

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9092 / December 17, 2009

SECURITIES EXCHANGE ACT OF 1934
Release No. 61190 / December 17, 2009

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3081 / December 17, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13719

In the Matter of

WILLIAM J. CARPENTER,
CPA

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)(ii) of the Commission’s Rules of Practice² against William J. Carpenter (“Carpenter” or “Respondent”).

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, 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, Carpenter 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, Carpenter 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 Carpenter’s Offer, the Commission finds³ that:

Summary

1. This matter involves violations of the federal securities laws and improper professional conduct by Carpenter in connection with the 2003 audit of Bally Total Fitness Holding Corporation (“Bally”) conducted by Ernst & Young LLP (“E&Y”). Carpenter served as the engagement partner for the 2003 audit.

* * *

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

* * *

(iv) With respect to persons licensed to practice as accountants, “improper professional conduct” under §201.102(e)(1)(ii) means:

* * *

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

* * *

(2) Repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

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

2. In connection with Bally's 2003 financial statements, Bally engaged in fraudulent financial accounting, including implementing two improper changes in accounting method rather than restating for accounting errors. 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.

3. Carpenter knew or should have known that E&Y's unqualified audit opinion regarding Bally's 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") – was false because E&Y's audit of Bally's 2003 financial statements was not performed in accordance with GAAS and Bally's financial statements were not in conformity with GAAP.

4. As a result of the false and misleading audit opinion, Carpenter was a cause of Bally's violations of Sections 17(a)(2) and (3) of the Securities Act and Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Exchange Act Rules 12b-20, 13a-1, 13a-11, and 13a-13.

Respondent

5. Carpenter is, and was at all relevant times, a Certified Public Accountant licensed in Illinois. Carpenter also served as the engagement partner on the Bally audit from the first quarter 2003 through the first quarter 2004. Carpenter retired from E&Y in 2009.

Issuer

6. Bally, 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

7. 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.

8. 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."

9. 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 by E&Y as the riskiest account in E&Y's Lake Michigan Area (LMA), based in Chicago.

Bally's Accounting Errors And E&Y's Audit Failures Relating To Fiscal Years 2001 And 2002

10. 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 issued unqualified audit opinions in connection with its audits of such financial statements, in violation of GAAS.⁴

Premature Recognition of Reactivation Revenues

11. 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

⁴ See AICPA's Codification of Auditing Standards AU § 508, *Reports on Audited Financial Statements*.

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.

12. Bally's revenue recognition 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 revenue recognition policy was not in conformity with GAAP because use of the method enabled Bally to recognize revenue before it was earned and was realized or realizable.⁵ 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.

13. In short, Bally violated GAAP by recognizing revenue related to the anticipated future payments before the reactivation transactions occurred. The accounting was clearly not in conformity with GAAP, and 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.

14. For at least six years, E&Y had audited Bally's "reactivation" revenue recognition practices. In each of those years, E&Y provided Bally with an unqualified audit opinion.

Premature Recognition Of Initiation Fee Revenue

15. 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.

16. 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 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

⁵ See, e.g., Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins* ("ARB 43"), 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).

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.

17. These errors continued through the relevant period and by recognizing initiation fee revenue from financed contracts over 22 months, Bally improperly recognized revenue before it was earned and realized or realizable in contravention of GAAP.

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

18. 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."

19. 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.

Bally's Accounting Errors And E&Y's Audit Failures Relating To Fiscal Year 2003

20. 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.

21. Following the decision to remain as Bally's auditor, E&Y selected Carpenter to be the new E&Y audit engagement partner for the Bally audit. Carpenter rotated onto the Bally audit engagement in April 2003. Carpenter had no prior contact with Bally or involvement in the audits of its financial statements.

22. Carpenter was selected because he was experienced and capable of "delivering tough messages." Carpenter was briefed by the LMA Area Managing Partner ("AMP") and the LMA Advisory Business Services Managing Partner ("AABS-MP"). Carpenter was told that Bally was considered one of the Firm's highest risk clients, and was instructed "to fix this situation to reduce the firm's risk."

Recognition Of Reactivation Revenue

23. After becoming the new engagement partner, Carpenter focused on reactivations as posing risk to E&Y. He reviewed a memorandum E&Y had prepared in connection with the FY 2000 audit (the “2000 memo”), 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. Carpenter 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.”

24. Carpenter raised a number of questions challenging the 2000 memorandum’s reasoning and conclusions, including whether the reactivation dues amount was “fixed and determinable” in light of the 2000 memo’s statement that the amount of dues was modified on occasion to entice reactivations. He also questioned how “customer acceptance,” a prerequisite of revenue recognition acknowledged in the 2000 memo, could occur if a customer hasn’t used Bally’s facilities. Carpenter conferred with members of the audit team and PPDs, who informed Carpenter that Bally’s historical accounting for reactivation revenue, although in their view GAAP-compliant, was “aggressive.” Carpenter remained concerned with Bally’s reactivation revenue recognition policy and had the view that Bally’s reactivation revenue recognition policy was more aggressive than he was willing to accept as the partner on the engagement.

25. 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, including Carpenter, 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, including Carpenter, demanded that Bally change its reactivation revenue recognition policy. That same day, after Carpenter and two senior E&Y partners, consulted with E&Y’s National Office, E&Y agreed to provide Bally with a preferability letter stating that the proposed change in reactivation revenue recognition policy to a cash basis was a more preferable method of accounting for reactivation revenues.

26. In August 2003, Bally sent E&Y a written request for approval of the proposed change in accounting. Under E&Y’s internal guidance, Carpenter and other senior E&Y partners were each required to approve the issuance of E&Y’s preferability letter. Carpenter did so on August 12, 2003.

27. Carpenter knew or should have known that Bally’s change in accounting for reactivation revenues was not, in fact, a change in accounting principle, 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.⁶ 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 Carpenter reviewed and authorized E&Y's issuance of an unqualified audit opinion on Bally's 2003 financial statements, in violation of GAAS.

Recognition Of Initiation Fee Revenue

28. For the year-end 2003 audit, E&Y and Carpenter turned their attention to Bally's other accounting estimates, including the member life estimates used in determining the amortization period of initiation fees that Carpenter knew or should have known were not in conformity with GAAP. Carpenter knew that 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.

29. 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 – in 1998, 2001 and 2002 - to do so. Carpenter also knew or should have known that, having failed to obtain from the Company an update of the average renewal period, E&Y had failed to arrive at its own independent estimate. Consistent with its audit planning concerns about Bally's aggressive estimates and the risk of financial fraud, the E&Y engagement team requested that Bally provide support for the member life estimate for the 2003 fiscal year. Despite repeated efforts to obtain the information, Carpenter and E&Y never received the requested support.

30. Rather than continuing to press Bally for support for its complex accounting estimates, at a meeting on January 25, 2004, E&Y, including Carpenter, 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 that subsequently totaled approximately \$260 million.

31. At the January 2004 meeting, E&Y, including Carpenter, 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. Carpenter knew or should have known that the change to a modified cash basis for the rest of Bally's revenue recognition accounting would have the effect of allowing Bally to avoid or at least reduce the significance of some of the charges E&Y

⁶ See Accounting Principles Board Opinion No. 20, *Accounting Changes*.

had identified. The proposed changes would also subsume some of the prior audit failures relating to initiation fee revenues. Bally changed its accounting and Carpenter and other senior E&Y partners each reviewed and authorized E&Y's issuance of a preferability letter. Carpenter knew or should have known that the preferability letter enabled Bally to improperly avoid a restatement with respect to initiation fee revenue.

32. Bally's change from accrual accounting to a modified cash basis of accounting was not, in fact, a change in accounting principle, 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 Carpenter nonetheless reviewed and authorized E&Y's issuance of an unqualified audit opinion on Bally's 2003 financial statements, in violation of GAAS.

E&Y's Audit Was Deficient And Not Performed In Accordance With GAAS

33. E&Y's 2003 audit was deficient and not performed in accordance with GAAS. E&Y and Carpenter failed to obtain sufficient competent evidential matter to support an opinion that Bally's estimates, including the average member life estimates, were reasonable.⁷ 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. . . ."

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

35. 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, Carpenter should have, but did not, question how two supposedly GAAP-compliant methodologies resulted in such a material disparity in earnings. If he had followed up, Carpenter 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.

36. 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, Carpenter was aware of the issues associated with the average member life estimate that required vigorous audit procedures, yet he failed to respond adequately.

⁷ See AU § 326, *Evidential Matter*.

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

Carpenter Knew Or Should Have Known Bally Made Improper Disclosures Concerning The Lack Of Disagreements And Reportable Events With E&Y

38. When an auditor to a public company resigns, Item 304 of Regulation S-K requires both the company and the auditor to disclose whether any "disagreements" or "reportable events" occurred in the two most recent fiscal years or any subsequent interim period. The term "disagreements" is interpreted broadly, to include any difference of opinion concerning any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedures which (if not resolved to the former auditor's satisfaction) would have caused it to make reference to the issue in its audit opinion. The term "reportable events" includes events such as the auditor having advised the company that it questions the reliability of (1) the company's financial statements, (2) management's representations, or (3) the company's internal controls. Item 304 also requires the former auditor to file a letter stating whether it agrees with the company's Item 304 disclosures and, if not, stating the areas of disagreement.

39. In March 2004, Carpenter, and other senior E&Y partners, including the Director of the Professional Practice Group, participated in a meeting during which they decided to resign as Bally's auditor. A memorandum prepared by Carpenter for the meeting, and given to others to review and comment prior to the meeting, identified reasons for resigning, including the engagement team's distrust of Bally's senior financial management; its concerns regarding the company's internal controls and accuracy of accounting records and the accuracy of management's accounting estimates. In addition, Carpenter knew of contentious discussions with Bally's management over various issues, including E&Y's demand that Bally end its practice of recognizing revenue from reactivations that Bally projected would occur in the future.

40. Following the internal E&Y meeting, E&Y, including Carpenter, advised Bally's Audit Committee that it would resign from the engagement because of concerns regarding management's tone, the company's need to demonstrate more concern regarding internal control issues and the accuracy of its accounting records, and the accuracy of management's estimates.

41. In Bally's 2003 Form 10-K disclosure, the Company announced E&Y's resignation but represented that there were no disagreements or reportable events. Similarly, E&Y filed a letter with the Commission stating that it agreed with Bally's statements there had been no disagreements or reportable events with Bally's management.

42. The events described above reflect "disagreements" and "reportable events" that were required to be disclosed under Item 304 of Regulation S-K. Carpenter knew or should have known that these disagreements and reportable events were required to be disclosed, but did not object to the representations in Bally's 2003 Form 10-K stating there had been no "disagreements" or "reportable events;" or prevent E&Y from issuing a letter agreeing with the Company's Item 304 disclosures.

Violations

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). 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.”

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

47. Carpenter was a cause of Bally’s violations. For 2003, Carpenter reviewed and authorized E&Y’s issuance of an audit report containing unqualified opinions stating that E&Y had conducted an audit of the company’s annual financial statements in accordance with GAAS and that Bally’s financial statements were presented in conformity with GAAP. This audit report was included in Bally’s Forms 10-K for 2003. However, Carpenter knew or should have known that E&Y’s audit report was false and misleading because E&Y failed to conduct the 2003 audit in accordance with GAAS and Bally was engaged in accounting practices and disclosures that were not in conformity with GAAP.

48. In auditing Bally's accounting practices relating to reactivation revenue and initiation fee revenue, Carpenter 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. Carpenter never insisted that Bally provide support for certain of these estimates, nor did Carpenter perform sufficient audit procedures to test and determine whether these accounting actions resulted in appropriate recognition of revenue. Had he done so, he would have reasonably determined that these accounting practices were not in conformity with GAAP.

49. Despite these accounting and audit failures, and in further violation of GAAS, Carpenter did not require E&Y to express a qualified or adverse audit opinion, or refuse by disclaimer to express any opinion at all, but instead issued audit reports that contained an unqualified opinion on Bally's 2003 financial statements. Carpenter also knew or should have known that Bally was making false and misleading disclosures. Nor did Carpenter propose that Bally correct its improper accounting in the quarterly financial statements that E&Y reviewed during 2003. Carpenter also reviewed and authorized E&Y's issuance of preferability letters that allowed Bally to switch its accounting policies for reactivation revenue and initiation fee revenue instead of restating for errors relating to that accounting.

50. Accordingly, Carpenter's failure to comply with GAAS was a cause of 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.

Findings

As a result of the conduct described above, Carpenter engaged in improper professional conduct through repeated instances of unreasonable conduct pursuant to Rules 102(e)(1)(ii) and 102(e)(1)(iv)(B)(2) of the Commission's Rules of Practice, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission. Carpenter also was a cause of Bally's violations of Sections 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.

IV.

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

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

A. Carpenter cease and desist from committing or causing any violations and any future violations of 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. Carpenter is denied the privilege of appearing or practicing before the Commission as an accountant pursuant to Rule 102(e)(1)(ii) and Rule 102(e)(1)(iv)(B)(2);

C. After 2 years from the date of this order, Carpenter may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Carpenter's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Carpenter, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Carpenter, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in Carpenter's or the firm's quality control system that would indicate that Carpenter will not receive appropriate supervision;

(c) Carpenter has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Carpenter acknowledges his responsibility, as long as Carpenter appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

D. The Commission will consider an application by Carpenter to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Carpenter's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Elizabeth M. Murphy
Secretary