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Report on

2012 Inspection of Ernst & Young LLP
(Headquartered in New York, New York)

Issued by the

Public Company Accounting Oversight Board

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THIS IS A PUBLIC VERSION OF A PCAOB INSPECTION REPORT

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

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2012 INSPECTION OF ERNST & YOUNG LLP

Preface

In 2012, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm Ernst & Young LLP ("the Firm") pursuant to the Sarbanes-Oxley Act of 2002 ("the Act").^{1/}

The inspection process is designed, and inspections are performed, to provide a basis for assessing the degree of compliance by a firm with applicable requirements related to auditing issuers. The inspection process included reviews of aspects of selected issuer audits completed by the Firm. The reviews were intended to identify whether deficiencies existed in those aspects of the audits, and whether such deficiencies indicated defects in the Firm's system of quality control over audits. In addition, the inspection included reviews of policies and procedures related to certain quality control processes of the Firm that could be expected to affect audit quality.

The issuer audits and aspects of those audits inspected were selected based on a number of risk-related and other factors. Due to the selection process, the deficiencies included in this report are not necessarily representative of the Firm's issuer audit practice.

The Board is issuing this report in accordance with the requirements of the Act.^{2/} The Board is releasing to the public Part I of the report and portions of Appendix B. Appendix B includes the Firm's comments, if any, on a draft of the report. 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.

^{1/} The Act requires the Board to conduct an annual inspection of each registered public accounting firm that regularly provides audit reports for more than 100 issuers.

^{2/} In its *Statement Concerning the Issuance of Inspection Reports*, PCAOB Release No. 104-2004-001 (August 26, 2004), the Board described its approach to making inspection-related information publicly available consistent with legal restrictions.

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's staff ("the inspection team") conducted primary procedures for the inspection from November 2011 through November 2012. The inspection team performed field work at the Firm's National Office and at 29 of its approximately 69 U.S. practice offices.

A. Review of Audit Engagements

The 2012 inspection of the Firm included reviews of aspects of 51 audits performed by the Firm and reviews of the Firm's audit work on one other issuer audit engagement in which the Firm played a role but was not the principal auditor. The inspection team identified matters that it considered to be deficiencies in the performance of the work it reviewed. Two of the deficiencies relate to auditing aspects of an issuer's financial statements that the issuer restated or announced an intention to restate after the primary inspection procedures.^{3/}

The inspection team considered certain of the deficiencies that it observed to be audit failures. Specifically, certain of the identified deficiencies were of such significance that it appeared that the Firm, at the time it issued its audit report, had failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements and/or on the effectiveness of internal control over financial reporting ("ICFR"). The audit deficiencies that reached this level of significance are described below.^{4/}

^{3/} The Board's inspection process did not include review of any additional audit work related to the restatement.

^{4/} 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. In addition, any references in this report to violations or potential violations of law, rules, or professional standards are not a result of an adversarial adjudicative process and do not constitute conclusive findings for purposes of imposing legal liability.

A.1. Issuer A

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR –

- The issuer generated revenue at numerous locations, where certain types of routine transactions were initiated and processed. In planning and performing its tests of controls, the Firm assumed that controls were designed and implemented consistently at all locations, even though it performed walkthrough procedures at only one location. Based on this assumption, it reduced the number of locations selected for testing. The Firm and the issuer's internal audit ("IA") identified multiple control exceptions, including exceptions at several locations tested, but these control exceptions were not the same across the locations. These results indicated that the Firm's assumption of uniform controls was incorrect and, therefore, the extent of the Firm's testing of the controls was insufficient.
- The primary controls over the inventory, payroll, and revenue processes that the Firm tested were at the location level. The Firm tested each control at locations selected using the approach described above. The Firm failed to appropriately evaluate whether certain of the control exceptions that it and the issuer's IA had identified at the issuer's locations represented control deficiencies and were, in combination, material weaknesses. Specifically, the Firm's testing approach provided that each control would be determined to be operating effectively if no exceptions were identified for at least 80 percent of the locations tested. This approach was inappropriate as it resulted in no further evaluation of exceptions for a substantial majority of the exceptions identified and the controls tested.
- The Firm's testing of the effectiveness of certain controls over revenue and accounts receivable was insufficient. The Firm's procedures were limited to reviewing reports and reconciliations for clerical accuracy and agreement to the general ledger and obtaining evidence that reviews had occurred, without evaluating whether the controls operated at a level of precision that would prevent or detect material misstatements.

- The Firm selected for testing one review control over the issuer's evaluation of property, plant, and equipment ("PPE") for potential impairment; however, the Firm failed to sufficiently test this control. Specifically, the Firm's procedures were limited to inspecting evidence of reviewer sign-off, without evaluating whether the control operated at a level of precision that would prevent or detect material misstatements.
- The Firm's substantive procedures to test the valuation of PPE were insufficient. Specifically, the Firm failed to evaluate whether deteriorating operating margins and operating losses at several of the individual locations represented indicators of impairment.

A.2. Issuer B

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR –

- The Firm identified a significant risk related to the determination of vendor-specific objective evidence ("VSOE") and the best estimate of selling price ("BESP") for multiple-element arrangements.
 - The Firm selected for testing one control, a review control, related to the VSOE and BESP estimation processes, but it failed to sufficiently test this control. Specifically, the Firm's procedures were limited to testing the clerical accuracy of the underlying calculations and obtaining evidence of reviewer sign-off or approval, without evaluating the sufficiency of management's review, including how issues were identified, investigated, and resolved.
 - The Firm failed to sufficiently test the issuer's assertions that VSOE existed for a type of service that the issuer sold as part of multiple-element arrangements and that this VSOE had not changed from the prior year. Specifically –

- In evaluating the issuer's ability to establish VSOE, the Firm failed to take into account that a significant volume of services were provided under fixed-fee arrangements.
 - In assessing the reasonableness of the assertion that VSOE had not changed, the Firm failed to take into account pricing pressures from declines in gross margins and industry competition.
 - The Firm's selection of a sample of contracts for testing the issuer's VSOE analysis was not designed in a manner that would reasonably be expected to produce a sample that was representative of the population of service contracts sold separately, as the Firm failed to determine whether the contracts selected for testing were stand-alone service contracts or multiple-element arrangements involving these services.
- The issuer used an external party (the "consultants") to document and perform testing of internal controls. The Firm inappropriately used the work of these consultants as evidence of the effectiveness of the majority of controls it selected for testing, including controls that the Firm determined were responsive to fraud or other significant risks, without performing its own independent testing of certain of these controls. In addition, the Firm failed to appropriately take into account management's oversight of the consultants in assessing their objectivity. Specifically, the consultants were engaged by the issuer's management, reported to a member of management in the accounting department who was the owner of certain controls the consultants tested, and met only once during the year with the issuer's audit committee.
 - The issuer acquired two significant businesses during the year. The Firm identified certain controls, consisting of the review of financial statements and journal entries and the reconciliation of balance sheet accounts, that it asserted provided assurance over the accounting for business combinations. The Firm's procedures to test these controls were limited to observing evidence of reviewer sign-off or approval, testing the clerical accuracy of reconciliations, and comparing certain amounts to supporting

documents and the general ledger. The Firm also stated that certain of its procedures were dual-purpose in nature and provided evidence of the effectiveness of these controls. The Firm, however, failed to test, through any of its procedures, whether the controls operated at a level of precision that would prevent or detect material misstatements related to business combinations.

A.3. Issuer C

The issuer generated a significant portion of its revenue from long-term contracts, which it recorded using the percentage-of-completion method of accounting. The Firm failed to evaluate the reasonableness of the issuer's approach for applying this method to the recognition of revenue from these contracts.

A.4. Issuer D

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR –

- The Firm selected for testing certain management review controls over (1) the issuer's reserves for sales returns and sales discounts and allowances and (2) the valuation of inventory (consisting of lower-of-cost-or-market write-downs and reserves for obsolete and excess inventory). The Firm failed to sufficiently test these controls, as its procedures were limited to observing signatures as evidence of review, testing the clerical accuracy of reports or reconciliations, comparing certain amounts related to the inventory write-downs and the reserves to supporting documents or the general ledger, and confirming that the issuer investigated results that control owners considered unusual. The Firm's procedures did not include evaluating whether the controls operated at a level of precision that would prevent or detect material misstatements.
- The Firm failed to test the operating effectiveness of any controls over the accuracy of the manually generated shipping information that the issuer used to initiate the recording of the majority of its revenue.

- The Firm failed to test the completeness of certain system-generated data and reports that it used in its controls and substantive testing related to inventory and sales reserves.
- The issuer used certain assumptions in its determination of the reserve for sales returns. The Firm's evaluation of these assumptions was insufficient, as it did not test the historical data used in developing the assumptions.
- The Firm failed to perform tests of details that were specifically responsive to the risk of fraud it had identified related to the reserve for sales discounts and allowances.
- The Firm's tests of the lower-of-cost-or-market inventory write-downs, with respect to which it had identified a fraud risk, were insufficient. Specifically, the Firm selected a sample of items for which the issuer had reduced the recorded value based on lower-of-cost-or-market considerations during the year in order to compare the recorded value of the items to sales prices that occurred after year end. The Firm failed to appropriately evaluate the results of its testing of these items, as follows –
 - For a significant portion of the sample there were no sales after year end, and the Firm performed no alternative procedures to evaluate the reasonableness of the recorded value for these items.
 - The Firm failed to consider available contrary information. For some of the items, the Firm observed sales prices that were significantly over the recorded value at year end. For certain other items, the Firm observed sales prices that were below the issuer's recorded value. In both of these situations, the Firm performed no additional procedures to evaluate the reasonableness of the recorded value.
- The Firm's procedures to test revenue were limited to comparisons of current-period amounts to prior-period amounts; however, these procedures provided little to no substantive assurance. Specifically, the Firm failed to (1) develop appropriate expectations; (2) set thresholds for

investigation of significant differences; and (3) test the completeness of certain data used in these procedures.

A.5. Issuer E

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR –

- The Firm failed to sufficiently test certain controls over the accounting for certain of the issuer's investments. Specifically, the Firm's procedures were limited to inquiring of management, comparing certain transactions to supporting documentation, and observing evidence that reviews that were part of the controls had occurred, without evaluating whether the controls operated at a level of precision that would prevent or detect material misstatements.
- The Firm failed to sufficiently test controls over the valuation of deferred tax assets and the accounting for, and disclosure of, variable interest entities. Specifically, the Firm's procedures to test certain review controls were limited to observing evidence that such reviews had occurred. The Firm also stated that certain of its substantive testing was dual-purpose in nature and provided evidence of the effectiveness of controls related to these processes. The Firm, however, failed to test, through any of its procedures, whether the controls operated at a level of precision that would prevent or detect material misstatements related to these processes.
- The Firm failed to sufficiently test controls over the period-end financial reporting process. Specifically –
 - The Firm selected for testing controls that included the review of journal entries, but the Firm's procedures did not include testing the effectiveness of the issuer's review. Specifically, its procedures to test the review aspect of these controls were limited to observing evidence of review and comparing information in journal entries to supporting documentation or the general ledger, without evaluating whether the controls operated at a level of precision that would prevent or detect material misstatements. Further, the Firm failed

to select its sample for testing these controls from the complete population of journal entries.

- The Firm failed to sufficiently test the operating effectiveness of certain automated application controls related to the period-end financial reporting process. Specifically, the Firm used a benchmarking strategy, through which it relied on a prior year's testing of the controls, even though it identified that the applications where these controls operated had been modified since it last tested the controls.
- The Firm inappropriately used the work of the issuer's consultants as evidence of the effectiveness of certain controls in multiple areas, including areas of fraud risk and other significant risk, without performing its own independent testing. In addition, the Firm failed to appropriately take into account management's oversight of the consultants in assessing their objectivity. Specifically, although the consultants reported to the issuer's audit committee, management was responsible for overseeing their daily activities.

A.6. Issuer F

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR –

- The Firm's tests of controls over the accounting for the majority of the issuer's sales transactions were insufficient. Specifically, the Firm failed to identify and select for testing any controls over the issuer's process for initiating and authorizing these sales transactions. Consequently, the Firm also did not support its control risk assessment related to revenue and its corresponding reduction of its substantive procedures. The Firm's substantive procedures to test this revenue consisted of tests of details related to the timing of revenue recognition and analytical procedures that provided little to no substantive assurance, as the Firm simply compared recorded amounts to those for other periods.

- The Firm selected for testing certain review controls over the issuer's customer rebate process for one of the issuer's divisions, but it failed to sufficiently test these controls. Specifically, the Firm's procedures were limited to observing evidence of reviewer sign-off or approval and, for one control, comparing rebate information used in the control to certain supporting documentation entered into the issuer's system. The Firm also stated that certain of its procedures were dual-purpose in nature and provided evidence of the effectiveness of these controls. The Firm, however, failed to test, through any of its procedures, whether the controls operated at a level of precision that would prevent or detect material misstatements related to the customer rebate process.

A.7. Issuer G

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR –

- The Firm's tests of certain review controls over revenue, deferred revenue, and accounts receivable were insufficient. Specifically, the Firm's procedures were limited to verifying the mathematical accuracy of calculations, observing that amounts agreed to the general ledger and/or certain supporting records, and observing evidence of reviewer sign-off or approval. The Firm's procedures did not include evaluating whether the controls operated at a level of precision that would prevent or detect material misstatements.
- During the year, the issuer acquired a significant business. The Firm's testing related to business combinations was deficient in the following respects –
 - The Firm's tests of certain review controls over the accounting for business combinations were insufficient. Specifically, the Firm's procedures were limited to observing evidence of reviewer sign-off, without evaluating whether the controls operated at a level of precision that would prevent or detect material misstatements.

- The Firm's tests of the valuation of certain acquired intangible assets were insufficient. Specifically, the Firm failed to evaluate, other than by inquiring of management, the reasonableness of the projected financial information the issuer used in determining the fair values of the intangible assets.
- The Firm's procedures to test the issuer's annual analysis of the potential impairment of indefinite-lived intangible assets were insufficient. Specifically, the Firm failed to sufficiently evaluate the reasonableness of the projected financial information the issuer used in its impairment analysis, as the Firm's procedures were limited to inquiring of management and observing that the revenue projections for the upcoming year agreed to the issuer's annual budget.

A.8. Issuer H

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR –

- During the year, the issuer completed a significant business combination. The Firm failed to sufficiently test controls over the accounting for business combinations. The only controls the Firm selected for testing with respect to the accounting for business combinations were certain review controls that were included within the issuer's period-end financial reporting process. The Firm also referenced its substantive testing when addressing its evaluation of controls over the accounting for business combinations. The Firm, however, failed to test, through any of its procedures, whether the controls operated at a level of precision that would prevent or detect material misstatements related to business combinations.
- The Firm failed to sufficiently test controls over the valuation of excess and obsolete inventory, as it selected for testing one control, a review control, over this process, but it did not sufficiently test this control. Specifically, the Firm's procedures to test the control were limited to inquiring of management, verifying that certain actions performed as part of the control had occurred, and comparing the information in relevant

journal entries to supporting documentation. There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had evaluated whether the control operated at a level of precision that would prevent or detect material misstatements. In addition, the Firm failed to test any controls over the accuracy and completeness of the system-generated information used in the performance of the control.

- The issuer amortized certain of its intangible assets on a straight-line basis over the estimated useful lives of the assets. There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had evaluated whether the issuer's use of the straight-line basis was appropriate given that the issuer's cash flow estimates related to these intangible assets indicated that the economic benefit of the intangible assets would be consumed on an accelerated basis.

A.9. Issuer I

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements –

- The Firm's evaluation of the appropriateness of the issuer's method of accounting for the value of, and income from, certain securities was insufficient. The issuer asserted that these securities were of "high credit quality" when acquired, which was necessary for the issuer to apply its chosen method of accounting for the securities. The Firm failed to take into account in its evaluation evidence that appeared inconsistent with this assertion, including (1) acquisition documents for certain of these securities that showed credit ratings below an AA rating, which is not indicative of high credit quality, including, for some securities, ratings below investment grade; (2) acquisition prices for certain of these securities that were significantly below par value; and (3) the issuer's history of impairment losses on similar securities.
- The Firm failed to evaluate the significance of the issuer's omission of disclosure in the notes to its financial statements of its policy for determining the accounting principles to be applied to these securities.

A.10. Issuer J

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR –

- The Firm selected for testing certain review controls over the valuation of a significant portion of inventory, but it failed to sufficiently test these controls. Specifically, the Firm's procedures were limited to obtaining evidence that such reviews had occurred, without evaluating whether these controls operated at a level of precision that would prevent or detect material misstatements.
- The Firm failed to evaluate the reasonableness of the projected financial information that the issuer used to value acquired trade names and customer relationships in its accounting for a business combination. In addition, the Firm failed to test the historical loan data the issuer used to value acquired loan portfolios.
- The Firm failed to test the pricing of certain finished goods inventory, beyond reperforming certain calculations and comparing the current-year manufacturing gross margins (which were used to determine the price of the inventory) to manufacturing gross margins for certain other inventory.

A.11. Issuer K

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. The deficiencies in the Firm's testing are as follows –

- During the year, the issuer completed several significant acquisitions. The Firm selected for testing certain controls over the accounting for business combinations. The Firm's tests of these controls, however, were insufficient, as its procedures were limited to inspecting purchase agreements, observing evidence of the approval of the journal entries related to the acquisitions, and comparing the journal entries to supporting documentation. The Firm also stated that certain of its procedures were dual-purpose in nature and provided evidence of the effectiveness of

these controls. The Firm, however, failed to test, through any of its procedures, whether the controls operated at a level of precision that would prevent or detect material misstatements related to the valuation of the acquired assets and assumed liabilities.

- The Firm failed to sufficiently test controls over a significant component of revenue. Specifically, the Firm's procedures to understand the likely sources of potential misstatements related to this component of revenue did not include procedures to obtain an understanding of the flow of transactions. In addition, the Firm did not identify and test any controls that were specific to this class of transactions, and there was no evidence in the audit documentation, and no persuasive other evidence, that the controls the Firm had tested over the issuer's other processes addressed the relevant assertions for this component. The Firm stated that certain of its substantive tests were dual-purpose in nature and provided evidence of the effectiveness of controls over this component of revenue. The Firm, however, failed to test, through any of its procedures, whether the controls were effective.

A.12. Issuer L

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR –

- The Firm selected for testing review controls over the valuation of mortgage-backed securities ("MBS"), but failed to sufficiently test certain of these controls. Specifically, the Firm's testing was limited to inquiring of management and obtaining evidence that the reviews had occurred. The Firm also stated that certain of its procedures were dual-purpose in nature and provided evidence of the effectiveness of these controls. The Firm, however, failed to test, through any of its procedures, whether the controls operated at a level of precision that would prevent or detect material misstatements related to the valuation of the MBS.
- The Firm's tests of the effectiveness of controls over derivatives were insufficient. Specifically, the Firm failed to identify and test any controls over the processes related to the hedge designation, fair value estimates, and hedge effectiveness testing. In addition, the Firm tested certain

management review controls over derivatives, but its testing was limited to inquiring of management, observing signatures as evidence of review, and/or otherwise verifying that certain actions performed as part of the controls had occurred. The Firm also stated that certain of its procedures were dual-purpose in nature and provided evidence of the effectiveness of these controls. The Firm, however, failed to test, through any of its procedures, whether the controls operated at a level of precision that would prevent or detect material misstatements related to derivatives.

A.13. Issuer M

In this audit, the Firm tested inventory in certain selected locations. The Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements –

- There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had –
 - Tested the existence of work-in-progress and finished goods inventory at some of the selected locations; and
 - Evaluated, when reaching its conclusion that it could rely on the issuer's cycle-count process, the implications of the issuer's practice of allowing individual locations to determine whether to include work-in-progress and finished goods inventory in the cycle counts.
- For some selected locations, the Firm failed to sufficiently test the existence of the recorded inventory. Specifically, the Firm made its selections for test counting from the inventory physically on hand at the locations, but did not also make inventory count selections from the amounts recorded in the system.
- The issuer used system-generated reports as part of its inventory cycle-count process. The Firm used these reports in its evaluation of the cycle-count process, but failed to test the accuracy and completeness of certain of these reports.

A.14. Issuer N

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR –

- The issuer generates most of its sales invoices using customer-submitted data that the issuer enters manually into its systems. The Firm selected for testing certain review controls over this revenue and the related accounts receivable; however, its procedures to test these controls were limited to inquiring of management; observing evidence that management reviews had occurred; recalculating certain amounts; comparing certain data to information in the general ledger, from which the data had been derived; and, for one transaction, comparing the pricing information in the system to a customer contract. The Firm's procedures did not include evaluating whether the controls operated at a level of precision that would prevent or detect material misstatements. In addition, the Firm failed to test any controls over the accuracy and completeness of certain system-generated reports the issuer used in the performance of these controls.
- The Firm's tests of controls over the period-end financial reporting process were insufficient. Specifically, although the Firm selected certain review controls for testing this process, the Firm's procedures to test the controls were limited to observing signatures as evidence of review; verifying that certain actions that constituted a part of the controls had occurred, such as the preparation of monthly reconciliations and reporting packages; and observing some notations made by the reviewers. The Firm, however, failed to perform procedures to determine whether these review controls operated at a level of precision that would prevent or detect material misstatements.

A.15. Issuer O

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR –

- The Firm failed to sufficiently test certain review controls over the issuer's accounting for revenue, accounts receivable, and PPE. The Firm's procedures to test these controls were limited to comparing balances to

the general ledger, obtaining supporting documentation for certain reconciling items, and/or observing evidence of reviewer sign-off. There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had evaluated whether the controls operated at a level of precision that would prevent or detect material misstatements.

- After identifying certain deficiencies in controls over revenue and accounts receivable, the Firm selected for testing two compensating controls.
 - These compensating controls used data from the issuer's budget, but the Firm failed to sufficiently tests controls over the development of the budget data. While the Firm tested certain entity-level controls ("ELCs") over the issuer's process for developing budgets, the Firm's procedures to test these controls were deficient, as its procedures were limited to inquiring of management, observing evidence of board approval of the annual budget, and comparing data in the budget to data in documents related to the approval of the budget and data used in the operation of the control.
 - For these compensating controls, the sample used by the Firm to test the compensating controls was inadequate because the Firm underestimated the number of times the control operated when computing the necessary sample size.
- The Firm failed to test the accuracy and completeness of certain system-generated data and reports that it used in its testing of controls over revenue and accounts receivable.

A.16. Issuer P

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. The Firm selected for testing review controls over the valuation of goodwill and other intangible assets, and over the accounting for income taxes, but its tests of these controls were insufficient. Specifically, the Firm's procedures were limited to observing evidence of review or approval. The Firm also obtained issuer-prepared analyses that were produced as part of some of the selected controls, and the Firm used these analyses in its substantive

testing. The Firm stated that this testing provided evidence of the effectiveness of these controls; however, the Firm failed to evaluate, through any of its procedures, whether the controls operated at a level of precision that would prevent or detect material misstatements related to these areas.

A.17. Issuer Q

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR, as the Firm did not perform sufficient testing of certain selected preventive and detective controls over access to applications that processed transactions related to all of the issuer's significant accounts. One of the controls selected for testing was the issuer's annual process to confirm, at an interim date, that user access granted to financially significant applications was appropriate. As a result of the annual process, the issuer determined that a significant number of user accounts required modifications or needed to be deleted. In testing this control, the Firm failed to perform sufficient procedures to respond to the risk that inappropriate access to significant financial applications existed. Specifically –

- The Firm failed to evaluate the effect of the significant number of user accounts identified with inappropriate access on the Firm's conclusions that the preventive controls were operating effectively.
- The Firm's procedures to test the detective control were insufficient, as there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm tested whether the user accounts identified with inappropriate user access executed unauthorized transactions during the year.
- The Firm identified certain employees that appeared to have inappropriate access to certain data and/or systems. There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had tested, beyond inquiry, the appropriateness of the access granted to these employees.
- The Firm failed to perform sufficient procedures to evaluate testing deviations it identified when testing the detective control. Specifically, the Firm did not evaluate the effect of the deviations on its assessment of the

risk associated with the control and of the operating effectiveness of the control.

A.18. Issuer R

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. During the year, the issuer acquired a number of businesses, including two that were significant. The Firm selected for testing a review control over the accounting for business combinations. The Firm's tests of this control were insufficient, as its procedures were limited to obtaining evidence that the review had occurred. The Firm also stated that certain of its procedures were dual-purpose in nature and that this testing provided evidence of the effectiveness of this control. The Firm, however, failed to test, through any of its procedures, whether the control operated at a level of precision that would prevent or detect material misstatements related to business combinations.

A.19. Issuer S

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. During the year, the issuer acquired a number of businesses, including two that were significant. The Firm selected for testing certain review controls over the accounting for business combinations, but its tests of these controls were insufficient. Specifically, the Firm's procedures were limited to obtaining evidence of reviewer sign-off or approval, without evaluating whether the controls operated at a level of precision that would prevent or detect material misstatements.

A.20. Issuer T

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. During the year, the issuer acquired a significant business. The Firm selected for testing certain review controls over the accounting for business combinations; however, its tests of these controls were insufficient. Specifically, the Firm's procedures were limited to obtaining evidence that such reviews had occurred and attending certain meetings that constituted a part of the operation of the controls. The Firm also referenced its substantive testing in certain of its documentation when addressing its evaluation of controls in this area. The Firm, however, failed to test, through any of its procedures, whether the controls operated at a

level of precision that would prevent or detect material misstatements related to business combinations.

A.21. Issuer U

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. The Firm selected for testing certain review controls over the accounting for income taxes; however, its tests of these controls were insufficient. Specifically, the Firm's procedures to test the controls were limited to attending certain quarterly meetings at which issuer personnel discussed tax issues and obtaining evidence that the reviews had occurred, without evaluating whether the controls operated at a level of precision that would prevent or detect material misstatements.

A.22. Issuer V

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. The Firm selected for testing certain controls over the accounting for income taxes, but the Firm's tests of these controls were insufficient. Specifically, the Firm's procedures were limited to inquiring of management, obtaining evidence that reports and reconciliations had been compared to the general ledger and other issuer-prepared documents, and verifying that certain actions performed as part of the control had occurred, without evaluating whether the controls operated at a level of precision that would prevent or detect material misstatements.

A.23. Issuer W

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. The Firm selected for testing certain controls over the accounting for income taxes, but the Firm's tests of these controls were insufficient. Specifically, the Firm's procedures to test the controls were limited to inquiring of management, reviewing reports and reconciliations for clerical accuracy and agreement to the general ledger and other issuer-prepared documents; and, for the review controls, obtaining evidence that reviews had occurred. The Firm also stated that certain of its substantive testing provided evidence of the effectiveness of controls in this area. The Firm, however, failed to test, through any of its procedures,

whether the controls operated at a level of precision that would prevent or detect material misstatements related to income taxes.

A.24. Issuer X

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR, as its tests of controls over revenue were insufficient. The Firm selected for testing a control over the occurrence and valuation of revenue that consisted of the verification of supporting documents before an invoice could be processed. The Firm's procedures to test this control consisted of independently evaluating whether the recognition of revenue was appropriate for a sample of revenue transactions. These procedures, however, did not sufficiently test the operating effectiveness of the control, as they did not include testing the activities of the issuer personnel who performed the control.

A.25. Issuer Y

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. During the year, the issuer acquired two significant businesses. The Firm selected for testing a review control over the issuer's accounting for business combinations, but its tests of this control were insufficient. Specifically, the Firm's procedures were limited to obtaining evidence of reviewer sign-off. The Firm also referenced its substantive testing of the business combinations when addressing its evaluation of effectiveness of this control. The Firm, however, failed to test, through any of its procedures, whether this control operated at a level of precision that would prevent or detect material misstatements related to business combinations.

B. Auditing Standards

Each of the deficiencies described in Part I.A of this report represents circumstances in which the Firm failed to comply with the requirement to obtain sufficient appropriate evidence to support its opinion that the financial statements were presented fairly, in all material respects, in accordance with applicable accounting principles, and/or for its opinion concerning whether the issuer maintained, in all material respects, effective internal control over financial reporting. Each deficiency relates to several applicable standards that govern the conduct of audits.

AU 230, *Due Professional Care in the Performance of Work* ("AU 230") requires the independent auditor to plan and perform his or her work with due professional care. AU 230 and Auditing Standard ("AS") AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement* ("AS No. 13") specify that due professional care includes the exercise of professional skepticism. This is an attitude that includes a questioning mind and a critical assessment of the appropriateness and sufficiency of audit evidence.

AS No. 13 requires the auditor to design and implement audit responses that address the identified risks of material misstatement, and AS No. 15, *Audit Evidence* ("AS No. 15") requires the auditor to plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for the audit opinion. Sufficiency is the measure of the quantity of audit evidence, and the quantity needed is affected by the risk of material misstatement and the quality of the audit evidence obtained. The appropriateness of evidence is measured by its quality; to be appropriate, evidence must be both relevant and reliable in support of the related conclusions.

AS No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements* ("AS No. 5") and AS No. 13 establish requirements regarding testing and evaluating internal control over financial reporting. In an audit of internal control over financial reporting in an integrated audit, AS No. 5 requires the auditor to plan and perform the audit to obtain appropriate evidence that is sufficient to support the auditor's opinion on internal control over financial reporting as of the date of that opinion. AS No. 13 requires that, if the auditor plans to assess control risk at less than the maximum and to base the nature, timing, and extent of substantive audit procedures on that lower assessment, the auditor must obtain evidence that the controls tested were designed and operating effectively during the entire period for which the auditor plans to rely on controls to modify the substantive procedures.

The deficiencies described in Part I.A of this report relate to one or more of the provisions referenced above, and in many cases also relate to the failure to perform, or to perform sufficiently, certain specific audit procedures that are required by other applicable auditing standards. The table below lists the specific auditing standards that are primarily implicated by the deficiencies identified in Part I.A of this report. The

broadly applicable aspects of AS No. 5, AS No. 13, and AS No. 15 discussed above are not repeated in the table below.^{5/}

PCAOB Auditing Standards	Issuers
AS No. 5, <i>An Audit of Internal Control Over Financial Reporting That is Integrated with An Audit of Financial Statements</i>	A, B, D, E, F, G, H, J, K, L, N, O, P, Q, R, S, T, U, V, W, X, and Y
AS No. 9, <i>Audit Planning</i>	A
AS No. 13, <i>The Auditor's Responses to the Risks of Material Misstatement</i>	D, E, F, H, J, K, L, P, R, and T
AS No. 14, <i>Evaluating Audit Results</i>	I
AS No. 15, <i>Audit Evidence</i>	D, H, and O
AU Section 316, <i>Consideration of Fraud in a Financial Statement Audit</i>	D
AU Section 326, <i>Evidential Matter</i>	M
AU Section 328, <i>Auditing Fair Value Measurements and Disclosures</i>	G and J
AU Section 329, <i>Substantive Analytical Procedures</i>	D
AU Section 331, <i>Inventories</i>	M
AU Section 332, <i>Auditing Derivative Instruments, Hedging Activities, and Investments in Securities</i>	I
AU Section 342, <i>Auditing Accounting Estimates</i>	A, B, C, D, and H
AU Section 350, <i>Audit Sampling</i>	B and E

C. General Information Concerning PCAOB Inspections

Board inspections are designed to identify whether weaknesses and deficiencies exist related to how a firm conducts audits and to address any such weaknesses and deficiencies. To achieve that goal, inspections include reviews of certain aspects of selected audit work performed by the Firm and reviews of certain aspects of the Firm's quality control system. The focus on weaknesses and deficiencies necessarily carries through to reports on inspections and, accordingly, Board inspection reports are not intended to serve as balanced report cards or overall rating tools. Further, the inclusion in an inspection report of certain deficiencies and potential deficiencies should not be construed as an indication that the Board has made any determination about other

^{5/} This table does not necessarily include reference to every auditing standard that may have been implicated by the deficiencies included in Part I.A.

aspects of the firm's systems, policies, procedures, practices, or conduct not included within the report.

The inspection team selects the audits and aspects to review, and the Firm is not allowed an opportunity to limit or influence the selections. In the course of reviewing aspects of selected audits, the inspection team may identify matters that it considers to be deficiencies in the performance of the work it reviews. Those deficiencies may include failures by the Firm to identify, or to address appropriately, financial statement misstatements, including failures to comply with disclosure requirements,^{6/} as well as failures by the Firm to perform, or to perform sufficiently, certain necessary audit procedures. 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 audit work, or the relevant issuers' financial statements or reporting on internal control, are free of any deficiencies not specifically described in an inspection report.

If the Board inspection team identifies deficiencies that exceed a certain significance threshold in the audit work it reviews, those deficiencies are summarized in the public portion of the Board's inspection report. The Board cautions, however, against extrapolating from the results presented in the public portion of the report to broader conclusions about the frequency of deficiencies throughout the Firm's practice. Audit work is selected for inspection largely on the basis of an analysis of factors that, in the inspection team's view, heighten the possibility that auditing deficiencies are present, rather than through a process intended to identify a representative sample.

In some cases, the conclusion that a firm failed to perform a procedure may be based on the absence of documentation and the absence of persuasive other evidence, even if the firm claimed to have performed the procedure. AS No. 3, *Audit*

^{6/} 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 applicable accounting principles, the Board's practice is to report that information to the Securities and Exchange Commission ("SEC" or "the Commission"), which has jurisdiction to determine proper accounting in issuers' financial statements. Any description in this report of financial statement misstatements or failures to comply with SEC disclosure requirements should not be understood as an indication that the SEC has considered or made any determination regarding these issues unless otherwise expressly stated.

Documentation ("AS No. 3") provides that, in various circumstances including PCAOB inspections, a firm that has not adequately documented that it performed a procedure, obtained evidence, or reached an appropriate conclusion must demonstrate with persuasive other evidence that it did so, and that oral assertions and explanations alone do not constitute persuasive other evidence.

Inclusion of a deficiency in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. 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 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 reporting on internal control, or to take steps to prevent reliance on previously expressed audit opinions.^{7/}

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 processes related to audit quality. This review addressed practices, policies, and procedures concerning audit performance and the following five areas (1) management structure and processes, including the tone at the top; (2) practices for partner management, including allocation of partner resources and partner evaluation, compensation, admission, and disciplinary actions; (3) policies and procedures for considering and addressing the risks involved in accepting and retaining clients, including the application of the Firm's risk-rating system; (4) processes related to the Firm's use of audit work that the Firm's foreign affiliates perform on the foreign operations of the Firm's U.S. issuer audit clients; and (5) the Firm's processes for monitoring audit performance, including processes for identifying and assessing indicators of deficiencies in audit performance, independence policies and procedures, and processes for responding to weaknesses in quality control.

END OF PART I

^{7/} The inspection team may review, either in the same inspection or in subsequent inspections, the adequacy of the firm's compliance with these requirements. Failure by a firm to take appropriate actions, or a firm's misrepresentations in responding to an inspection report, about whether it has taken such actions, could be a basis for Board disciplinary sanctions.



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

APPENDIX B

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 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, minus any portion granted confidential treatment, is attached hereto and made part of this final inspection report.^{8/}

^{8/} The Board does not make public any of a firm's comments that address a nonpublic portion of the report. 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 at all. 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.

Ms. Helen Munter
Director
Division of Registration and Inspections
Public Company Accounting Oversight Board
1666 K Street NW
Washington, D.C. 20006-2803

June 5, 2013

Response to Part I of the Draft Report on the 2012 Inspection of Ernst & Young LLP

Dear Ms. Munter:

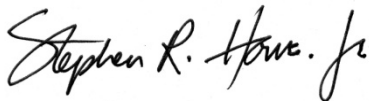
We are pleased to provide our response to the Public Company Accounting Oversight Board (the “Board” or the “PCAOB”) regarding Part I of the Draft Report on the 2012 Inspection of Ernst & Young LLP (the “Report”).

We have thoroughly evaluated the matters described in Part I – *Inspection Procedures and Certain Observations* of the Report and have taken actions to address findings in accordance with PCAOB standards and our policies.

The PCAOB’s inspection process assists us in identifying areas where we can continue to improve audit quality. We respect and benefit from this process as it aids us in fulfilling our responsibilities to investors, other stakeholders, and the capital markets generally.

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,



Stephen R. Howe, Jr.
Managing Partner



G. Thomas Hough
Vice-Chairman Assurance Services