23 March 2010

To:

Recently, there have been extensive media reports about the release of the Bankruptcy Examiner’s Report relating to the September 2008 bankruptcy of Lehman Brothers. Ernst & Young was Lehman Brothers’ independent auditors.

The concept of an examiner’s report is a feature of US bankruptcy law. It does not represent the views of a court or a regulatory body, nor is the Report the result of a legal process. Instead, an examiner’s report is intended to identify potential claims that, if pursued, may result in a recovery for the bankrupt company or its creditors. EY is confident we will prevail should any of the potential claims identified against us be pursued.

We wanted to provide you with EY’s perspective on some of the potential claims in the Examiner’s Report. We also wanted to address certain media coverage and commentary on the Examiner’s Report that has at times been inaccurate, if not misleading. A few key points are set out below:

**General Comments**

- EY’s last audit was for the year ended November 30, 2007. Our opinion stated that Lehman’s financial statements for 2007 were fairly presented in accordance with US GAAP, and we remain of that view. We reviewed but did not audit the interim periods for Lehman’s first and second quarters of fiscal 2008.

- Lehman’s bankruptcy was the result of a series of unprecedented adverse events in the financial markets. The months leading up to Lehman’s bankruptcy were among the most turbulent periods in our economic history. Lehman’s bankruptcy was caused by a collapse in its liquidity, which was in turn caused by declining asset values and loss of market confidence in Lehman. It was not caused by accounting issues or disclosure issues.

- The Examiner identified no potential claims that the assets and liabilities reported on Lehman’s financial statements (approximately $691 billion and $669 billion respectively, at November 30, 2007) were improperly valued or accounted for incorrectly.

**Accounting and Disclosure Issues Relating to Repo 105 Transactions**

- There has been significant media attention about potential claims identified by the Examiner related to what Lehman referred to as “Repo 105” transactions. What has not been reported in the media is that the Examiner did not challenge Lehman’s accounting for its Repo 105 transactions.

- As recognized by the Examiner, all investment banks used repo transactions extensively to fund their operations on a daily basis; these banks all operated in a high-risk, high-leverage business model. Most repo transactions are accounted for as financings; some (the Repo 105 transactions) are accounted for as sales if they meet the requirements of SFAS 140.

- The Repo 105 transactions involved the sale by Lehman of high quality liquid assets (generally government-backed securities), in return for which Lehman received cash. The media reports that these were “sham transactions” designed to off-load Lehman’s “bad assets” are inaccurate.
• Because effective control of the securities was surrendered to the counterparty in the Repo 105 arrangements, the accounting literature (SFAS 140) required Lehman to account for Repo 105 transactions as sales rather than financings.

• The potential claims against EY arise solely from the Examiner's conclusion that these transactions ($38.6 billion at November 30, 2007) should have been specifically disclosed in the footnotes to Lehman's financial statements, and that Lehman should have disclosed in its MD&A the impact these transactions would have had on its leverage ratios if they had been recorded as financing transactions.

• While no specific disclosures around Repo 105 transactions were reflected in Lehman's financial statement footnotes, the 2007 audited financial statements were presented in accordance with US GAAP, and clearly portrayed Lehman as a leveraged entity operating in a risky and volatile industry. Lehman's 2007 audited financial statements included footnote disclosure of off balance sheet commitments of almost $1 trillion.

• Lehman's leverage ratios are not a GAAP financial measure; they were included in Lehman's MD&A, not its audited financial statements. Lehman concluded no further MD&A disclosures were required; EY did not take exception to that judgment.

• If the Repo 105 transactions were treated as if they were on the balance sheet for leverage ratio purposes, as the Examiner suggests, Lehman's reported gross leverage would have been 32.4 instead of 30.7 at November 30, 2007. Also, contrary to media reports, the decline in Lehman's reported leverage from its first to second quarters of 2008 was not a result of an increased use of Repo 105 transactions. Lehman's Repo 105 transaction volumes were comparable at the end of its first and second quarters.

Handling of the Whistleblower's Issues

• The media has inaccurately reported that EY concealed a May 2008 whistleblower letter from Lehman’s Audit Committee. The whistleblower letter, which raised various significant potential concerns about Lehman’s financial controls and reporting but did not mention Repo 105, was directed to Lehman’s management. When we learned of the letter, our lead partner promptly called the Audit Committee Chair; we also insisted that Lehman’s management inform the Securities & Exchange Commission and the Federal Reserve Bank of the letter. EY’s lead partner discussed the whistleblower letter with the Lehman Audit Committee on at least three occasions during June and July 2008.

• In the investigations that ensued, the writer of the letter did briefly reference Repo 105 transactions in an interview with EY partners. He also confirmed to EY that he was unaware of any material financial reporting errors. Lehman’s senior executives did not advise us of any reservations they had about the company’s Repo 105 transactions.

• Lehman’s September 2008 bankruptcy prevented EY from completing its assessment of the whistleblower’s allegations. The allegations would have been the subject of significant attention had EY completed its third quarter review and 2008 year-end audit.

Should any of the potential claims be pursued, we are confident we will prevail.

Thank you for your support in this matter. Please feel free to call me directly at any time at

With best regards,