Public Company Accounting Oversight Board ("PCAOB") regarding its report (the "Report") on the 2004 inspection of Ernst & Young LLP ("E&Y"). The inspection process is a fundamental component of the PCAOB's mission.

As the independent auditor of more than 2,500 public companies in the United States, our overriding objective is to make certain that all aspects of our auditing and quality control processes are of high quality for the continued benefit of the capital markets in which the public participates and on which they rely. The PCAOB's inspections assist us in identifying areas where we can continue to improve our performance.

We respect the PCAOB's inspection process and understand that judgments are involved both in performing an audit and in subsequently inspecting it. Recognizing the constructive intent of the inspection process, we made every effort to cooperate with the inspection staff. We thoroughly evaluated each matter described in the Report and have taken actions where appropriate in accordance with E&Y's policies and PCAOB standards for each of the engagements described in *Part I – Inspection Procedures and Certain Observations*.

As noted in the Report, Issuer A restated its 2003 balance sheet in its 2004 Form 10-K by including the capitalized lease in assets held for disposal as part of discontinued operations with no effect on net income and Issuer B revised its segment reporting disclosures in its 2004 Form 10-K. With respect to Issuers C through H, we addressed the matters described in the Report by performing additional procedures or improving the existing documentation in our working papers where required. As a result of these actions, no new facts came to our attention that caused us to believe that our previously issued auditor's reports should be withdrawn.

Mr. George Diacont

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With respect to Issuers D, E, F, and G, we acknowledge that the documentation of our audit procedures and evidence should have been improved in these 2003 audits, and note that in 2004 we issued updated accounting and auditing guidance regarding a financial institution's allowance for loan losses that emphasized appropriate audit documentation. Existing accounting and bank regulatory guidance allows for "unallocated" components of the allowance for loan losses that are reasonably and consistently determined and adequately documented estimates of probable loss, and recognizes that significant judgment is required in the process. In the audits described in the Report, given the specific circumstances and the nature of evidence generally available to support the various components of a financial institution's allowance for loan losses, and in particular the "unallocated" component, we believe that we obtained sufficient competent evidential matter to support the opinions in our auditor's reports. We welcome continued dialogue on ways to further improve our future work and documentation in this highly judgmental audit area.

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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. We believe that future inspections will continue to enhance our audit quality and strengthen the accounting profession.

Respectfully submitted,

Ernst & Young LLP

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