

PUBLIC ACCOUNTING REPORT

IN THIS ISSUE

BKD Re-Elects Spencer to Top Spot.....	2
2009 Dec.-Sept. M&A Chart.....	3
KPMG FY09 Global Revenue	4
SEC 4Q Actions against Firm's Personnel.....	5
People, Firms & Promotions	8

MaloneBailey Enters New York

Firm fuels expansion with acquisition of Kempisty clients and key staff.

MaloneBailey/Houston is expanding their physical presence to the Big Apple with a deal that is expected to be effective just after the new year.

MaloneBailey and Kempisty & Co./New York agreed to a deal for the Houston-based firm to acquire the New York City's firm clients and some key people.

"This expansion is part of our plan to strengthen our position as a market leader in the SEC practice area," said MaloneBailey's MP Wesley Middleton. "The office gives us a significant presence in the New York market and gives us a good foundation with their SEC and broker dealer work. They have also built a great Chinese practice. The great part about this is they were a lot like us as a firm, just smaller."

While the move is a geographical step outside MaloneBailey's comfort zone, the firm is staying close to its underpinnings; Kempisty has a solid SEC client base of 20 registrants and 25 broker dealers. MaloneBailey is well known for its SEC practice, which as of FY08 accounted for 81% of the firm's revenue. MaloneBailey has 114 SEC clients and two broker dealers. The firm has the highest SEC registrant count of any nonnational firm.

The SEC client count figures are as of Dec. 28, 2009, according to *AuditAnalytics.com*.

Firm Founding Partner and SEC Practice Leader John Malone said the

See **MALONEBAILEY**, page 6

E&Y and Six Current and Former Partners Sanctioned by SEC

Payment to the SEC is the third highest by an audit firm.

The SEC brought the discipline hammer down on Ernst & Young and six of its current and former partners, asserting that Bally's Total Fitness' accounting was less than fit, and the firm and its personnel "knew or should have known about fraudulent financial accounting and disclosures."

For E&Y's part in the issues, the firm agreed to an \$8.5 million payment, the third highest payout by an accounting firm to the SEC.

In addition to a monetary sanction, the firm agreed to censure and to undertake

See **E&Y**, page 3

Top SEC Payouts By Auditors

Firm	Client/HQ	Payout (\$mil)	Date
Deloitte	Adelphia Communications Corp.	50.0	April 26, 2005
KPMG	Xerox Corp.	10.0	April 19, 2005
KPMG	Gemstar-TV Guide International/Los Angeles	10.0	Oct. 20, 2004
E&Y	Bally Total Fitness Holding Corp.	8.5	Dec. 17, 2009
Andersen	Waste Management/Houston	7.0	June 19, 2001
PricewaterhouseCoopers ^{1,2}	Multiple clients	5.0	July 17, 2002
PricewaterhouseCoopers	Warnaco Group	2.4	May 10, 2004
PKF	AremisSoft Corp.	2.0	Apr. 12, 2006
Grant Thornton	MCA	1.5	Aug. 5, 2004
PricewaterhouseCoopers	SmarTalk Teleservices/Los Angeles	1.0	May 22, 2003
Ernst & Young Chartered Accountants ³	SmartForce	0.75	July 19, 2007
Moret Ernst & Young Accountants ⁶	Baan Company N.V./Barneveld, Netherlands	0.40	June 27, 2002
Deloitte	Just For Feet	0.375	April 26, 2005

Editor's Note: Chart includes payments of more than \$100,000 to the SEC, but does not include fee disgorgement, fee reimbursement or prejudgement interest.

¹The SEC also charged PricewaterhouseCoopers Securities. ² PwC paid \$2.75 million and PwC Securities paid \$2.25 million.

M&P Votes to return to RSM Fold

Arbitrator's ruling gave M&P little option.

When the arbitrator sided with RSM McGladrey and H&R Block shortly before Thanksgiving in the separation battle with McGladrey & Pullen, M&P was left with few options, according to several partners who spoke to PAR on the condition of anonymity.

Given the landscape, the firm did what many observers believed would happen from the outset—they worked it out with RSM and HRB. Under the terms of the deal, RSM partners keep a couple of percentage points of profit more than they did before talk of separations and the filing of legal actions filled the air through late summer and early fall.

"The arbitrators ruling was the deciding factor," one partner said. "When you realize the impact of the [arbitration] ruling there wasn't much you could do. Well make that one thing realistically, patch it back up. No one wants to look bad but, you either destroy what you have left as firm by being essentially an audit-only enterprise, and really that just isn't viable given certain economic realities or you cut the best deal you can based on the cards you have in your hand."

Sticking with the poker analogy another partner said in frustration "we had a terrible hand,"

See **M&P**, page 4

MaloneBailey, continued from page 1

new Big Apple office added depth to MaloneBailey's "Broker Dealer audit expertise and Chinese audit capabilities" and provided enormous opportunity for firm clients and the firm's employees.

"We will bring our oil and gas expertise to the New York market and will continue to emphasize our strong niche expertise," Malone said. "This is one more step in the realization of our vision to have an international presence."

With the firm set to start the new year in New York City, a logical question is how did they get there, after all the Big Apple doesn't intuitively seem like a natural progression for a firm based in the Space City; the two metropolises are 1,419 miles apart as the crow flies.

Middleton said the move happened through the strategic-planning process and timing.

"Acquisitions are a big priority for us," he told *PAR*. "New York was on our list, but wasn't near the top of the priorities. The opportunity came up with Phil [Kempisty] who we knew, it was a good firm and the deal was a great fit. Because it was the right opportunity, the timing was right."

"The deal came together quickly taking three to four months to hammer out," Middleton added.

MaloneBailey isn't done on the acquisition front; although if the firm closes negotiations on deals it is currently working on, they should be much closer to the firm's traditional graphic footprint.

"We have two candidates in our local market we are in serious discussions with and hope to close those this year," Middleton said. "New York is a foundation for our future plans, but that

is not to say we plan to expand up and down the East Coast. We wouldn't turn it down if the right opportunity presented itself. We have aggressive growth plans. Our goal is to be a Top 100 firm in the future."

In addition to digesting the Kempisty transaction, the firm is currently preparing to embark on a branding campaign that began with the firm dropping the ampersand from its moniker and going with the popular approach of going to market with one name.

"We really want to raise the firm's brand recognition, communicating who we are," Middleton said. "We feel it will be a two-pronged approach: one focus is getting the name out in the local markets we are in and through our niche practices."

The firm is also working on the launch of its private company practice. ■

E&Y, continued from page 3

"It is deeply disconcerting that partners, even at the highest levels of E&Y, failed to fulfill their basic obligations to the investing public by not conducting proper audits. This case is a sharp reminder to outside auditors that they must carry out their duties with due diligence. The \$8.5 million settlement, one of the highest ever paid by an accounting firm, reflects the seriousness of their misconduct," said Director of the SEC's Division of Enforcement Robert Khuzami.

The SEC took exception with E&Y's unqualified audit opinions stating that Bally's financial statements from 2001 to 2003, which stated the firm had conducted its audits in accordance with GAAS and that Bally's financial statements conformed to GAAP. It was those documents that the SEC identified several problems, primarily premature recognition of reactivation revenues, premature recognition of initiation fee revenue and what the watchdog termed false and misleading disclosures regarding a \$55 million charge in FY 2002.

The SEC said, 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 did not conform to GAAP.

"E&Y's audit reports were misleading because E&Y failed to conduct its audits in accordance with GAAS," the SEC said in its complaint. "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."

Judging from the SEC's complaint, the regulator took an especially dim view of the issues cited by them and contained in the audit opinions, in light of the fact that "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,'" according to the SEC's complaint.

"Ernst & Young and its partners on the Bally engagement violated their fundamental duty to function as public watchdogs, even after E&Y personnel identified Bally as one of the firm's riskiest audit clients," said Associate Director in the SEC's Division of Enforcement Fredric Firestone.

Bally had been identified by E&Y as one of its riskiest 18 accounts, following a thorough review of its client roster to help identify clients that posed the greatest risk to the firm and then decide whether to manage that risk or resign from the audit engagement.

The review covered more than 10,000 audit clients in North America, according to the SEC.

Even in the world of risky accounts, Bally seemed to distinguish themselves, as the company was seen as the riskiest account in E&Y's Lake Michigan Area.

The 18 risky accounts were termed "National Focus Accounts" and were monitored by the Americas Executive Board, according to the SEC.

Bally had earned the "risky audit status" from E&Y for several reasons, according to the SEC, not the least of which was 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 regulator also said E&Y felt "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."

The SEC added that, "E&Y's internal guidance notes that a history of 'aggressive' applications of accounting policies could indicate a predisposition to misstate the financial statements."

Another event that caught the SEC's attention was following the completion of the FY 2002 audit in March 2003, prior to Bally's filing its 2002 Form 10-K, E&Y had considered resigning from the engagement because of "risk issues," but decided against resigning in favor of staying on and reducing the risk to the firm.

The SEC said, "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.'"

E&Y finally did resign the Bally's engagement in 2004.

See *E&Y*, page 8