

KOSS CORP
Form 10-Q/A
June 30, 2010
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q/A

Amendment No. 1

**x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934**

for the quarterly period ended December 31, 2009

OR

**o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934**

Commission File Number 0-3295

KOSS CORPORATION

(Exact Name of Registrant as Specified in its Charter)

Edgar Filing: KOSS CORP - Form 10-Q/A

A DELAWARE CORPORATION
(State or other jurisdiction of
incorporation or organization)

39-1168275
(I.R.S. Employer Identification No.)

4129 North Port Washington Avenue, Milwaukee, Wisconsin
(Address of principal executive offices)

53212
(Zip Code)

Registrant's telephone number, including area code: **(414) 964-5000**

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.). Yes No

At June 30, 2010, there were 7,382,706 shares outstanding of the registrant's common stock.

Table of Contents

KOSS CORPORATION AND SUBSIDIARY

FORM 10-Q/A

December 31, 2009

INDEX

	Page
<u>PART I</u>	
<u>FINANCIAL INFORMATION</u>	
<u>Item 1.</u>	
<u>Financial Statements</u>	
<u>Condensed Consolidated Statements of Operations (Unaudited) Three months and six months ended December 31, 2009 and 2008</u>	4
<u>Condensed Consolidated Balance Sheets December 31, 2009 (Unaudited) and June 30, 2009</u>	5
<u>Condensed Consolidated Statements of Cash Flows (Unaudited) Six months ended December 31, 2009 and 2008</u>	6
<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	7
<u>Item 2.</u>	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	25
<u>Item 4.</u>	
<u>Controls and Procedures</u>	30
<u>PART II</u>	
<u>OTHER INFORMATION</u>	
<u>Item 1.</u>	
<u>Legal Proceedings</u>	34
<u>Item 5.</u>	
<u>Exhibits</u>	34

Table of Contents

EXPLANATORY NOTE

This Quarterly Report on Form 10-Q/A for the three and six months ended December 31, 2009 includes the unaudited condensed consolidated statements of operations for the three and six months ended December 31, 2009, the unaudited condensed consolidated balance sheet as of December 31, 2009 and the unaudited condensed consolidated statements of cash flows for the six months ended December 31, 2009. The comparative consolidated balance sheet as of June 30, 2009 has been restated. The comparative unaudited condensed consolidated statements of operations for the three and six months ended December 31, 2008 and the unaudited condensed consolidated statement of cash flows for the six months ended December 31, 2008 have been restated.

On December 18, 2009, the Company learned of certain unauthorized transactions made by Sujata Sachdeva, its former Vice President of Finance and Principal Accounting Officer. The Company subsequently learned that Ms. Sachdeva colluded with two other employees of the accounting department in the misappropriation and circumvention of the Company's existing internal controls and established operating procedures. In carrying out the unauthorized transactions, these three former employees failed to adhere to the Company's existing procedures for processing payments and concealed the misappropriations from management, including the directors and remaining officers of the Company. Ms. Sachdeva and these other former employees were terminated shortly after the Company learned of the unauthorized transactions. On January 20, 2010, Ms. Sachdeva was indicted in connection with these misappropriations from the Company.

Koss Corporation and its wholly-owned subsidiary (the Company or Koss Corporation) is amending this Quarterly Report on Form 10-Q/A to include its condensed consolidated financial statements and related notes to the condensed consolidated financial statements which were not included in the Form 10-Q filed on February 16, 2010. The condensed consolidated financial information was not included in that filing because the Company was restating its financial information primarily to reflect adjustments relating to the unauthorized transactions previously disclosed in Form 8-K Current Reports filed on December 21 and 24, 2009 and January 4, 7, 11 and 20, 2010. These adjustments are more fully described in Note 2 to our restated condensed consolidated financial statements in this Form 10-Q/A and in our recently filed Annual Report on Form 10-K/A for the year ended June 30, 2009.

The Company has amended its Quarterly Report on Form 10-Q/A for the three months ended September 30, 2009 to include restated financial information. The Company has also amended its Quarterly Report on Form 10-Q/A for the three and nine months ended March 31, 2010 to include condensed consolidated financial statements. This Quarterly Report on Form 10-Q/A should be read in conjunction with those filings on Form 10-Q/A.

The following items of the Form 10-Q have been modified or revised in this Amendment No. 1 to Form 10-Q/A to reflect these restatements and related events:

Part I, Item 1.	Financial Statements
Part I, Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations
Part I, Item 4.	Controls and Procedures
Part II, Item 1.	Legal Proceedings
Part II, Item 5.	Exhibits

Table of Contents

PART I
FINANCIAL INFORMATION

Item 1. Financial Statements.

KOSS CORPORATION AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

	Three Months Ended December 31		Six Months Ended December 31	
	2009	2008 (Restated, See Note 2)	2009	2008 (Restated, See Note 2)
Net sales	\$ 12,216,054	\$ 10,946,469	\$ 23,830,699	\$ 23,444,505
Cost of goods sold	7,272,639	5,762,389	13,237,312	12,679,050
Gross profit	4,943,415	5,184,080	10,593,387	10,765,455
Operating Expenses:				
Selling, general and administrative expenses	2,491,634	2,844,952	5,230,932	5,497,746
Unauthorized transactions	4,962,824	2,102,820	10,286,988	3,791,872
Unauthorized transaction related costs and recoveries, net	240,000		240,000	
Total operating expenses	7,694,458	4,947,772	15,757,920	9,289,618
(Loss) income from operations	(2,751,043)	236,308	(5,164,533)	1,475,837
Other Income (Expense):				
Royalty income		78,750		166,250
Interest income	10	1,446	13	15,499
Interest expense	(118,997)	(64,800)	(177,975)	(106,149)
Total Other Income, net	(118,987)	15,396	(177,962)	75,600
(Loss) income before income tax (benefit) provision	(2,870,030)	251,704	(5,342,495)	1,551,437
Income tax (benefit) provision	(1,021,838)	73,997	(1,900,553)	531,885
Net (loss) income	\$ (1,848,192)	\$ 177,707	\$ (3,441,942)	\$ 1,019,552
(Loss) earnings per common share:				
Basic	\$ (0.25)	\$ 0.02	\$ (0.47)	\$ 0.14
Diluted	\$ (0.25)	\$ 0.02	\$ (0.47)	\$ 0.14
Dividends declared per common share				
	\$ 0.060	\$ 0.065	\$ 0.125	\$ 0.130

The accompanying notes are an integral part of these condensed consolidated financial statements.

Edgar Filing: KOSS CORP - Form 10-Q/A

Table of Contents

KOSS CORPORATION AND SUBSIDIARY

CONDENSED CONSOLIDATED BALANCE SHEETS

	(Unaudited) December 31, 2009	June 30, 2009 (Restated, See Note 2)
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 745,656	\$ 1,498,876
Accounts receivable, less allowance for doubtful accounts of \$2,078,969 and \$1,588,923, respectively	6,876,892	4,660,727
Inventories	10,366,766	8,708,835
Prepaid expenses	288,998	151,337
Income taxes receivable	230,009	
Deferred income taxes	1,640,429	1,385,497
Total Current Assets	20,148,750	16,405,272
Equipment and leasehold improvements, net	2,317,767	2,240,572
Other Assets:		
Product software development costs	2,032,475	1,727,040
Deferred income taxes	3,797,511	6,311,282
Cash surrender value of life insurance	3,254,106	2,917,223
Other assets		25,000
Total Other Assets	9,084,092	10,980,545
Total Assets	\$ 31,550,609	\$ 29,626,389
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	\$ 7,227,241	\$ 3,122,721
Accrued liabilities	2,522,491	2,090,054
Dividends payable	442,962	479,876
Income taxes payable		4,404,382
Line of credit	5,863,349	
Total Current Liabilities	16,056,043	10,097,033
Long-Term Liabilities:		
Deferred compensation	1,646,850	1,541,240
Derivative liability	125,000	125,000
Other liabilities	725,000	725,000
Total Long-Term Liabilities	2,496,850	2,391,240
Total Liabilities	18,552,893	12,488,273
Stockholders Equity:		
Common stock, \$0.005 par value, authorized 20,000,000 shares; issued and outstanding 7,382,706 shares	36,914	36,914
Paid in capital	1,281,355	1,056,975
Retained earnings	11,679,447	16,044,227
Total Stockholders Equity	12,997,716	17,138,116
Total Liabilities and Stockholders Equity	\$ 31,550,609	\$ 29,626,389

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents

KOSS CORPORATION AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

Six Months Ended December 31,	2009	2008 (Restated, See Note 2)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	\$ (3,441,942)	\$ 1,019,552
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Provision for doubtful accounts	490,046	203,189
Provision (provision reversal) for obsolete inventories	57,570	(41,584)
Loss on disposals of equipment and leasehold improvements	2,007	8,177
Depreciation of equipment and leasehold improvements	346,561	440,344
Stock-based compensation expense	224,380	221,330
Provision for deferred income taxes	2,258,839	(1,086,899)
Change in cash surrender value of life insurance	11,620	13,557
Deferred compensation	105,610	107,271
Net changes in operating assets and liabilities	(4,656,807)	878,819
Net cash (used in) provided by operating activities	(4,602,116)	1,763,756
CASH FLOWS FROM INVESTING ACTIVITIES:		
Maturity of investments	25,000	75,000
Life insurance premiums paid	(348,503)	(348,503)
Purchase of equipment and leasehold improvements	(425,763)	(733,986)
Product software development expenditures	(305,435)	(494,232)
Net cash used in investing activities	(1,054,701)	(1,501,721)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from line of credit	5,863,349	
Dividends paid to stockholders	(959,752)	(960,790)
Purchase of treasury shares		(42,058)
Net cash provided by (used in) financing activities	4,903,597	(1,002,848)
Net decrease in cash and cash equivalents	(753,220)	(740,813)
Cash and cash equivalents at beginning of period	1,498,876	3,162,233
Cash and cash equivalents at end of period	\$ 745,656	\$ 2,421,420

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents

KOSS CORPORATION AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2009

(Unaudited)

1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

On June 30, 2009, the Company adopted Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC). This pronouncement establishes the FASB ASC as the source of authoritative accounting principles recognized by the FASB to be applied in preparation of financial statements in conformity with generally accepted accounting principles in the United States of America (GAAP). The adoption of this standard had no impact on the Company's condensed consolidated financial statements.

The unaudited condensed consolidated financial statements presented herein are based on interim amounts. In the opinion of management, all adjustments (consisting of normal recurring accruals) necessary to present fairly the financial position, results of operations and cash flows for all periods presented have been made. All significant intercompany transactions have been eliminated. The results of operations for the quarter ended December 31, 2009 are not necessarily indicative of the operating results for the full year.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Registrant's June 30, 2009 Annual Report on Form 10-K/A.

2. RESTATEMENT OF CONSOLIDATED FINANCIAL STATEMENTS

On December 24, 2009 and January 4, 2010, the Company announced that the audited consolidated financial statements included in our Annual Reports on Form 10-K since fiscal year 2005 and the unaudited condensed consolidated financial statements included in our Quarterly Report on Form 10-Q for the three months ended September 30, 2009 should no longer be relied upon.

As previously disclosed in Form 8-K Current Reports filed on December 21 and 24, 2009 and January 4, 7, 11 and 20, 2010, Koss Corporation learned of certain unauthorized transactions from at least its fiscal year ended June 30, 2005 and through December 2009. The Company has determined that its previously issued consolidated financial statements contained errors resulting from these unauthorized transactions.

As part of the financial statement review to isolate the unauthorized transactions, it was determined that certain accounting policies had not been applied properly in the current and prior periods. As a result, the restatements also include certain accounting adjustments related to the

Edgar Filing: KOSS CORP - Form 10-Q/A

correction of errors resulting from the noncompliance with the Company's accounting policies.

All share and per-share data have been adjusted to give effect to the stock split on December 1, 2009.

Table of Contents

The following table summarizes the changes to previously reported earnings. The amounts listed as previously recorded in the income statement were recorded as reductions to net sales, increases to cost of goods sold or as increases to selling, general and administrative expenses in the previously issued condensed consolidated financial statements for the three and six months ended December 31, 2008.

	Three Months ended December 31, 2008		Six Months ended December 31, 2008	
	Restatement	Per Share	Restatement	Per Share
Unauthorized transaction losses	\$ (2,102,820)	\$ (0.28)	\$ (3,791,872)	\$ (0.51)
Unauthorized transaction losses previously recorded in the income statement:				
Net sales	643,049	0.08	1,401,286	0.19
Cost of goods sold	(90,043)	(0.01)	382,869	0.05
Selling, general and administrative expenses	216,017	0.02	382,935	0.05
Additional restatement adjustments:				
Net sales	15,825	0.00	269,590	0.04
Cost of goods sold	1,132,365	0.15	828,366	0.11
Selling, general and administrative expenses	(104,870)	(0.01)	73,945	0.01
Royalty income	78,750	0.01	107,917	0.01
Interest expense	(64,800)	(0.01)	(106,149)	(0.01)
Loss before income tax benefit	(276,527)	(0.05)	(451,113)	(0.06)
Income tax effect of restatement	(131,780)	(0.02)	(234,447)	(0.03)
Total reduction in net income	\$ (144,747)	\$ (0.03)	\$ (216,666)	\$ (0.03)

The condensed consolidated statements of operations, condensed consolidated balance sheets and condensed consolidated statements of cash flows detailed below reconcile the previously reported amounts to the restated amounts being reported on in this Quarterly Report on Form 10-Q/A. The restatement adjustments reflected in the financial statement line items are further described below the reconciling consolidated financial statements in the applicable section to which they pertain.

Table of Contents

KOSS CORPORATION AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS INFORMATION

Three Months Ended December 31,	2008 (as previously reported)	Adjustments	2008 (as restated)
Net sales	\$ 10,287,595	\$ 658,874	\$ 10,946,469
Cost of goods sold	6,804,711	(1,042,322)	5,762,389
Gross profit	3,482,884	1,701,196	5,184,080
Operating Expenses:			
Selling, general and administrative expenses	2,956,099	(111,147)	2,844,952
Unauthorized transactions		2,102,820	2,102,820
Total Operating Expenses	2,956,099	1,991,673	4,947,772
Income from operations	526,785	(290,477)	236,308
Other Income (Expense):			
Royalty income		78,750	78,750
Interest income	1,446		1,446
Interest expense		(64,800)	(64,800)
Total Other Income, net	1,446	13,950	15,396
Income before income tax provision	528,231	(276,527)	251,704
Income tax provision	205,777	(131,780)	73,997
Net income	\$ 322,454	\$ (144,747)	\$ 177,707
Earnings per common share:			
Basic	\$ 0.05	\$ (0.03)	\$ 0.02
Diluted	\$ 0.05	\$ (0.03)	\$ 0.02
Dividends declared per common share	\$ 0.065	\$	\$ 0.065

Table of Contents

KOSS CORPORATION AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS INFORMATION

Six Months Ended December 31,	2008 (as previously reported)	Adjustments	2008 (as restated)
Net sales	\$ 21,773,629	\$ 1,670,876	\$ 23,444,505
Cost of goods sold	13,890,285	(1,211,235)	12,679,050
Gross profit	7,883,344	2,882,111	10,765,455
Operating Expenses:			
Selling, general and administrative expenses	5,954,626	(456,880)	5,497,746
Unauthorized transactions		3,791,872	3,791,872
Total Operating Expenses	5,954,626	3,334,992	9,289,618
Income from operations	1,928,718	(452,881)	1,475,837
Other Income (Expense):			
Royalty income	58,333	107,917	166,250
Interest income	15,499		15,499
Interest expense		(106,149)	(106,149)
Total Other Income, net	73,832	1,768	75,600
Income before income tax provision	2,002,550	(451,113)	1,551,437
Income tax provision	766,332	(234,447)	531,885
Net income	\$ 1,236,218	\$ (216,666)	\$ 1,019,552
Earnings per common share:			
Basic	\$ 0.17	\$ (0.03)	\$ 0.14
Diluted	\$ 0.17	\$ (0.03)	\$ 0.14
Dividends declared per common share	\$ 0.13	\$	\$ 0.13

Table of Contents

KOSS CORPORATION AND SUBSIDIARY

CONDENSED CONSOLIDATED BALANCE SHEET INFORMATION

As of June 30,	2009 (as previously reported)	Adjustments	2009 (as restated)
ASSETS			
Current Assets:			
Cash and cash equivalents	\$ 1,664,407	\$ (165,531)	\$ 1,498,876
Accounts receivable, less allowance for doubtful accounts of \$1,498,736	8,679,606	(4,018,879)	4,660,727
Inventories	9,763,158	(1,054,323)	8,708,835
Prepaid expenses	179,549	(28,212)	151,337
Deferred income taxes	720,121	665,376	1,385,497
Total Current Assets	21,006,841	(4,601,569)	16,405,272
Equipment and leasehold improvements, net	4,076,198	(1,835,626)	2,240,572
Other Assets:			
Product software development costs		1,727,040	1,727,040
Deferred income taxes	1,237,727	5,073,555	6,311,282
Cash surrender value of life insurance		2,917,223	2,917,223
Other assets	2,149,586	(2,124,586)	25,000
Total Other Assets	3,387,313	7,593,232	10,980,545
Total Assets	\$ 28,470,352	\$ 1,156,037	\$ 29,626,389
LIABILITIES AND STOCKHOLDERS EQUITY			
Current Liabilities:			
Accounts payable	\$ 1,810,466	\$ 1,312,255	\$ 3,122,721
Accrued liabilities	1,153,089	936,965	2,090,054
Dividends payable	479,876		479,876
Income taxes payable	175,568	4,228,814	4,404,382
Total Current Liabilities	3,618,999	6,478,034	10,097,033
Long-Term Liabilities:			
Deferred compensation	1,095,961	445,279	1,541,240
Derivative liability	125,000		125,000
Other liabilities		725,000	725,000
Total Long-Term Liabilities	1,220,961	1,170,279	2,391,240
Total Liabilities	4,839,960	7,648,313	12,488,273
Stockholders Equity:			
Common stock, \$0.005 par value, authorized 20,000,000 shares; issued and outstanding 7,382,706 shares	2,049,384	(2,012,470)	36,914
Paid in capital		1,056,975	1,056,975
Retained earnings	21,581,008	(5,536,781)	16,044,227
Total Stockholders Equity	23,630,392	(6,492,276)	17,138,116
Total Liabilities and Stockholders Equity	\$ 28,470,352	\$ 1,156,037	\$ 29,626,389

Table of Contents

KOSS CORPORATION AND SUBSIDIARY

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOW INFORMATION

Six Months Ended December 31,	2008 (as previously reported)	Adjustments	2008 (as restated)
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 1,236,218	\$ (216,666)	\$ 1,019,552
Adjustments to reconcile net income to net cash provided by operating activities:			
Provision for doubtful accounts		203,189	203,189
Reversal of provision for obsolete inventories		(41,584)	(41,584)
Loss on disposals of equipment and leasehold improvements		8,177	8,177
Depreciation of equipment and leasehold improvements	475,847	(35,503)	440,344
Stock-based compensation expense	199,989	21,341	221,330
Provision for deferred income taxes		(1,086,899)	(1,086,899)
Change in cash surrender value of life insurance		13,557	13,557
Deferred compensation		107,271	107,271
Net changes in operating assets and liabilities	980,390	(101,571)	878,819
Net cash provided by operating activities	2,892,444	(1,128,688)	1,763,756
CASH FLOWS FROM INVESTING ACTIVITIES:			
Maturity of investments		75,000	75,000
Life insurance premiums paid		(348,503)	(348,503)
Purchase of equipment and leasehold improvements	(1,322,810)	588,824	(733,986)
Product software development expenditures		(494,232)	(494,232)
Net cash used in investing activities	(1,322,810)	(178,911)	(1,501,721)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Dividends paid to stockholders	(960,315)	(475)	(960,790)
Purchase of treasury shares	(42,057)	(1)	(42,058)
Net cash used by financing activities	(1,002,372)	(476)	(1,002,848)
Net increase (decrease) in cash and cash equivalents	567,262	(1,308,075)	(740,813)
Cash and cash equivalents at beginning of period	3,322,873	(160,640)	3,162,233
Cash and cash equivalents at end of period	\$ 3,890,135	\$ (1,468,715)	\$ 2,421,420

Table of Contents

The financial accounts and transactions that were affected and a description of matters that were discovered in the restatement process are summarized as follows:

Net Sales

The Company has determined that its previously filed condensed consolidated financial statements contained errors for understatement of revenue because of the unauthorized transactions. Certain unauthorized transactions improperly reduced various sales accounts through the use of manual journal entries or system transactions. In the three months and six months ended December 31, 2008, net sales were understated by the amounts set forth in Table A, below.

Table A

Restatement Adjustments Related to Net Sales

	3 mos. ended December 31, 2008	6 mos. ended December 31, 2008
Restatement adjustments to increase gross sales	\$ 712,749	\$ 1,409,309
Restatement adjustments to sales allowances	(53,875)	261,567
Total	\$ 658,874	\$ 1,670,876

Cost of Goods Sold

Cost of goods sold was overstated in the reporting periods as a result of various entries made in connection with the unauthorized transactions. Portions of the unauthorized transactions were improperly charged to cost of goods sold. The majority of the erroneous charges were made to materials, fringe benefit overhead accounts, engineering and depreciation as set forth in Table B, below for the three and six months ended December 31, 2008.

Table B

Restatement Adjustments Related to Cost of Goods Sold

	3 mos. ended December 31, 2008	6 mos. ended December 31, 2008
Material and all other	\$ (889,522)	\$ (1,015,667)
Labor	(76,181)	(126,148)
Freight	(132,676)	1,783

Edgar Filing: KOSS CORP - Form 10-Q/A

Fringe benefits	(9,611)	(59,193)
Engineering	(7,500)	(126,661)
Depreciation	73,168	114,651
Total	\$ (1,042,322)	\$ (1,211,235)

Selling, General and Administrative Expenses

The financial statement review included an evaluation of various balance sheet accounts along with their corresponding income statement items that are included in selling, general and administrative expenses. It was determined that the items listed below were misstated.

- Provision for doubtful accounts was understated as was the allowance for doubtful accounts.
- Accounting for the cash surrender value of life insurance was improperly stated because of not including all of the related life insurance policies.

Table of Contents

- Deferred compensation expense was understated for the three and six months ended December 31, 2008 as a result of not properly applying the assumptions for mortality and years of service as well as using a discount rate that was too high.
- Costs for professional fees and product development expense were overstated as a result of erroneous manual journal entries. The erroneous charges were recorded to these line items in both periods.

The amounts related to the above misstatements for the three and six months ended December 31, 2008 are summarized in Table C, below.

Table C

Restatement Adjustments Related to Selling,

General and Administrative Expenses

	3 mos. ended December 31, 2008	6 mos. ended December 31, 2008
Provision for doubtful accounts	\$ 89,762	\$ 65,350
Stock-based compensation expense	(89,324)	21,341
Change in miscellaneous income	7,735	(334,946)
Deferred compensation expense	53,636	107,271
Professional fees	17,372	(4,229)
Fringe benefits	(9,607)	(49,500)
Officers' life insurance	(89,650)	174,813
Bonuses	(28,200)	8,800
Koss Employee Stock Ownership Trust/401(k)	(57,485)	(83,577)
Donations	14,128	12,500
Financial public relations	1,110	(58,889)
Gain/loss on fixed asset disposals	3,103	8,177
New product development, sales, marketing and commissions	(59,623)	(96,782)
Depreciation	(49,549)	(150,154)
Miscellaneous expense	(32,236)	(45,329)
Other selling, general and administrative	117,681	(31,726)
Total	\$ (111,147)	\$ (456,880)

Income Tax Provision

The impact of the various account adjustments on the income tax provision is detailed below in Table D, below for the three and six months ended December 31, 2008.

Table D

Restatement Adjustments Related to Income Tax Provision

	3 mos. ended December 31, 2008		6 mos. ended December 31, 2008	
Federal income tax provision	\$	(132,204)	\$	(276,503)
State income tax provision		(15,282)		3,625
Foreign income tax provision		15,706		38,431
Income tax provision	\$	(131,780)	\$	(234,447)

Table of Contents

Cash and Cash Equivalents

Cash was improperly overstated because of the unauthorized transactions. The impact on cash is shown in Table E, below.

Table E

Restatement Adjustments Related to Cash

	June 30, 2009
Correction of cash balance	\$ (165,531)

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable was overstated because of not properly applying cash received against the outstanding invoices.

The allowance for doubtful accounts was understated. It has been restated to provide for amounts that are expected to not be collected because of bankruptcies and accounts showing slow payment. The impact of accounts receivable and allowance for doubtful accounts is provided in Table F, below.

Table F

Restatement Adjustments Related to Accounts Receivable,
and Allowance for Doubtful Accounts

	June 30, 2009
Accounts receivable because of delayed cash posting	\$ (3,407,667)
Allowance for doubtful accounts	(611,212)
Total	\$ (4,018,879)

Inventories

Edgar Filing: KOSS CORP - Form 10-Q/A

Inventories were overstated as a result of not properly accounting for the inventory in transit, insufficient provision for obsolete or slow-moving inventory and treating advance payments as inventory. The impact of these items is provided in Table G, below.

Table G

Restatement Adjustments Related to Inventory

		June 30, 2009
Inventory in transit	\$	289,622
Obsolete and slow-moving inventory		(901,229)
Prepaid inventory		(402,642)
LIFO reserve		9,071
Freight on inventory		25,614
Other		(74,759)
Total	\$	(1,054,323)

Equipment and Leasehold Improvements

Assets no longer used in the business were not removed from equipment and leasehold improvements. As part of the restatement, the Company reviewed the assets and wrote off certain assets that were no

Table of Contents

longer being used in the business. Almost all of the assets which were written off had been fully depreciated prior to these adjustments. Loss on disposal was \$1,046 and \$2,007 for the three and six months ended December 31, 2009, respectively. Loss on disposal was \$3,103 and \$8,177 for the three and six months ended December 31, 2008, respectively. Product software development costs were reclassified and reported separately in the restated consolidated balance sheets. The impact of the equipment and leasehold improvements is provided in Table H below.

Table H

Restatement Adjustments Related to Equipment and Leasehold Improvements

	June 30, 2009
Leasehold improvements	\$ (77,468)
Machinery, equipment, furniture and fixtures	(511,937)
Tools, dies, molds and patterns	(6,534,676)
	(7,124,081)
Accumulated depreciation	5,288,455
Total	\$ (1,835,626)

Product Software Development Costs

The cost of purchased software technology is capitalized and stated at the lower of unamortized cost or expected net realizable value. These amounts were included in equipment and leasehold improvements in the previous filings and have been reclassified to a separate line item in the consolidated balance sheets in the restatement. The balance sheet impact of the restatement to product software development costs is as shown in Table I, below.

Table I

Restatement Adjustments Related to Product Software Development Costs

	June 30, 2009
Reclassification from equipment and leasehold improvements	\$ 1,727,040

Cash Surrender Value of Life Insurance

Cash surrender value of life insurance has been restated because of an error in the previously calculated amounts. In addition, it was previously reported in Other assets but has now been classified separately in the restated consolidated balance sheets. The balance sheet impact of the restatement to cash surrender value is as shown in Table J, below.

Table J

Restatement Adjustments Related to Cash Surrender Value

	June 30, 2009
Correction of error	\$ 792,637

Liabilities

Various current liabilities were not properly stated due to the unauthorized transactions or as a result of different estimates at the time the statements were prepared. The following accounts were affected:

Table of Contents

- Accounts payable was understated on the June 30, 2009 consolidated balance sheet because of an erroneous transaction for approximately \$1,290,000. Other changes to accounts payable are for reclassification of deposits to an asset account and to include accounts receivable credit balances in accounts payable.

- Accrued liabilities have been revised to:

- Include proper cutoff of professional fees at each period end;

- Adjust accrued returns based on detailed analysis of returns, price adjustments and shipping adjustments;

- Increase accrued product warranty obligations to reflect the estimated costs of future returns of product based on an analysis of annual returns and the cost of replacing the returned items. The Company believes this properly values the potential liability based on annual returns and cost of replacing the returned items.

- The liability for deferred compensation was understated as a result of not properly applying the assumptions for mortality and years of service as well as using a discount rate that was too high.

The balance sheet impact of the restatement of liabilities is as shown in Table K, below.

Table K

Restatement Adjustments Related to Accounts Payable,

Accrued Liabilities and Long-term Liabilities

	June 30, 2009
Erroneous transactions	\$ 1,290,011
Reclassification of advance payments to deposits	110,263
Accounts receivable credit balances	25,573
Erroneous adjustments to accounts payable	167,083
Other accounts payable	(280,675)
Accounts payable	\$ 1,312,255

Edgar Filing: KOSS CORP - Form 10-Q/A

	June 30, 2009
Legal and professional fees	\$ 166,939
Accrued returns	219,773
Product warranty obligations	312,420
Cooperative advertising and promotion allowances	(250,000)
Accrued interest	354,644
Accrued product development	5,877
Fringe benefits	4,467
Other accrued liabilities	122,845
Accrued liabilities	\$ 936,965

Table of Contents

	June 30, 2009
Long-term product warranty obligations	\$ 725,000
Deferred compensation liability	445,279
Long-term liabilities	\$ 1,170,279

Income Taxes Payable

The impact of the various account adjustments on income taxes payable is detailed below in Table L, below.

Table L

Restatement Adjustments Related to Income Taxes Payable

	June 30, 2009
Accrued federal income tax	\$ 3,428,169
Accrued state income tax	1,002,085
Other	(201,440)
Income taxes payable	\$ 4,228,814

3. EARNINGS (LOSS) PER COMMON AND COMMON STOCK EQUIVALENT SHARE

Basic earnings (loss) per common share are computed based on the weighted average number of common shares outstanding. The weighted average number of common shares outstanding for the quarters ending December 31, 2009 and 2008 were 7,382,706 and 7,388,726, respectively. When dilutive, stock options are included in earnings per share as share equivalents using the treasury stock method. For the quarters ended December 31, 2009 and 2008 there were no common stock equivalents related to stock option grants that were included in the computation of the weighted-average number of shares outstanding for diluted earnings (loss) per share. Shares under option of 1,203,308 were excluded from diluted weighted average common shares outstanding for the quarter ended December 31, 2009 as they would be anti-dilutive due to the Company's net loss for the quarter. The dilutive effect of stock options of 1,123,308 for which the exercise price was higher than the average market price for the quarter ended December 31, 2008 were excluded from the calculation of diluted earnings per share.

4. INCOME TAXES

The Company files income tax returns in the United States (Federal), Wisconsin (state) and various other state jurisdictions. The company is not currently subject to income tax examinations in any of our significant tax jurisdictions. The Company recognizes interest related to unrecognized tax benefits as interest expense. As part of the unauthorized transactions, the Company has accrued interest of \$495,520 and \$354,644 at December 31, 2009 and June 30, 2009, respectively. Tax years open to examination by tax authorities under the statute of limitations include fiscal 2007 through 2009 for Federal and fiscal 2005 through 2009 for most state jurisdictions.

The total liability for unrecognized tax benefits was \$300,000 as of December 31, 2009 and June 30, 2009. The liability does not include an amount for accrued penalties. The Company recognizes penalties related to unrecognized tax benefits in the provision for income taxes. The Company recognizes interest related to unrecognized tax benefits as interest expense. The Company does not expect a significant increase or decrease to the total amounts of unrecognized tax benefits within the next 12 months. There was no change in the amount of unrecognized tax benefits during the six months ended December 31, 2009.

Table of Contents

5. INVENTORIES

The classification of inventories is as follows: