

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61191 / December 17, 2009

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3082 / December 17, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13720

<p>In the Matter of</p> <p>RANDY G. FLETCHALL, CPA,</p> <p>Respondent.</p>

**ORDER INSTITUTING PUBLIC
ADMINISTRATIVE PROCEEDINGS
PURSUANT TO SECTION 4C OF THE
EXCHANGE ACT OF 1934 AND RULE
102(e) OF THE COMMISSION'S
RULES OF PRACTICE, MAKING
FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that that public administrative proceedings be, and hereby are, instituted against Randy G. Fletchall, CPA (“Fletchall” or “Respondent”) pursuant to Section 4C¹ of the Securities Exchange Act of 1934 (“Exchange Act”) and Rule 102(e)(1)(ii) of the Commission’s Rules of Practice.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 relevant part:

The Commission may censure a person . . . who is found . . .

* * *

(ii) to have engaged in unethical or improper professional conduct.

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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 him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative Proceedings Pursuant to Section 4C of the Exchange Act of 1934 and Rule 102(e) of the Commission’s Rules of Practice, Making Findings, and Imposing Remedial Sanctions (“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 improper professional conduct in 2003 by Fletchall, who was the head of the National Office of Ernst & Young LLP (“E&Y”). Fletchall engaged in a single instance of highly unreasonable conduct with respect to a change of accounting policy by an E&Y audit client, Bally Total Fitness Holding Corporation (“Bally”), in connection with a particular revenue recognition issue. Bally’s prior accounting policy for the revenue at issue, which E&Y had audited for years, was clearly not in conformity with accounting principles generally accepted in the United States (“GAAP”).

2. In connection with his role in a consultation on the change in Bally’s revenue recognition policy, Fletchall did not make sufficient inquiries under circumstances where heightened scrutiny was warranted. Notwithstanding the need for heightened scrutiny, Fletchall failed to exercise due care as required by professional standards.

(iv) with respect to persons licensed to practice as accountants, “improper professional conduct” under Rule 102(e)(1)(ii) means:

* * *

(B) either of the following two types of negligent conduct:

(1) a single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted.

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.

Respondent

3. Randy G. Fletchall, age 57, is and was at all relevant times a certified public accountant licensed in Arizona, New York and Texas and a partner at E&Y. Starting in 2001, Fletchall was E&Y's Vice-Chair for Assurance and Advisory Business Services ("AABS") Professional Practice through June 2003, when his title was changed to Vice-Chair, AABS Professional Practice and Risk Management. Fletchall was appointed to E&Y's Americas Executive Board in July 2003.

Other Relevant Entities

4. E&Y is a national public accounting firm and, during the relevant period, served as the independent auditor for Bally.

5. Bally is 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 of 1933, 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.

Bally's "Reactivation" Revenue Recognition

6. The particular revenue recognition policy about which Fletchall was consulted pertained to Bally's "reactivation" revenue. "Reactivations" 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 such monthly dues. Accordingly, for those canceled members who had completed the initial contract period, Bally waited at least six months after receiving their last monthly dues payment and then began soliciting those canceled members to reactivate. Those who accepted the reactivation offers did so, on average, 36 months after having stopped paying their 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.

7. Bally's reactivation revenue recognition policy was to project (as of the balance sheet date) the reactivation payments it anticipated receiving during the coming year and then immediately recognize most of these projected payments by improperly allocating them to past periods. Bally's reactivation revenue recognition policy was not in conformity with GAAP

because the use of this method enabled Bally to recognize revenue before it was earned and was realized or realizable.⁴ 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.

During the Consultation, Fletchall Did Not Exercise Due Care Where Heightened Scrutiny Was Warranted

8. On June 16, 2003, Fletchall received a telephone call from E&Y partners Mark V. Sever, Kenneth W. Peterson, and William J. Carpenter. Sever was the National Director of Area Professional Practice and reported directly to Fletchall. Peterson was the Professional Practice Director for E&Y's Lake Michigan Area office while also serving as the Independent Review Partner on the Bally audit. Carpenter was the Bally audit engagement partner. During this consultation, which lasted 25 minutes, Sever, Peterson and Carpenter requested Fletchall's approval for E&Y to issue a preferability letter concerning Bally's change from recognizing "reactivation" revenue on an accrual basis to recognizing "reactivation" revenue on a cash basis.

9. Under E&Y's internal procedures, approval from the National Office was a mandatory prerequisite to E&Y issuing a preferability letter. In this case, Fletchall determined whether to give National Office approval to issue the preferability letter.

10. A "preferability letter" is issued by an auditor to a client concerning a change in accounting principle. A preferability letter may only be issued when an auditor's client is changing from an accounting principle that is in conformity with GAAP to another accounting principle that is both (a) in conformity with GAAP and (b) is "preferable" to the previously applied principle. A preferability letter may not be issued if the change is from an error, that is, an accounting principle that is not in conformity with GAAP to an accounting principle that is in conformity with GAAP. If an error exists such that a company's previously issued financial statements were not fairly presented, in all material respects, in conformity with GAAP, the auditor is required to insist upon a correction of the error. If the company does not restate its financial statements to correct the error, the auditor must issue a qualified or adverse audit opinion.

11. During the consultation on June 16, 2003, Fletchall did not exercise due care by making sufficient inquiries, despite the fact that heightened scrutiny was warranted in connection

⁴ See, e.g., Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins*, Chapter 1A (1953); Accounting Principles Board Opinion No. 10, Omnibus Opinion (1966); Statement of Financial Accounting Concepts No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises* (1985); Staff Accounting Bulletin No. 101, *Revenue Recognition in Financial Statements*, Topic 13.A (1999).

with Bally's accounting for reactivations. Fletchall had knowledge of circumstances that warranted heightened scrutiny.

12. First, because he was in charge of risk management efforts for E&Y's AABS practice, Fletchall became aware in the fall of 2002 that, out of E&Y's approximately 10,000 North American clients, Bally was one of E&Y's 18 highest risk clients. He also knew that 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. These 18 riskiest accounts -- including Bally -- were so-called "National Focus Accounts" and were monitored by the Americas Executive Board.

13. Second, Fletchall had been informed previously that Bally's accounting positions were "aggressive." In October 2002, Fletchall was provided with a memorandum regarding E&Y's 2002 client continuance process. An attachment to this memorandum provided additional information about a list of E&Y clients designated for additional attention and stated, among other things, Bally's "CEO and CFO are former [E&Y] partners, have been aggressive in accounting positions, and very focused on meeting or beating Wall Street expectations." Additionally, Sever discussed with Fletchall the list of National Focus Accounts and the reasons why those accounts had been selected as National Focus Accounts.

14. Third, in the course of the consultation about the preferability letter, Sever informed Fletchall that Bally's revenue recognition policy for "reactivations," while in his view GAAP-compliant, was "aggressive."

15. According to the E&Y firm-wide revenue recognition guidance co-issued by Fletchall in 1997, "Aggressive accounting policies or practices" are a "warning signal" that requires E&Y to "carefully evaluate the appropriateness of the client's accounting for the transaction . . ." That guidance further notes that revenue recognition is an area that is particularly susceptible to fraud.

16. Fourth and finally, Fletchall's "first reaction [to the request for a preferability letter] was it seemed a little strange, going from an accrual basis to a cash basis." Under GAAP, accrual accounting is presumptively the proper basis for accounting, and cash basis accounting is presumptively wrong because it is proper under GAAP only when collectibility of amounts owed by customers is not reasonably assured.

Fletchall's Approval of the Preferability Letter Constituted A Single Instance of Highly Unreasonable Conduct in Violation of His Duty to Exercise Due Care in Accordance with Professional Standards

17. Article V of the Principles of Professional Conduct (ET Section 56) requires that an accountant exercise due care when discharging professional responsibilities. Due care requires the accountant to discharge professional responsibilities with competence and diligence. Diligence imposes the responsibility to render services carefully, to be thorough, and to observe applicable technical and ethical standards.

18. Notwithstanding the fact that heightened scrutiny was warranted, Fletchall did not exercise due care. Specifically, he failed to obtain sufficient information that was required for him to: (1) overcome concerns regarding the historical accounting by Bally that should have been raised by the warning signals associated with the proposed accounting change, and (2) determine whether the proposed preferability letter could be issued.

19. With respect to the latter determination, Fletchall failed to exercise due care by conducting sufficient inquiries regarding Bally's prior accounting method. Fletchall was required to understand the current accounting policy, the proposed new accounting policy, and compare the two in order to determine whether the proposed new accounting policy was, indeed, preferable. Second, Fletchall was required to determine if Bally had provided sufficient justification for the change to overcome the "presumption that an accounting principle once adopted should not be changed" Accounting Principles Board Opinion No. 20, ¶¶ 15 & 16.

20. A reasonable accountant who understood Bally's accrual basis of recognizing revenue for "reactivations" would conclude that it was not in conformity with GAAP, because Bally was recognizing revenue that was not realized or realizable, and had not been earned.

21. Thus, if Fletchall had exercised due care in determining whether to approve E&Y's issuance of the preferability letter, by making sufficient inquiries regarding Bally's accounting for reactivations, he would have concluded that: (1) Bally's current accounting policy was not in conformity with GAAP and was in fact an accounting error; (2) no preferability letter could be issued, and (3) Bally was required to restate its previously issued financial statements to correct that accounting error.

22. Nonetheless, during the call on June 16, 2003, Fletchall reached a "firm conclusion" that cash basis accounting was preferable to accrual basis accounting for recognizing "reactivation" revenue and he gave oral approval to Sever, Peterson, and Carpenter that, subject to the receipt of an acceptable written request for a preferability letter from Bally, E&Y would issue the preferability letter. Fletchall's views did not change when he later received Bally's written request for a preferability letter, and on August 10, 2003, Fletchall gave his written approval to issue the preferability letter.

23. As a result of Bally's failure to correct its improper accounting for reactivations in the appropriate manner, Bally improperly avoided restating its previously issued financial statements and instead improperly recorded a \$20.3 million (pre-tax effect) cumulative effect charge to implement a cash basis of accounting for recognizing reactivation revenue.

Findings

Based on the foregoing, Fletchall engaged in improper professional conduct pursuant to Rules 102(e)(1)(ii) and 102(e)(1)(iv)(B)(1) of the Commission's Rules of Practice. Specifically, the Commission finds Fletchall's failure constitutes a single instance of highly unreasonable

conduct that resulted in a violation of professional standards in circumstances in which Fletchall knew or should have known that heightened scrutiny was warranted.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanction agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

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

By the Commission.

Elizabeth M. Murphy
Secretary