Our commitment to audit quality

Information for audit committees and other stakeholders

Ernst & Young LLP

December 2014

Building a better working world
Audit committees and other stakeholders........................................................................................................... 1

1  Our commitment to audit quality .......................................................................................................................... 2

2  Our audit quality focus areas and recent actions .................................................................................................. 4

3  How we work to perform quality audits ................................................................................................................. 6

4  Creating high-performing teams and managing performance .................................................................................. 10

5  Monitoring audit quality ........................................................................................................................................... 12

6  PCAOB inspection activities, our reports and related matters .................................................................................. 14
Audit committees and other stakeholders

We are pleased to present this report on the commitment of the US audit practice of Ernst & Young LLP (the Firm or EY) to audit quality. Our intent is to make our audit practice more transparent by describing certain aspects of our system of quality control and discussing actions we have taken and continue to take to further improve audit quality. This report also discusses our internal monitoring activities, inspections by the Public Company Accounting Oversight Board (PCAOB) and related matters.

At EY, the delivery of quality audits is central to our purpose, values, management and processes. We take seriously the public franchise that has been entrusted to us and embrace the responsibility of serving the public interest and capital markets with excellence and professionalism. Our reputation is based on providing quality audit services objectively, independently and with appropriate professional skepticism.

Executing quality audits is a key part of Vision 2020, which sets out our purpose, ambition and strategy to provide exceptional client service worldwide. We have an unwavering commitment to quality and service. That means we are committed to making the necessary investments in people, processes and technology to give our global audit practice the ability to continue delivering the quality audits our stakeholders expect. The EY Global network is aligned in this purpose and is committed to quality and improving our practices worldwide.

The profession and the PCAOB continue to discuss audit quality indicators that audit committees and other stakeholders might consider in evaluating audit quality at a firm or audit engagement level. While we have long used a variety of metrics, measures and indicators to monitor our assurance practice and the quality of our work, the discussion of audit quality indicators is still in its early stages. There isn't a commonly accepted definition of audit quality, and a number of important questions remain to be answered on this complex topic, including what are the most appropriate measures and how those measures might inform one about audit quality.

In this year’s report, we have included a number of data points about our audit practice and, where appropriate, a brief discussion to provide context. We will use feedback from audit committees and other stakeholders to continue to assess and respond to the questions in this challenging and important area.

Our goal through this report is to foster further dialogue with our stakeholders about our commitment to audit quality. We appreciate your interest in our many quality improvement efforts and hope this report provides you with useful information. We welcome comments or questions that you may have about the Firm or the matters discussed in this report. Please contact any EY partner for more information.

Sincerely,

Stephen R. Howe, Jr.
Managing Partner
Ernst & Young LLP

Francis C. Mahoney
Vice Chair of Assurance
Ernst & Young LLP
Our commitment to audit quality

Quality audits provide credibility to financial reporting that is vital to the efficient functioning of the capital markets. Performing audits with integrity, expertise, objectivity and professional skepticism is at the heart of our responsibility as independent auditors — a responsibility we take most seriously.

Our quality control systems and practices are designed and operate to provide reasonable assurance that our work meets our professional standards and regulatory requirements. We believe we are meeting this important objective.

We nevertheless believe that we must make continuous investment and continuous improvement. In today’s dynamic environment, audits can’t be static. We are constantly striving to improve our performance to address increasingly complex business activities, new accounting and auditing standards and other changes in the business environment. This year, we continued to pursue several initiatives relating to audit quality, including those developed based on observations in our internal monitoring activities and external inspections.

Tone at the top

Quality begins with setting the right tone at the top of the organization. The global Ernst & Young organization promotes a culture of integrity. Our Global Code of Conduct provides a clear set of standards and behaviors that are grounded in our values and guide our actions and business conduct.

Our senior leaders set the tone and make clear for our people that quality and professional responsibility are of paramount importance. Our approach to ethics and integrity is embedded in our culture of consultation, our training programs and internal communications. Our internal message consistently has been that no company or business engagement is more important than the reputation of the Firm and each of our professionals.

We communicate to our people that performing quality work in compliance with professional standards is their most important responsibility. Senior leadership regularly reinforces these expectations. Quality is also a key element in how we evaluate and reward our senior leadership, our audit professionals and professionals from other service lines who are involved in the execution of audits.

The importance of the audit practice to EY

In December 2012, EY’s global organization launched Vision 2020, a plan to make it the leading global professional services organization over this decade. Executing quality audits is a central tenet of the Vision 2020 strategy.

Under Vision 2020, our audit practice is projected to continue to be the Firm’s largest practice in fiscal 2020 and the primary driver of our brand. Our reputation for audit quality is fundamental to achieving our ambition. We understand that our credibility in the market depends on the quality of our audit work. To that end, the EY global organization is undertaking several significant initiatives to build new audit tools and improve our methodology, processes and technology. These Audit Transformation efforts represent the largest investment under Vision 2020.
Responsibility and accountability for audit quality

Everyone at EY is responsible and accountable for audit quality. The responsibility and accountability for audit quality do not reside solely with the partner in charge of the audit who approves the issuance of our audit report. This responsibility and accountability begin at the top of the organization and run throughout the Firm. Our people understand that the responsibility for audit quality resides with each and every one of our partners and professional staff members in all of our service lines involved in performing and supporting audits.

This year, we further refined and formalized a framework to make more explicit the accountability for audit quality at all levels of the Firm. This framework is tied directly to making meaningful progress in many audit quality initiatives and to showing improvements in our inspection results. The framework is an important consideration in how our partners and other executives are rated and compensated. We believe these actions have increased and will continue to increase our focus, at all levels of the Firm, on the importance of delivering quality audits.

Our investments in audit quality

We continuously strive to improve audit quality. Our investments in structure, people, methodology and various processes have been substantial and necessary to meet the challenges of today’s business and regulatory environment. We believe that audit quality today is higher as a result of our continuous focus and improvement. We are committed to this path because that is what is right, what the investing public demands and what all of our stakeholders expect.

Our global network is making an investment of more than $400 million to build new audit tools and improve methodology, processes and technology. We are also developing new data analysis tools to help us more effectively and efficiently analyze large amounts of data and support critical thinking to identify issues, trends and anomalies.

In the fall of 2014, we began rolling out EY Canvas, our new audit tool that will replace our current audit support platform. Our goal with this and other new tools is to improve audit quality and project management. We plan a worldwide deployment of the new tool in 2015.

We expect EY Canvas to enhance audit quality and performance by better aligning the significant risks identified during an audit with the audit procedures that address those risks and by enabling our teams to better tailor audit procedures to the specific characteristics of the entity being audited.

Everyone at EY is responsible and accountable for audit quality. Our people understand that the responsibility for audit quality resides with each and every one of our partners and professional staff members in all of our service lines involved in performing and supporting audits.
Our audit quality focus areas and recent actions

Continuous improvement in audit quality requires challenging prior approaches to audit execution. We also focus on continuous improvement by evaluating all inspection findings and taking actions in response. Some of those actions may have an immediate effect. Others may take longer to take effect or require further revision before producing demonstrable results. In these cases, we understand that progress may be more of a journey to improvement.

Making improvements in our audits of ICFR

Recent PCAOB findings for EY and the profession as a whole indicate the need for improvement in audits of internal control over financial reporting (ICFR). The majority of findings in Part I of our most recently released PCAOB inspection report relate to ICFR audit matters.

During 2014, we have continued to invest significantly in training at all levels and have issued new guidance, tools and templates to help our audit teams make improvements in specific ICFR audit areas, such as evaluating and testing management review controls and evaluating an entity’s controls over the use of electronic audit evidence (EAE). We have increased our support team of Control and Methodology Leaders in our Quality Network (described later) to help audit teams address the application of audit standards and Firm methodology. Leaders at our national, region and office levels have continued to stress the need for added focus on ICFR, consistent with our responsibilities under professional standards.

Our greater emphasis on auditing ICFR also has often increased management’s focus on relevant controls. Implementing the updated internal control framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) is providing many of the entities we audit with the opportunity to take a fresh look at the specificity of company policies and procedures in certain ICFR areas.

We believe the actions we have taken to date are substantial and are resulting in measurable improvements to our work in this area. However, we recognize this effort is a multi-year undertaking that requires continued monitoring and adjustment as teams execute on the revised guidance. With highly focused implementation and monitoring efforts, we expect these improvements to become increasingly evident.

Quality Network

Over the past two years, we have significantly expanded our Quality Network that works closely with Assurance leadership and engagement teams. We now have an average of 11 full-time equivalent (FTE) professionals devoted to this function in each of our six US Regions. Our Quality Network is led by a senior partner who previously served in our Professional Practice group.

In each Region, the Quality Implementation Leader leads a network of professionals responsible for monitoring and enhancing audit quality by, among other things:

- Performing pre-issuance reviews and coaching audit teams
- Serving as a point of contact on questions related to the Firm’s audit methodology and guidance
- Supporting internal and external inspections
- Evaluating quality occurrences (i.e., situations involving a significant audit deficiency identified in the internal or external inspections or a restatement of financial statements) and related remediation efforts
- Coordinating and monitoring risk management processes, including client acceptance and continuance, audit partner rotation, audit partner workload and audit engagement staffing

Our Quality Network also actively drives usage of our team-directed coaching kits and our milestones audit execution program, both of which are discussed later in this report.
Professional Practice

Our Professional Practice group provides thought leadership and guidance on accounting, auditing, financial reporting, Securities and Exchange Commission (SEC) matters and other technical issues to our audit teams, the entities we audit and other stakeholders.

We have expanded our ranks of professionals in Professional Practice to keep pace with our growing audit practice and increase in audit partners. In the last three years, we have increased overall Professional Practice staffing by 45% and staffing at the partner level by 33%.

We have added to the ranks of partners in our National Accounting and National Auditing groups, Professional Practice partners located across the country and our Professional Practice Quality and Regulatory Matters (PPQRM) group. Our PPQRM group conducts our internal inspection program, monitors performance of pre-issuance reviews and firmwide remediation efforts and interfaces with the PCAOB in connection with its annual inspection of our Firm.

Our independence function

Our independence function provides the infrastructure and resources to help our professionals and the Firm meet applicable professional standards, regulatory requirements and our standards of quality with respect to independence. The organization consists of centrally based independence professionals and a network of independence professionals assigned to the Regions. Twenty partners lead our independence function and assist our teams.

Our annual independence learning program covers our independence requirements and focuses on recent policy changes, SEC, PCAOB and American Institute of Certified Public Accountants (AICPA) requirements and recurring themes and topics of importance. Professionals and certain other personnel are required to complete this annual learning. Timely completion is required and monitored closely.

<table>
<thead>
<tr>
<th>Professional Practice partners to audit partners</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
</tr>
<tr>
<td>2013</td>
</tr>
<tr>
<td>2014</td>
</tr>
</tbody>
</table>
How we work to perform quality audits

Providing services to the right organizations is an essential element of our quality control and risk management processes. We currently have the leading market share in auditing Fortune 500 (29%), Fortune 1000 (30%) and Russell 3000 (27%) companies. In each of the past three years, we have audited more companies that completed initial public offerings than any other firm. We also audit six of the top 10 companies on Fortune magazine’s 2014 list of the world’s most admired companies.

We have a rigorous process for evaluating risk and deciding whether to accept or continue to work on audit engagements. We consider independence requirements, identify and deal appropriately with any conflicts of interest and decline engagements that we believe may pose excessive risk.

<table>
<thead>
<tr>
<th>Number of public company clients</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
</tr>
<tr>
<td>2013</td>
</tr>
<tr>
<td>2014</td>
</tr>
</tbody>
</table>

Our mutual fund clients are evaluated at the overall fund complex level, and the figures in the table do not reflect more than 700 mutual fund issuers we audit.

Over the past three years, we have recognized the increased effort required to execute higher quality audits, particularly for integrated audits of public companies where we issue reports on the financial statements and ICFR.

Over the past three years, the hours we have spent on audits of public companies have increased 46%. This growth reflects the required increase in audit effort in a number of areas, especially ICFR, evaluating EAE, securities price testing and the engagement quality review.

The effort required to audit transactions (e.g., mergers and acquisitions, divestitures, carve-outs and spin-off transactions) and capital raising activities, including initial public offerings, also has increased significantly.

<table>
<thead>
<tr>
<th>Percentage increase in total public company audit engagement hours from the prior fiscal year</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
</tr>
<tr>
<td>2013</td>
</tr>
<tr>
<td>2014</td>
</tr>
</tbody>
</table>

Our people

Our people are our most valuable resource and the foundation for the delivery of quality audits. We have responded to the growing number of audit hours by stepping up our hiring of both experienced professionals and new college and university graduates and by promoting more of our people at all levels. We now have nearly 9,200 FTE professionals in our audit practice, up 24% from 7,400 in fiscal 2011.

<table>
<thead>
<tr>
<th>Number of audit partners and professional staff (on an FTE basis) – fiscal year</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012 Audit partners Executive directors (EDs), senior managers and managers Seniors and staff Total</td>
</tr>
<tr>
<td>824 1,779 5,370 7,973</td>
</tr>
<tr>
<td>2013 Audit partners EDs, senior managers and managers Seniors and staff Total</td>
</tr>
<tr>
<td>869 1,901 5,794 8,564</td>
</tr>
<tr>
<td>2014 Audit partners EDs, senior managers and managers Seniors and staff Total</td>
</tr>
<tr>
<td>904 2,073 6,191 9,168</td>
</tr>
</tbody>
</table>
We believe that audit quality is enhanced by timely, direct executive participation in audits. The audit partner in charge leads the team and sets the tone for the conduct and execution of the audit engagement. Therefore, we annually review the assignment of partners to the entities we audit so that the partner in charge has the capacity, skills, abilities and experience to fulfill his or her responsibilities. Furthermore, we comply with the audit partner rotation requirements of the SEC and other regulatory bodies (e.g., for certain financial institutions and insurance companies).

We also carefully consider a number of factors when assigning our professionals to audit teams, including knowledge of required accounting and auditing standards, engagement size and complexity, specialized industry knowledge and experience, timing of work, continuity and opportunities for on-the-job training.

Throughout the engagement staffing process, we are mindful of the supervision and on-the-job coaching requirements for our less-experienced people. As we have increased our hiring of experienced professionals and new graduates, we have also increased our ranks of partners, senior managers and managers to help balance the overall staff mix.

Audit partner hours on audit engagements increased 21% over the past three years but declined as a percentage of total audit hours because of the 31% increase in overall audit hours. Offsetting the increase in audit partner hours spent on audit engagements was a decrease in audit partner hours spent on non-client activities.

Interdisciplinary teams

We are involving more subject matter specialists in our audits in response to the increasing complexity in certain areas. Our information technology (IT) specialists are playing a bigger role in audits, because of the increase in emphasis on auditing ICFR and EAE. IT hours on audit engagements have increased by more than 20% since 2011 and represented 6.6% of total audit hours in fiscal 2014.

Similarly, hours our tax specialists incurred on audit engagements have increased 42% since 2011, because of increases in complexity and a greater emphasis on internal control over income taxes. In fiscal 2014, tax specialists’ hours represented 5.9% of total audit hours.

Hours of our valuation specialists providing audit support (primarily in issues related to valuation) have increased 22% since 2011 and in fiscal 2014 represented 1.6% of total audit hours.
Our commitment to audit quality

Workload management

Workload management has been a focus of our audit quality efforts. Demands on our professionals have continued to increase as a result of the complexities we’ve discussed and the need for us to increase our monitoring of our various quality initiatives.

We continue to closely evaluate the workloads of our audit professionals on both client and non-client activities and focus on whether they have the time necessary to perform quality work and that an appropriate level of executive involvement can occur at all stages of the audit. We have expanded the use of our Personal Workload Tool to help our audit partners, executive directors and senior managers and engagement executives from certain other service lines (e.g., tax partners working on public company audits) and Region leadership better evaluate the totality of each executive’s responsibilities and ability to handle the workload.

<table>
<thead>
<tr>
<th>Average annual hours incurred by audit professionals</th>
<th>Fiscal 2014</th>
<th>Fiscal 2013</th>
<th>Fiscal 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partners</td>
<td>2,596</td>
<td>2,603</td>
<td>2,586</td>
</tr>
<tr>
<td>EDs, senior managers and managers</td>
<td>2,474</td>
<td>2,469</td>
<td>2,451</td>
</tr>
<tr>
<td>Seniors and staff</td>
<td>2,400</td>
<td>2,385</td>
<td>2,365</td>
</tr>
</tbody>
</table>

While overall average annual hours have remained relatively stable over the past three years, there has been a shift toward client-related activities and away from non-client-related tasks, because of the need to increase hours spent on audits.

We encourage questions at all levels within the engagement team. We encourage our people to challenge whether we have arrived at the appropriate conclusion.

Culture of consultation

We continue to promote a culture of consultation as the best way to provide a quality audit. In today’s environment of challenging financial reporting issues, complicated accounting guidance and more complex audit judgments, we believe our consultation culture is a sign of strength. We encourage questions at all levels within the engagement team. We encourage our people to challenge whether we have arrived at the appropriate conclusion. We believe that we are smarter as a group and that consulting and leveraging the Firm’s resources help us get to the most appropriate answer. We encourage all EY professionals to make full use of the broad and diverse collective knowledge, expertise and experience available within the Firm. In each of the past three years, there have been more than 3,000 formal Professional Practice consultations on accounting, auditing and financial reporting matters.

Audit execution milestones

Planning is critical to the execution of a quality audit. By completing audit planning in a timely manner, teams can develop the appropriate audit strategies, execute interim testing earlier in the audit cycle and evaluate testing results so that any necessary changes to the audit scope or approach can be developed and executed in a timely manner. More timely execution also gives us the ability to monitor our efforts more effectively.

To help us achieve this objective, we are continuing a milestones program we launched in 2013 in which audit teams establish goals early in the audit cycle for when they will complete planning, internal control evaluation, interim audit work and other key audit efforts, including review by the executives on the audit.

We continue to make progress on this initiative and expect to realize further benefits over time as these milestones become more embedded as part of the audit cycle.
Coaching kits

While we continue to significantly expand classroom training at all levels, we are increasing our emphasis on on-the-job coaching to help our people transform knowledge into practice.

We continue to refine the engagement team-directed practice aids we call coaching kits that we developed in 2013, and we have developed additional kits in 2014. We now have coaching kits on 20 topics to help our audit teams better address certain areas of audit execution. The topics, which respond to issues we’ve observed in our internal and external inspections, include:

- Identifying and evaluating EAE
- Evaluating and testing management review controls
- Auditing management’s estimates
- Using the work of internal audit and others
- Auditing income taxes
- Scoping a multilocation engagement

Each kit provides a series of exercises that help team members use the facts and circumstances of their engagement to better understand and apply audit concepts, along with related guidance and tools. Engagement team members at all levels, including partners, participate in these exercises. Certain of the coaching kits are required on all of our audits of public companies. This year, we expect our audit engagement teams to complete more than 3,000 coaching kits as part of their audits of public companies.

One common audit methodology

A cornerstone of our global audit methodology, which we call EY GAM, is making risk assessments to determine the nature, timing and extent of our audit procedures. EY GAM also emphasizes applying appropriate professional skepticism in the execution of audit procedures.

We regularly update EY GAM and our forms, templates and examples to reflect new standards, emerging auditing issues, implementation experience and to respond to internal and external inspection results. To improve the quality of our audits, we have enhanced our guidance and tools related to testing internal controls and reliance on data and reports. We also have revised our audit methodology in areas such as fraud risks, auditing management’s estimates and performing substantive analytical procedures.
Creating high-performing teams and managing performance

Attracting, developing and retaining talented people are critical to our success. By offering a wealth of experiences and opportunities, we develop outstanding people who can achieve their potential.

**Recruiting and hiring**

We recruit on college and university campuses and also hire people with prior work experience. In fiscal 2014, we hired nearly 2,000 new graduates and 760 experienced professionals into our audit practice.

Because our people are highly skilled and highly trained, they are often sought after by many other companies to fill important roles. As a result, our ability to continue to attract, develop and retain top talent year after year is critical.

Turnover in any one year may fluctuate due in part to the strength of the economy. Our turnover rates were 16.5% in fiscal 2012, 18.4% in fiscal 2013 and 19.9% in fiscal 2014. While the rate has increased, we are constantly looking at ways to improve retention. Our increased hiring of experienced professionals has helped offset the higher turnover rate. We have a record number of FTE professionals in our audit practice and expect to continue to increase our hiring of graduates and experienced professionals in fiscal 2015.

Retaining experienced and knowledgeable professionals in the Firm is a priority. This continuity is important to addressing our workload management and broader audit quality efforts. For experienced hires, the length of service in the following table reflects only time with the Firm and does not include any years of prior work experience.

<table>
<thead>
<tr>
<th>Average length of EY service of audit professionals (in years)</th>
<th>Fiscal 2014</th>
<th>Fiscal 2013</th>
<th>Fiscal 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partners</td>
<td>21.5</td>
<td>21.3</td>
<td>21.0</td>
</tr>
<tr>
<td>Senior managers</td>
<td>11.2</td>
<td>11.3</td>
<td>11.2</td>
</tr>
<tr>
<td>Managers</td>
<td>5.6</td>
<td>5.9</td>
<td>6.0</td>
</tr>
<tr>
<td>Seniors</td>
<td>3.2</td>
<td>3.4</td>
<td>3.4</td>
</tr>
<tr>
<td>Staff</td>
<td>1.3</td>
<td>1.3</td>
<td>1.3</td>
</tr>
</tbody>
</table>

We remain focused on continuously improving the EY workplace environment and experience, and we are proud of the awards the Firm has earned. Some recent examples include:

- *Fortune* magazine’s “100 Best Companies to Work For” for the 16th year
- *DiversityInc* magazine’s Top 50 Companies for Diversity
- World’s most attractive professional services employer in Universum’s *World’s Most Attractive Employer* rankings
- *Working Mother* magazine’s 100 Best Companies for Working Mothers

**Professional development**

Training our professionals is a key component of our overall audit quality initiative. We continue to significantly expand classroom training at all levels.

Core audit training courses are supplemented by learning programs we develop in response to changes in auditing standards, accounting standards, independence and professional standards, and emerging practice issues. In recent years, we have invested in additional classroom training for our professionals, especially managers, senior managers and partners. Our partners through managers attend semiannual Executive Events, where we address emerging issues in accounting and auditing, including lessons learned from internal and PCAOB inspections.
We require each audit professional to obtain at least 20 hours of continuing professional education each year and at least 120 hours over a three-year period. Most of our audit professionals significantly exceed these requirements.

| Average annual continuing education hours per audit professional – fiscal year |
|---|---|
| 2012 | 108 hours |
| 2013 | 102 |
| 2014 | 122 |

Performance management

We have a comprehensive performance management process that requires our professionals to set goals, have clear work expectations, receive feedback and talk about their performance. As part of the annual review process, each professional, in conjunction with a more experienced counselor, identifies opportunities for further development. Professionals and their counselors are guided by a set of service line competencies that articulate the knowledge and skills that should be developed for a particular rank.

Partners and other professionals are evaluated and compensated based on criteria that include specific quality and risk management indicators, covering planned actions and related results.

Our partner compensation philosophy calls for meaningfully differentiated rewards based on a partner’s level of performance. In accordance with the SEC’s independence rules, our audit partners do not earn or receive compensation based on the provision of any non-audit services by EY to companies we audit.

Non-compliance with quality standards results in remedial actions that may include a compensation adjustment in addition to required special training, additional supervision or reassignment. A serious non-compliance matter or pattern of non-compliance may result in actions that include separation from the Firm.
5 Monitoring audit quality

Our monitoring of the effectiveness of the actions we take to improve our work is an important part of our quality control system. Monitoring allows us to evaluate the progress we are making on our efforts to continuously improve audit quality and to make appropriate changes to our action plans, where necessary, to facilitate further improvement.

We perform reviews of engagements by inspecting engagement documentation, reports and financial statements for a selection of completed and in-process engagements. Those reviews are sufficiently comprehensive to enable us to assess compliance with applicable professional standards and the Firm’s quality control policies and procedures. During 2014, we expect to look at the work of approximately one half of our audit partners with direct audit responsibilities through the various monitoring activities we describe below.

Post-issuance reviews

The annual Audit Quality Review (AQR) program is a cornerstone of our efforts to monitor audit quality and identify areas where improvements can be made. We select audit engagements for AQR using a risk-based approach that emphasizes audits that are large, complex or of significant public interest and also considers the time since a partner’s last inspection. The AQR program measures compliance with professional standards, relevant regulatory requirements and Firm policies and procedures.

In 2013, we adopted a more rigorous inspection framework. We believe the increased focus and inspection rigor were necessary to appropriately support and further the quality of our work over the longer term.

We also conduct a supplemental monitoring review (SMR) program in specific audit areas to focus on whether teams are applying new audit guidance appropriately. These reviews are designed to assess the effectiveness of actions we have taken to improve the performance of our work in the specific audit areas.

During our 2013 inspection year (which generally covered audits of the year ended December 31, 2012), we reviewed 283 audit engagements under our AQR and SMR programs, compared with 339 audits in our 2012 inspection year and 268 audits in our 2011 inspection year. We reviewed fewer engagements in our 2013 inspection year because we underwent an AICPA peer review, as described later.

Areas identified in our 2013 inspection year as requiring increased focus include our audits of ICFR, evaluating controls over the use of EAE, scoping multilocation audits, auditing management’s estimates and performing substantive analytical procedures.

We will review slightly fewer engagements in 2014 because we are expanding our pre-issuance review program. Based on our results to date, we have observed improvements in several areas, including in our audits of ICFR.

Consistent with our external inspection activities, our internal monitoring programs identify findings on inspected engagements. All more than minor findings are remediated timely and, depending upon severity, such findings are taken into consideration in the evaluations and related compensation of the partners and other members of the engagement teams. We track all individual findings, look for trends and analyze overall results as part of our continuous improvement efforts. We also look to identify the cause(s) of the findings and assess whether an individual matter may be more pervasive and require a change or enhancement to our audit methodology, policies, practices, procedures or training.
Pre-issuance reviews

We have expanded the program we launched in 2012 to review selected audits of public companies before we issue audit reports as part of our overall monitoring efforts. We also use these reviews to assess how well our teams understand and are applying new guidance, tools and enablers in areas such as ICFR and EAE.

Audits that have undergone pre-issuance reviews have demonstrated improved post-issuance inspection results. We therefore believe the pre-issuance review program is an important effort in our drive to improve audit quality.

<table>
<thead>
<tr>
<th>Number of pre-issuance reviews performed</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012 audits</td>
</tr>
<tr>
<td>2013</td>
</tr>
<tr>
<td>2014 (estimated)</td>
</tr>
</tbody>
</table>

The pre-audit report issuance reviews we expect to perform in 2014 will involve approximately 14% of our total public company audit base.

We believe this program provides timely and important interim feedback, benefiting not only the individual audit reviewed but also other audits performed by those teams. The approach provides valuable coaching to our teams while the audit is still in process and allows for appropriate adjustments to be made, where necessary, before we issue the audit reports. We also believe this program provides the Firm with important information that can be used more broadly for the benefit of all of our audit teams.

Restatements

Another area we monitor is the level of restatements of financial statements. The percentages and numbers in the table are based on our audits of SEC registrants filing on Form 10-K and include our audits of more than 700 mutual fund issuers each year.

<table>
<thead>
<tr>
<th>Restatements (percentage is of issuers we audit)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year</td>
</tr>
<tr>
<td>2011 filings</td>
</tr>
<tr>
<td>2012</td>
</tr>
<tr>
<td>2013</td>
</tr>
</tbody>
</table>

The most common audit areas giving rise to restatement activity included revenue recognition, income taxes, noncontrolling interest accounting and earnings per share.

Independence compliance monitoring

All professional personnel and certain other people at EY are required to confirm compliance with our independence policies and procedures no less than annually. Partners through managers are required to confirm compliance with certain independence matters quarterly.

We conduct testing to assess compliance with these and other independence requirements. For example, we audit each partner’s compliance with our independence policies approximately every five years, and Firm leadership is audited every three years.
PCAOB inspection activities, our reports and related matters

The PCAOB conducts annual inspections of our system of quality control and selected public company audit engagements.

The public portion of the PCAOB report (Part I) describes the procedures performed during the inspection and certain observations regarding audit performance on specific engagements. Part II of the inspection report includes the PCAOB’s observations on certain policies, practices and procedures related to a firm’s system of quality control. An inspected firm has one year to address any deficiencies identified in this section of the report to the PCAOB’s satisfaction. Deficiencies that are not remediated to the PCAOB’s satisfaction within this time frame may be reported publicly.

The PCAOB inspection reports point out that the PCAOB chooses audits for inspection based on various risk factors and the selected audits are not a representative sample of all audits conducted by a firm. As a result, the PCAOB cautions against drawing comparisons or conclusions based on the number of reported deficiencies.

### Part I findings

<table>
<thead>
<tr>
<th>Inspection year</th>
<th>Fiscal year of audits inspected (generally)</th>
<th>Number of inspected audits</th>
<th>Audits identified in Part 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>Dec. 2010</td>
<td>56</td>
<td>20</td>
</tr>
<tr>
<td>2012</td>
<td>Dec. 2011</td>
<td>52</td>
<td>25</td>
</tr>
<tr>
<td>2013</td>
<td>Dec. 2012</td>
<td>57</td>
<td>28</td>
</tr>
</tbody>
</table>

In our 2013 inspection report, the findings in 27 of the 28 issuer audits cited in Part I of the report relate to ICFR. This ICFR findings level compares with 23 of 25 issuer audits in our 2012 PCAOB inspection report and 15 of 20 issuer audits in 2011.

The most prevalent area of inspection findings in the PCAOB inspection reports for the profession as a whole also relates to the audits of ICFR.

### Our perspective and actions

We were disappointed with our overall inspection results and trends and recognized that we needed to take a number of significant actions to improve our performance, particularly in audits of ICFR. We have taken and are taking steps to address all of the matters described in the inspection reports to improve the overall quality of our audits.

### Part II findings

In June 2014, the PCAOB concluded that we had satisfactorily addressed the majority of the Part II matters included in its report on 2010 inspections (covering primarily 2009 year-end audits) but that we had not remediated two specific findings within the required time frame to the PCAOB’s satisfaction. As a result, findings related to evaluating contrary or new evidence in auditing management estimates and performing engagement quality reviews were publicly disclosed. We are continuing to take actions to improve the quality of our work in these areas.

### Status of inspection reports

In recent inspection reports, the PCAOB has identified several areas in which it believes improvement is necessary. Areas identified by the PCAOB and our AQR program are critical inputs to our development of action plans for continuous improvement. Many of the steps we are taking to address these areas were discussed earlier in this report.
The actions we take in response to the PCAOB’s observations are influenced by many factors including, for example, the nature of the observations, the time required to evaluate and implement changes in policies, processes and training, and our ability to monitor the effectiveness of the changes we implement. We have made and will continue to make significant investments in people and processes to implement corrective actions and to monitor the effectiveness of those actions.

We take all PCAOB Part II observations seriously and believe we have actions planned or underway to address effectively all Part II matters within the required remediation period. We value the PCAOB inspection process because it, along with our internal monitoring efforts, helps us to identify areas where we can continue to improve our performance. Our overriding objective is to make certain that we perform quality audits.

<table>
<thead>
<tr>
<th>Status of inspection reports</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
</tr>
<tr>
<td>Inspection is currently in process</td>
</tr>
<tr>
<td>2013</td>
</tr>
<tr>
<td>Report issued in August 2014; EY final response to be filed in August 2015</td>
</tr>
<tr>
<td>2012</td>
</tr>
<tr>
<td>Report issued in June 2013; EY final response filed in June 2014; PCAOB review of our response is in process</td>
</tr>
<tr>
<td>2011</td>
</tr>
<tr>
<td>Report issued in December 2012; EY final response filed in December 2013; PCAOB review of our response is in process</td>
</tr>
<tr>
<td>2004 - 2010</td>
</tr>
<tr>
<td>Inspections reports are closed</td>
</tr>
</tbody>
</table>

**Peer review**

The Firm participates in the AICPA peer review program that requires a triennial review of our system of quality control for our accounting and auditing practice for audits of entities other than SEC issuers. Our last peer review was conducted in 2013 and concluded just after our November 2013 update was issued.

In a peer review, firms can receive a rating of pass, pass with deficiency(ies) or fail. The firm that conducted our 2013 peer review issued a report with a pass rating. The peer review firm’s report concluded that our system of quality control for our nonpublic company audits had been suitably designed and complied with during the peer review year to provide the Firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.

**Other reviews**

We are also subject to limited inspections by other foreign regulators related either to US companies with securities registered on foreign exchanges or component audits of US company operations. In addition, the US Department of Labor conducts periodic inspections of our employee benefit plan audits.
About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

Ernst & Young LLP is a client-serving member firm of Ernst & Young Global Limited operating in the US.

© 2014 Ernst & Young LLP.
All Rights Reserved.
SCORE no. BB2888
ED: None

This and many of the publications produced by our US Professional Practice Group, are available free on AccountingLink at www.ey.com/us/accountinglink.

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.