

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9096 / December 17, 2009

SECURITIES EXCHANGE ACT OF 1934
Release No. 61196 / December 17, 2009

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3087 / December 17, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13725

In the Matter of

ERNST & YOUNG LLP

Respondent.

**ORDER INSTITUTING PUBLIC
ADMINISTRATIVE AND CEASE-AND-
DESIST PROCEEDINGS, PURSUANT TO
SECTION 8A OF THE SECURITIES ACT
OF 1933, SECTIONS 4C AND 21C OF THE
SECURITIES EXCHANGE ACT OF 1934,
AND RULE 102(e) OF THE
COMMISSION'S RULES OF PRACTICE,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 (“Securities Act”), Sections 4C¹ and 21C of the Securities Exchange Act of 1934 (“Exchange Act”), and Rule 102(e)(1)(iii) of the Commission’s Rules of Practice against Ernst & Young LLP (“Respondent”).²

¹ Section 4C provides, in relevant part, that:

The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications to represent others . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

² Rule 102(e)(1) provides, in pertinent part, that:

The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found...

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Sections 4C and 21C of the Securities Exchange Act of 1934, and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds³ that:

Summary

1. This matter involves violations of the federal securities laws by Ernst & Young LLP ("E&Y") while serving as public auditor for Bally Total Fitness Holding Corporation ("Bally") from 2001 through 2004. In connection with Bally's 2001-2003 financial statements, Bally engaged in fraudulent financial accounting, including prematurely recognizing revenue and improperly deferring costs, which overstated income and inflated stockholders' equity. Bally also made false and misleading disclosures regarding a \$55 million special charge in its 2002 Form 10-K. On November 30, 2005, Bally filed its 2004 Form 10-K, which restated its previously reported financial statements for 2002 and 2003, and selected financial data for 2000 and 2001.

2. Notwithstanding that it knew or should have known of Bally's fraudulent financial accounting and false and misleading disclosures, E&Y issued unqualified audit opinions regarding Bally's 2001-2003 financial statements, which stated that E&Y had conducted its audits in accordance with auditing standards generally accepted in the United States ("GAAS") and that Bally's financial statements were presented in conformity with accounting principles generally accepted in the United States ("GAAP"). Contrary to the audit opinions, E&Y's audits of Bally's financial statements were not performed in accordance with GAAS and Bally's financial statements were not in conformity with GAAP.

(iii) to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.

³ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

3. By issuing these false and misleading audit opinions, E&Y was a cause of and aided and abetted Bally's violations of Sections 17(a)(2) and (3) of the Securities Act and Sections 13(a) and (b)(2)(A) of the Exchange Act and Exchange Act Rules 12b-20, 13a-1, 13a-11, and 13a-13. E&Y also violated Section 10A of the Exchange Act by not bringing to the attention of Bally's Audit Committee Bally's false and misleading disclosures of the \$55 million special charge.

Respondent

4. Ernst & Young LLP was Bally's independent auditor throughout the relevant period. On March 30, 2004, Bally announced that E&Y had resigned as its independent auditor.

Issuer

5. Bally Total Fitness Holding Corporation, a Delaware corporation, purported to be the largest, and only nationwide, commercial operator of fitness centers. At all relevant times, Bally's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange ("NYSE"). The NYSE delisted Bally's common stock on June 8, 2007. After filing for reorganization under Chapter 11 of the Bankruptcy Code, on September 17, 2007, Bally emerged as a privately held reorganized entity. On February 28, 2008, the Commission filed a settled injunctive action against Bally in the United States District Court for the District of Columbia, charging Bally with violating Section 17(a) of the Securities Act, Sections 10(b), 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, and Rules 10b-5, 12b-20, 13a-1, 13a-11 and 13a-13 thereunder. The District Court issued permanent injunctions on May 8, 2008.

Background

6. For many years up until it resigned in 2004, E&Y audited Bally's financial statements. Bally's principal source of revenue was selling gym membership contracts, which provided customers access to gyms in exchange for the payment of both a one-time initiation fee and monthly dues. The one-time fee was typically several thousand dollars, while the monthly dues typically were less than \$10 per month. Most of Bally's customers financed their initiation fees. To maintain their memberships, customers were required to pay their initiation fee in full and pay monthly dues. The initiation fees were Bally's biggest source of revenue. The obligation to pay the initiation fee was legally enforceable; there was no legal obligation to pay monthly dues beyond the initial contract period.

7. E&Y recognized Bally as a risky audit and, from at least 1996 through 2003, designated Bally as a "close monitoring" account because Bally presented a risk that created "a significant chance the firm [E&Y] will suffer damage to its reputation, monetarily, or both." Bally was designated a close monitoring account for several reasons, including, among other things, that Bally's managers were former E&Y audit partners who were "difficult" and had "historically been aggressive in selecting accounting principles and determining estimates;" the managers placed undue emphasis on maintaining stock prices; management used "(un)reliable

. . . estimation process[es] or questionable judgments;" and Bally's compensation plans placed undue emphasis on reported earnings. E&Y's internal guidance notes that a "history of 'aggressive' applications of accounting policies could indicate a predisposition to misstate the financial statements."

8. In early 2002, E&Y sought to reduce its risk by identifying its riskiest clients and resigning from them or otherwise managing the risk they presented to E&Y. Out of a total of over 10,000 audit clients in North America, E&Y identified Bally as one of the riskiest 18 accounts. These 18 accounts were so-called "National Focus Accounts" and were monitored by the Americas Executive Board. Not only was Bally identified as a National Focus Account, it was identified as the riskiest account in E&Y's Lake Michigan Area.

Bally's Accounting Errors and E&Y's Audit Failures **Relating to Fiscal Years 2001 and 2002**

9. In connection with fiscal years 2001 and 2002, as well as earlier years, Bally engaged in certain practices relating to its recognition of reactivation revenue, initiation fee revenue, and deferred costs that made its financial statements false and misleading. E&Y, which knew or should have known of these practices, issued unqualified audit opinions in connection with its audits of such financial statements.

Premature Recognition of Reactivation Revenues

10. Bally recognized revenue from what it called "reactivations," which were payments from Bally members who had completed their initial contract period, but whose memberships were canceled for failure to pay the monthly dues necessary to maintain their membership. Bally did not attempt to recover those dues because there was no legal obligation to pay dues. Accordingly, for those canceled members who had completed the initial contract period, Bally waited at least six months after receiving their last payment and then began soliciting these canceled members to reactivate. Those who accepted the reactivation offers did so, on average, 36 months after having stopped paying monthly dues. The reactivation offers did not contain claims for or seek payment of "past due" amounts. Instead, they asked for either a nominal reactivation fee or no reactivation fee at all, and the payment of monthly dues for a period of future service.

11. Bally's reactivation accounting policy was to project (as of the balance sheet date) the reactivation payments it anticipated receiving in the coming year and then immediately recognize most of these projected payments by improperly allocating them to past periods. Bally's reactivation accounting was not in conformity with GAAP because Bally recognized revenue before it was earned and was realized or realizable. Bally recognized revenue before it was earned because, among other things, it barred canceled former members from the gyms, and therefore, had not provided services to those of its canceled members who might reactivate in the future. Additionally, Bally recognized revenue before it was realized or realizable because it was recognizing revenue for reactivations that had not yet occurred, which it anticipated from canceled former members whom it could not identify individually and who had no legal obligation to reactivate or pay Bally anything at all. In short, Bally violated GAAP by

recognizing revenue related to the anticipated future payments before the reactivation transactions occurred.

12. E&Y knew or should have known that Bally's accounting policy for reactivation revenues was not in conformity with GAAP, yet it issued unqualified opinions regarding Bally's 2001 and 2002 financial statements.

Premature Recognition of Initiation Fee Revenue

13. Members paid a substantial initiation fee in connection with new membership contracts. Beginning in 1997, Bally recognized initiation fee revenue over the estimated average membership life, which included an estimate for both the average initial contract period and the average renewal period. Bally computed the weighted average expected membership life to be 22 months for financed memberships and 36 months for cash memberships.

14. Bally's 1997 computations of the weighted average expected membership life were flawed. A cursory inspection of the computations would have revealed these flaws. In 1997, E&Y had checked Bally's arithmetic and suggested some minor adjustments, but had failed to test whether Bally's computations produced results that were consistent with reality, and failed to determine that Bally's computation was fundamentally incorrect. The errors in Bally's estimates had the effect of understating the average membership life. As a result, Bally's member life estimates improperly accelerated revenue recognition and distorted the economic reality of Bally's business.

15. These errors continued through the relevant period and E&Y knew or should have known that by recognizing initiation fee revenue from financed contracts over 22 months, Bally was improperly recognizing revenue before it was earned and realized or realizable in contravention of GAAP.

E&Y's Audits Were Deficient and Not Performed in Accordance with GAAS

16. E&Y's audits of Bally's reactivation accounting and initiation fee revenues were deficient and not performed in accordance with GAAS. As an initial matter, E&Y knew that Bally was a risky client due to, among other things, management's aggressive accounting policies.

17. E&Y prepared a memorandum in connection with the FY 2000 audit, which concluded, improperly, that Bally's reactivation revenue accrual "does not appear to be precluded by SAB 101." The memorandum indicated that (a) members who did not pay dues after the initial contract period were barred from the gyms after a grace period, and (b) these members had no legally enforceable obligation to pay dues after the initial contract period or to reactivate their memberships. E&Y knew or should have known that these facts undermined and contradicted the conclusion that the reactivation accrual "does not appear to be precluded by SAB 101." E&Y should not have concluded that Bally's reactivation revenue policy was in conformity with GAAP and thus E&Y failed to reasonably assess whether Bally's financial statements were presented in conformity with GAAP, as required by GAAS.

18. E&Y also knew or should have known that part of the rationale contained in the 2000 memo supporting Bally's reactivation revenue policy -- that reactivation revenue was a continuation of the original contract -- was contrary to a representation that Bally had previously made to the Commission staff, in connection with its calculation of the average membership life estimate, that reactivation memberships were "in substance and in form, new contractual arrangements." E&Y failed to address or resolve Bally's conflicting revenue recognition treatments of reactivation memberships.

19. Initiation fee revenue was the largest component of Bally's revenue. In 1997, Bally had committed to the Commission staff that the company would periodically update its member life estimates. Contrary to that commitment, Bally failed to update its member life estimates throughout the period E&Y remained its auditor.

20. E&Y knew of Bally's failure to keep that commitment. In fact, E&Y formally requested Bally to update its member life computations in 1998, 2001, and 2002, but Bally never did so. In response to E&Y's 2001 request, Bally asserted that the 1997 calculations were still "an appropriate approximation of the current historical average membership length" because the original calculation constituted a "35-year historical average." In fact, the 1997 calculation did not constitute a 35-year historical average, but reflected an average from a much smaller pool of data. E&Y knew or should have known that Bally's representations regarding the 1997 calculation were false.

21. E&Y failed to perform adequate audit procedures with regard to the renewal period estimate and the resulting amortization period. Rather, E&Y simply carried forward the 1997 estimates pertaining to the average renewal period. Given the critical nature of this accounting estimate, E&Y's failure to obtain from the Company an update or to arrive at its own independent estimate constitutes a departure from GAAS.

22. E&Y knew or should have known that Bally's 2001 and 2002 financial statements were not presented in conformity with GAAP, and it failed to qualify its opinion or issue an adverse opinion as required by GAAS.

E&Y Seeks To Reduce Its Risk: 2002-2003

23. In 2001 and 2002, a series of widely-known financial scandals led E&Y to assess its audit risks and the firm took steps to identify and resign from or focus on certain of its riskiest clients. Internally, E&Y was communicating the dangers of retaining high risk clients, but even though E&Y identified Bally as one of its riskiest clients during the 2002 client continuance process, E&Y did not resign from Bally. Instead, E&Y tried to reduce the risk that Bally's accounting practices posed to E&Y by, among other things, insisting for the first time that Bally record the numerous accounting errors that had "historically been [placed by E&Y] on the summary of audit differences."

24. In addition, as a result of the implementation of the "Focus Accounts" program, Bally, its accounting, and its retention as an E&Y client came under scrutiny from E&Y regional and national management. E&Y's National Office actively participated in events relating to

Bally's critical accounting issues. From July 2002 through March 2003, E&Y had numerous internal communications and meetings regarding the risks posed by Bally generally, as well as particular risky accounting issues, including, among other things, Bally's revenue recognition estimates. Bally was the subject of a series of meetings with E&Y management, and Bally was placed on a list of National Focus Accounts for Americas Executive Board attention.

**E&Y Knew or Should Have Known Bally Made False and Misleading Disclosures
Regarding a \$55 Million Charge in Fiscal Year 2002**

25. As of 2002, Bally's allowance for doubtful accounts ("ADA") had long been on E&Y's list of concerns regarding aggressive accounting. Bally's estimate of the ADA was another area in which management's estimates appeared aggressive. Year in and year out, from 1997 through 2002, Bally consistently used a 41% reserve rate, despite changes in the economy and in market conditions. The resulting ADA was always at the low end of the range that E&Y had deemed to be reasonable.

26. During the third quarter of 2002, E&Y determined that Bally's collections had deteriorated substantially, and E&Y advised Bally that it needed to increase its ADA in order to cover the shortfall resulting from the deteriorating collections. Bally insisted that no change be made to the ADA until the fourth quarter to allow it time to obtain waivers of debt covenants provisions from Bally's lenders.

27. During the fourth quarter of 2002, Bally agreed to increase its ADA by \$55 million and ultimately presented it as a "special charge" in Bally's year-end financial statements. In its 2002 Form 10-K, Bally made false and misleading disclosures regarding the reasons for the charge, and E&Y knew or should have known that the disclosures were improper. The only reason for the charge cited in the Form 10-K was that Bally's estimation was based on an accelerated monetization scenario which would result in collecting less than book value. No mention was made of the deterioration of the collectability of Bally's accounts receivable portfolio, which had been identified by E&Y as requiring Bally to take a charge.

28. The \$55 million special charge virtually eliminated Bally's 2002 earnings. E&Y knew or should have known that Bally's disclosures failed to disclose accurately the reasons for the "special charge," yet E&Y did not object. E&Y also failed to tell Bally's Audit Committee about Bally's false and misleading disclosures.

Bally's Accounting Errors and E&Y's Audit Failures Relating to Fiscal Year 2003

29. In March 2003, after the 2002 audit had concluded but before the company had filed its 2002 Form 10-K, E&Y contemplated resigning from the Bally engagement "due to risk issues." E&Y decided against resigning in favor of staying on and reducing its risk.

30. Following the decision to remain as Bally's auditor, a new E&Y audit engagement partner rotated on to the Bally engagement in April 2003. The new engagement partner, who was selected because he was experienced and capable of delivering tough messages, was instructed to "fix this situation to reduce the firm's risk."

Recognition of Reactivation Revenue

31. In June 2003, Bally was in the process of refinancing its bank debt through a private debt offering, to be followed by a public exchange offering. In connection therewith, Bally needed E&Y to provide a comfort letter to the underwriters and a consent regarding Bally's use of E&Y's unqualified audit opinion relating to the 2002 audit. E&Y told Bally that unless it stopped accruing reactivation revenue, E&Y would not provide those documents, which left Bally with no real alternative but to agree to stop accruing reactivation revenue. Even though a few months earlier E&Y had issued an unqualified audit opinion regarding Bally's 2002 financial statements that included its reactivation revenue accrual, in a June 16, 2003 meeting, E&Y demanded that Bally change its reactivation accounting. That same day, after the audit team consulted with E&Y's National Office, E&Y agreed to provide Bally with a preferability letter stating that the proposed change in reactivation accounting to a cash basis was a more preferable method of accounting for reactivation revenues.

32. E&Y knew or should have known that Bally's change in accounting for reactivation revenues was not, in fact, a change in accounting, but rather was a correction of an error that required a restatement because Bally's original accrual methodology was not in conformity with GAAP. A change in accounting can only be used to move from a GAAP-compliant accounting methodology to a more preferable GAAP-compliant accounting methodology; errors in previously issued financial statements cannot be corrected through an accounting change. Bally's 2003 financial statements, therefore, improperly included a cumulative effect charge of \$20.3 million associated with its change in accounting principle when its prior years' financial statements should have been restated. Accordingly, Bally's 2003 financial statements were not presented in conformity with GAAP, yet E&Y issued an unqualified audit opinion on Bally's 2003 financial statements.

Recognition of Initiation Fee Revenue

33. For the year-end 2003 audit, E&Y turned its attention to Bally's other accounting estimates, including the member life estimates used in determining the amortization period of initiation fees that E&Y knew or should have known were not in conformity with GAAP. E&Y had repeatedly identified as a "critical accounting policy" Bally's initiation fee revenue recognition methodology. Given the concerns about fraud perpetrated by means of accounting estimates, for the 2003 audit, E&Y planned to focus its attention on Bally's membership revenue recognition methodology.

34. E&Y's audit planning reflected its awareness that Bally had failed to update its member life estimate since 1997 and that the company had ignored both its commitment to the Commission staff to do so and E&Y's repeated recommendations to do so. Consistent with its audit planning concerns about Bally's aggressive estimates and the risk of financial fraud, E&Y requested that Bally provide support for the member life estimate for the 2003 fiscal year. Despite repeated efforts to obtain the information, E&Y never received the requested support.

35. Rather than continuing to press Bally for support for its complex accounting estimates, at a meeting on January 25, 2004, E&Y encouraged Bally to change its complex

accounting methods, including initiation fee revenues. E&Y prepared an agenda for the January 2004 meeting with Bally; four of the five agenda items related to identified audit adjustments totaling approximately \$260 million.

36. At the January 2004 meeting, E&Y notified Bally that it would have to take a charge relating to new accounting guidance that Bally had failed to implement during the third quarter of 2003. E&Y also identified three adjustments that Bally would have to book. E&Y made clear that the new accounting guidance would require Bally to apply a modified cash basis of accounting to some of its contracts. As Bally and E&Y discussed the proposed change, Bally's CFO proposed adopting a modified cash basis of accounting for all of the company's membership contracts. E&Y knew or should have known that the change to a modified cash basis for the rest of Bally's revenue recognition accounting would allow Bally to avoid or at least reduce the significance of some of the charges E&Y had identified. The proposed changes would also subsume some of the prior audit failures relating to initiation fee revenues. Bally changed its accounting and E&Y issued a preferability letter that it knew or should have known enabled Bally to improperly avoid a restatement.

37. Bally's change from accrual accounting to a modified cash basis of accounting was not, in fact, a change in accounting, but rather involved a correction of an error that required a restatement because Bally's implementation of the deferral method for recognition of initiation fee revenue was not in conformity with GAAP. Accordingly, Bally's 2003 financial statements were not presented in conformity with GAAP, but E&Y nonetheless issued an unqualified audit opinion on Bally's 2003 financial statements.

E&Y's Audit Was Deficient and Not Performed in Accordance with GAAS

38. E&Y's 2003 audit was deficient and not performed in accordance with GAAS. E&Y failed to obtain sufficient competent evidential matter to support an opinion that Bally's estimates, including the average member life estimates, were reasonable. E&Y told Bally's audit committee that GAAS prescribed certain "mandatory procedures," including: "reviewing accounting estimates for biases that could result in material misstatement due to fraud, including retrospective review of significant prior year estimates. . . ."

39. E&Y also did not follow up on evidence that Bally's average member life estimates were biased and unsubstantiated.

40. The change in accounting to a modified cash basis resulted in Bally recording a cumulative effect adjustment ("CEA") of more than \$441 million, which was much more than the effect of the identified audit adjustments referred to above, but allowed Bally to provide a positive explanation for the effect. Given that a significant amount of the CEA related to how Bally had amortized the initiation fees over a period of less than two years, E&Y should have questioned how two supposedly GAAP-compliant methodologies resulted in such a material disparity in earnings. Nonetheless, E&Y failed to do so. If it had followed up, E&Y would have determined that Bally's prior calculation of the member life estimates was not reasonable and the

Company's straight-line amortization of the financed membership initiation fees over a 22-month period was not in conformity with GAAP.

41. Just as E&Y's issuance of a preferability letter with regard to the change in accounting for reactivation dues was improper, so too was its issuance of a preferability letter with regard to the change to a modified cash basis for initiation fees. By the time E&Y began the 2003 audit, E&Y was aware of the issues associated with the average member life estimate that required vigorous audit procedures, yet E&Y failed to respond adequately.

42. E&Y knew or should have known that Bally's 2003 financial statements were not presented in conformity with GAAP, and it failed to qualify its opinion or issue an adverse opinion as required by GAAS.

Legal Analysis

43. Section 17(a)(2) of the Securities Act prohibits obtaining money or property by means of untrue statements of material fact or misleading omissions of material fact in the offer or sale of securities. Section 17(a)(3) of the Securities Act prohibits engaging in transactions, practices or courses of business which operate or would operate as a fraud or deceit upon the purchaser in the offer or sale of securities. Information is material where there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision. *Basic, Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). Establishing violations of Section 17(a)(2) and 17(a)(3) does not require a showing of scienter. *Aaron v. SEC*, 446 U.S. 680, 697 (1980).

44. Section 13(a) of the Exchange Act and Rules 13a-1, 13a-11 and 13a-13 thereunder require all issuers with securities registered under Section 12 of the Exchange Act to file annual, current and quarterly reports on Form 10-K, Form 8-K and Form 10-Q, respectively. Exchange Act Rule 12b-20 further requires that, in addition to the information expressly required to be included in such reports, the issuer must include such additional material information as may be necessary to make the required statements, in light of the circumstances under which they were made, not misleading. The obligation to file these periodic reports includes the obligation that they be complete and accurate in all material respects. *See, e.g., SEC v. IMC Int'l, Inc.*, 384 F. Supp. 889, 893 (N.D. Tex.), *aff'd mem.*, 505 F.2d 733 (5th Cir. 1974), *cert. denied sub nom.* No showing of scienter is necessary to establish a violation of Section 13(a) of the Exchange Act and Rules 13a-1, 13a-11, 13a-13 and 12b-20. *See SEC v. McNulty*, 137 F.3d 732, 740-741 (2d Cir. 1998).

45. Section 13(b)(2)(A) of the Exchange Act requires issuers to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer."

47. Bally violated Section 17(a)(2) and (3) of the Securities Act and Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder by, among other things, prematurely recognizing income and improperly deferring costs which resulted in its books and records being false, failing to maintain accurate books and records and

including material, false and misleading financial statements and information in annual, quarterly and current reports filed with the Commission in connection with fiscal years 2001 through 2003.

48. E&Y's failure to comply with GAAS was a cause of and aided and abetted Bally's violations. For each of the years 2001-2003, E&Y issued audit reports containing unqualified opinions stating that E&Y had conducted an audit of the company's annual financial statements in accordance with GAAS, that Bally's financial reporting was in conformity with GAAP, and that Bally's reported results fairly represented the financial condition of the company. E&Y consented to the inclusion of these audit reports in Bally's Forms 10-K for 2001-2003. However, E&Y's audit reports were misleading because E&Y failed to conduct its audits in accordance with GAAS. E&Y also knew or should have known that Bally was engaged in non-GAAP and other accounting actions that were not disclosed to investors and prevented Bally's reported financial results from fairly representing its financial condition.

49. In auditing Bally's accounting practices relating to reactivation revenue and initiation fee revenue, E&Y failed under GAAS to exercise due professional care and skepticism, failed to obtain sufficient competent evidential matter and substituted managements' representations for competent evidence supporting the accounting. In fact, E&Y never insisted that Bally provide support for certain of these estimates, nor did E&Y itself perform sufficient audit procedures to test and determine whether these accounting actions resulted in appropriate revenue. Had it done so, it would have reasonably determined that these accounting practices were not in conformity with GAAP.

50. Despite these accounting and audit failures, and in further violation of GAAS, E&Y did not express a qualified or adverse audit opinion, or refuse by disclaimer to express any opinion at all, but instead issued audit reports that contained unqualified opinions on Bally's 2001-2003 financial statements. E&Y also knew or should have known that Bally was making false and misleading disclosures such as in connection with its \$55 million special charge. Nor did E&Y propose that Bally correct its improper accounting in the quarterly financial statements that E&Y reviewed during 2001-2003. E&Y also improperly issued preferability letters that allowed Bally to switch its reactivation accounting and initiation fee revenue accounting instead of restating for errors relating to that accounting. Accordingly, E&Y's failure to comply with GAAS was a cause of and aided and abetted Bally's violations of Section 17(a)(2) and (3) of the Securities Act and Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder.

51. E&Y also willfully violated Section 10A(b) of the Exchange Act in connection with Bally's failure to disclose that the \$55 million special charge recorded in its FY 2002 financial statements was due to a deterioration in the collectability of the Company's receivables. E&Y failed to report this illegal act to the Audit Committee in accordance with Section 10A(b).

Findings

As a result of the conduct described above, E&Y willfully⁴ violated Section 10A(b) of the Exchange Act and was a cause of and willfully aided and abetted Bally's violations of Section 17(a)(2) and (3) of the Securities Act and Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder.

Undertakings

Respondent has agreed to the following undertakings:

A. Undertaking Concerning a Payment in the Nature of a Penalty

E&Y shall, within 10 days of the entry of an Order, make a payment in the nature of a penalty in the amount of \$8.5 million to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies E&Y as a Respondent in these proceedings, and the file number of these proceedings. A copy of the cover letter and money order or check shall be sent to Kenneth R. Lench, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, D.C. 20549.

B. Undertaking Concerning Ongoing Cooperation

E&Y agrees that E&Y (including its partners, principals, officers, agents and employees) shall cooperate fully with the Commission with respect to any matter relating to the Commission's investigation of Bally, including but not limited to any litigation or other proceeding related to or resulting from that investigation. Such cooperation shall include, but is not limited to:

(a) production of information-- at the Commission's request, upon reasonable notice, and without subpoena, E&Y (including its partners, principals, officers, agents and employees) shall truthfully and completely disclose all information requested by SEC staff in connection with the Commission's investigation, litigation or other proceedings, except with respect to information related to clients other than Bally, which information shall be produced in response to subpoena;

(b) production of documents -- at the Commission's request, upon reasonable notice, and without subpoena, E&Y (including its partners, principals, officers, agents and

⁴ A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)).

employees) shall provide any document, record, or other tangible evidence requested by SEC staff in connection with the Commission's investigation, litigation or other proceedings, except with respect to documents related to clients other than Bally, which documents shall be provided in response to subpoena;

(c) production of cooperative personnel -- at the Commission's request, upon reasonable notice, and without subpoena, E&Y (including its partners, principals, officers, agents and employees) shall use its best efforts to secure the attendance and truthful statements or testimony of any E&Y partner, principal, officer, agent, or employee, excluding any such person who is a party to litigation with the Commission, at any meeting, interview, testimony, deposition, trial, or other legal proceeding.

The foregoing obligations are subject to E&Y's reservation of rights:

(i) to claim that documents or information requested is subject to attorney client privilege or attorney work-product protection; and

(ii) to seek entry of a confidentiality order as to (aa) sensitive business documents or information, (bb) sensitive personnel documents or information, or (cc) confidential information pertaining to clients other than Bally.

C. Undertakings Concerning Auditing Matters

1. *National Office Consultations.* The goal of this undertaking is for E&Y to avoid circumstances under which a member of the National Office Professional Practice group, or any person in a comparable position, is consulted on a matter for which he or she may lack sufficient objectivity based on prior involvement with the same client. E&Y shall adopt, implement and enforce written policies and procedures to provide reasonable assurances that no member of the Professional Practice group, or any person in a comparable position, engages in a consultation on an accounting, auditing, reporting or other issue relating to an audit or review of a public company client, if that member or person currently serves, or within the prior seven years has served, as a member of the engagement team or an independent or engagement quality review partner for such client; notwithstanding the foregoing, any person excluded based on prior involvement may provide background factual information relating to the client, or may inform others providing the consultation of the applicable technical guidance relating to issues that are not the same as or similar to issues with which the person was previously involved at the client.

2. *High Risk Clients.* The goal of this undertaking is to require E&Y to adopt, implement and enforce written policies and procedures to provide reasonable assurances that E&Y National Office Professional Practice partners, or persons in comparable positions, engaged in risk management roles do not lack sufficient objectivity because of their current or prior duties or responsibilities with respect to clients identified as presenting high risk to E&Y, including without limitation all Focus Account clients. Such policies and procedures shall require, at a minimum, that any partner who currently serves as, or has served as within the prior

seven years, a member of the engagement team or an independent or engagement quality review partner for such client, shall refrain from the exercise of the risk management duties and responsibilities of a National Office Professional Practice partner, or of a comparable position, with respect to such client identified as presenting high risk to E&Y; notwithstanding the foregoing, any person excluded based on prior involvement may provide background factual information relating to the client, or may inform others of the applicable technical guidance relating to issues that are not the same as or similar to issues with which the person was previously involved at the client.

3. *Preferability Letters.* The purpose of this undertaking is to require E&Y to engage in an internal review of its existing policies and procedures concerning the issuance of preferability letter opinions, make such revisions as may be necessary, and then engage in steps to implement and enforce such policies and procedures so as to provide reasonable assurances that, prior to the issuance of any preferability letter, E&Y applies sufficient professional scrutiny to, and documents the application of such scrutiny to, requests by public company clients to change to an alternative method of accounting. E&Y shall make such revisions as may be necessary in order to adopt, implement and enforce written policies and procedures, concerning the review and approval of preferability letters issued by E&Y to public company clients, in order to provide reasonable assurances that E&Y complies with all applicable professional standards, regulatory and legal requirements, and E&Y policies. E&Y's obligation hereunder shall include, without limitation, a requirement to document in the audit workpapers a complete analysis as to: (a) whether the prior method of accounting is in conformity with GAAP; (b) whether the new proposed method is in conformity with GAAP; (c) whether the client proposed the change in accounting principle; (d) whether or not the client has provided sufficient justification for the change in accounting principle; and (e) whether or not the change in accounting principle is presented in accordance with GAAP. In addition, E&Y shall make such revisions as may be necessary in order to adopt, implement and enforce written policies and procedures to provide reasonable assurances that that documentation of the review and approval of preferability letters issuable to public company clients, including the review of the aforementioned workpapers, is completed and included in the workpapers prior to the issuance of any such letters.

4. *Documentation of Consultations.* The purpose of this undertaking is to require E&Y to engage in an internal review of its existing policies and procedures concerning documentation of National Office Professional Practice group, or any person in a comparable position, consultations, make such revisions as may be necessary, and then engage in steps to implement and enforce such policies and procedures. E&Y shall make such revisions as may be necessary in order to adopt, implement and enforce written policies and procedures to provide reasonable assurances that workpapers prepared in connection with audits and reviews of the financial statements of public companies include documentation of consultations with E&Y's National Office Professional Practice group, persons in comparable positions, firm specialists or others within or without the firm. The documentation of such consultations shall include a description of the issue considered, any action taken with respect to the issue, and the basis for conclusion with respect to the issue. Such documentation shall be retained for seven years and subject to inspection by the Public Company Accounting Oversight Board. The policies and

procedures also should address documentation of inquiries of employees of public audit clients pertaining to such consultations.

5. *Disagreements and Reportable Events.* The goal of this undertaking is to require E&Y to engage in an internal review of its existing policies and procedures concerning compliance with the provisions of Item 304 of Regulation S-K (“Item 304”). E&Y shall adopt, implement and enforce written policies and procedures providing reasonable assurance that E&Y complies with Item 304, including ensuring that training is provided to E&Y’s National Office Professional Practice group, persons in comparable positions and its engagement teams.

6. *Detection and Reporting of Illegal Client Activity (Section 10A Compliance).* The goal of this undertaking is to require E&Y to engage in an internal review of its existing policies and procedures concerning compliance with Section 10A of the Exchange Act, make such revisions as may be necessary, and then engage in steps to implement and enforce such policies and procedures so as to provide reasonable assurances that E&Y will comply with its obligations under Section 10A. E&Y shall make such revisions as may be necessary in order to adopt, implement and enforce written policies and procedures providing reasonable assurance that E&Y complies with Section 10A of the Securities of Exchange Act of 1934, as amended, including without limitation, for each audit subject to Section 10A, procedures designed to provide reasonable assurance of detecting illegal acts that would have a direct and material effect on the determination of financial statement amounts, and to comply with all requirements under the standards of the Commission and the Public Company Accounting Oversight Board and Section 10A to evaluate and report suspected illegal acts.

7. *Certification of Compliance.* The chairman of E&Y shall certify in writing compliance with each of the above undertakings (the “Certificate of Compliance”). The certification shall identify each of the above undertakings with which E&Y believes it has complied and shall provide written evidence of compliance in the form of a narrative which is supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and E&Y agrees to provide such evidence. The certification and supporting material shall be submitted to Assistant Director Kenneth R. Lench of the Division of Enforcement. This certification shall be submitted no later than six months from the date of this order.

8. *Independent Consultant.* No later than 3 months after successfully certifying to the Commission that all of the above undertakings have been completed, E&Y shall select and retain an Independent Consultant, qualified to examine and assess compliance with the above Undertakings Concerning Auditing Matters. In advance of retention by E&Y, the selected Independent Consultant shall be confirmed to be acceptable to the Commission staff. E&Y may not retain as Independent Consultant any individual or entity that has provided legal, auditing or other services to, or has had any affiliation with, E&Y during the prior two years. Moreover, E&Y shall require the Independent Consultant to enter into an agreement that provides that, for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with E&Y, or any of its present or former affiliates, partners,

directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the staff of the Division of Enforcement, enter into any employment, consultant, attorney-client, auditing or other professional relationship with E&Y, or any of its present or former affiliates, partners, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

E&Y shall provide a copy of the complete Certification of Compliance, including all attachments, previously submitted to the Commission staff, together with such other evidence as E&Y may deem appropriate to enable the Independent Consultant to reasonably evaluate E&Y's compliance with the undertakings in this Order and their effectiveness in achieving their stated goals. E&Y shall provide the Independent Consultant with reasonable access to such E&Y personnel, records and information, as the Independent Consultant may request in connection with the Independent Consultant's review.

Following completion of the Independent Consultant's review, the Independent Consultant shall prepare a detailed written report describing the actions taken by E&Y in response to the above undertakings and the effectiveness of such actions, and certifying that (i) E&Y has complied with the above undertakings, and (ii) the undertakings appear to be effective in achieving their stated goals. If the consultant cannot so certify, the consultant shall (i) describe in the written report the reason that the consultant is unable to so certify, (ii) prepare and submit to E&Y written recommendations to E&Y designed to bring E&Y into effective compliance with the goals of the undertakings, and (iii) attach a copy of such written recommendations as an exhibit to the written report. A copy of the Independent Consultant's report, certification and recommendations, if any, shall be submitted to Assistant Director Kenneth R. Lench of the Division of Enforcement within twelve months of the commencement of the Independent Consultant's review, or such additional time as necessary for the Independent Consultant to complete the review and make the required certification.

In determining whether to accept the Offer, the Commission has considered these undertakings. Respondent agrees that if the Division of Enforcement believes that Respondent has not satisfied these undertakings, it may petition the Commission to reopen the matter to determine whether additional sanctions are appropriate.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent E&Y's Offer.

Accordingly, pursuant to Section 8A of the Securities Act, Sections 4C and 21C of the Exchange Act, and Rule 102(e)(1)(iii) of the Commission's Rules of Practice, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Section 10A of the Exchange Act and Sections 17(a)(2) and (3) of the Securities Act, and from causing any violations and any future violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder;

B. Respondent is censured pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice;

C. Respondent shall comply with the undertakings enumerated in Section III.C above.

By the Commission.

Elizabeth M. Murphy
Secretary