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The SEC also charged the audit firm and six partners for their roles In the accounting violations. Volt the SEC's website (www. Sec. Gob) and search the link to " Litigation Releases" to locate Litigation Release 20470 Issued on February 28, 2008 against Bally Total Fitness Holding Corporation to learn more about this revenue fraud. Required: a. Read the release and the accompanying complaint in this matter and briefly summarize the three types of alleged revenue frauds. . Return to the opening page on the SEC's website and search the link for " Press Releases" to locate the December 7, 2009 announcement of the SEC's charges against the audit firm and the six partners. C. Read the press release and briefly summarize the SEC's description of the nature of audit risk associated with the Ballsy audit engagement. D. Read the complaint against the audit engagement partner, who served as the 2001 and 2002 engagement partner.

What factors caused the audit firm to recognize Bally as a high risk audit client for 1996-2003? Answer: The following answers are based on the SEC's Litigation Release No. 20470 and related press releases associated with the fraud at Bally Total Fitness Holding Corporation: a. According to the SEC press releases and Litigation Release No. 20470, Bally initiation fees, prepaid dues, and reactivation fees. Initiation fees: Bally fraudulently and prematurely recognized revenue from initiation fees.

Part of the price of a Bally health club membership was a one-time initiation fee that was either paid in full when the member Joined or was financed over a period of time, typically 36 months Regardless of how the initiation fee was paid, accounting standards prohibit Bally from recognizing all the revenues from initiation fees immediately. Instead, accounting standards require that Bally recognize initiation fee revenue over the entire membership life.

This means that for members who maintained their memberships beyond the financing period, or initial period of membership, Bally was required to defer initiation fee revenue and recognize it over the estimated membership life, not over the term of the initial period of membership. However, Bally prematurely recognized its members' initiation fee revenue over a period that was not only shorter than the estimated membership life, but in most instances even shorter than the initial period of membership. Personal Training Services: In addition to selling health club memberships, Bally also sold personal training services (I. . , exercise sessions with personal trainers). Some customers prepaid for sessions with personal trainers. Accounting standards require that revenue from prepaid personal training services be recognized only when earned, which is when the personal training services were actually provided. Bally, however, recognized revenue related to personal training services before those services were actually provided. Reactivation Fees: Bally also fraudulently recognized revenue from unpaid dues on inactive memberships. Not all Bally members who completed their initial membership contract term renewed their membership.

Instead, they ceased paying dues. Those members who had paid all amounts due under the initial membership contract, but who had then stopped paying monthly dues for six months or longer, were solicited by Bally for " reactivation. " Under that offer, lapsed members could rejoin by paying a " reactivation fee," which was lower than an " initiation fee. " Accounting standards prohibit Bally from recognizing any venue from " reactivation fees" until after the reactivating members had entered into binding contracts.

Rather than comply with accounting standards, Bally simply projected the number of reactivating members that it anticipated rejoining up to three years into the future, and then recognized those anticipated but hypothetical reactivation fees as revenue. The company recognized that hypothetical revenue over a period composed of: (a) the average delinquent period (that is, the period between when members stopped paying their monthly dues and when they reactivated) (b) the average reactivation period. In later years, they abandoned this methodology and adopted a modified cash basis of accounting for reactivation fees. B.

Yes, there is a press release by SEC's against audit firms and six partners. C. The press release notes that the SEC's order against the audit firm (Ernst & Young) finds that the firm identified Bally as a risky audit because its managers were former principles and determining estimates," and whose compensation plans placed " undue emphasis on reported earnings. " Out of more than 10, 000 audit clients in North America, E&Y identified Bally as one of E&Ys riskiest 18 accounts and as the ickiest account in the Lake Michigan area. D. Based on complaint against John M. Kiss who served as the engagement partner for the 2001 and 2002 audits.