

KOSS CORP
Form 10-K/A
October 12, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

AMENDMENT NO. 1 TO

FORM 10-K/A

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

For the fiscal year ended June 30, 2010

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)

Delaware

(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**

Securities registered pursuant to Section 12(b) of the Act:

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Title of Each Class
Common Stock \$0.005 par value

Name of Each Exchange on Which Registered
The Nasdaq Stock Market LLC

NONE

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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 ☒

The aggregate market value of the common voting stock held by nonaffiliates of the registrant as of December 31, 2009 was approximately \$13,772,465 (based on the \$5.51 per share closing price of the Company's common stock as reported on the NASDAQ Stock Market on December 31, 2009).

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On September 10, 2010, 7,382,706 shares of voting common stock were outstanding.

Documents Incorporated by Reference

Part III of this Form 10-K incorporates by reference information from Koss Corporation's Proxy Statement for its 2010 Annual Meeting of Stockholders filed with the Commission under Regulation 14A within 120 days of the end of the fiscal year covered by this Form 10-K.

Explanatory Note

The purpose of this Amendment No. 1 to Form 10-K/A is to supplement and clarify the Company's disclosures in Item 9A. Controls and Procedures. Other than the revisions to Item 9A. Controls and Procedures and the filing of the Exhibits attached hereto, no other changes have been made to this Annual Report on Form 10-K.

ITEM 9A.

CONTROLS AND PROCEDURES.

Disclosure Controls and Procedures.

Disclosure controls and procedures (as defined in Rules 13(a)-15(e) and 15(d)-15(e)) of the Securities Exchange Act of 1934, as amended (the Exchange Act) are designed to ensure that (1) information required to be disclosed in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms; and (2) that such information is accumulated and communicated to management, including the principal executive officer and principal financial officer, to allow timely decisions regarding required disclosures. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error, the circumvention or overriding of controls and procedures and collusion to circumvent and conceal the overriding of controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

The Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as of June 30, 2010. As discussed in "Changes in Internal Controls" below, the Company recently implemented remedial measures in response to the previously disclosed unauthorized transactions. Although the Company's management believes that these remedial measures have addressed the weaknesses in the Company's disclosure controls and procedures, the Company must allow a sufficient amount of time to elapse to permit testing of these controls in order to confirm their effectiveness. Subject to this testing and confirmation process, management believes that the Company's disclosure controls and procedures will be deemed effective. However, as a result of the Company's inability to complete the testing and confirmation process, management has concluded that the Company's disclosure controls and procedures as of June 30, 2010 were not effective.

The Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, continues to evaluate the effectiveness of the Company's disclosure controls and procedures to identify any additional enhancements that may provide greater comfort that the Company's disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure and are effective to provide reasonable assurance that such information is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

Management's Annual Report on Internal Controls over Financial Reporting.

The Company's management, including its Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining adequate internal control of financial reporting (as defined in Exchange Act Rules 13(a)-15(f) and 15(d)-15(f)) and designing such internal controls to provide reasonable assurances regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Because of inherent limitations, a system of internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate due to change in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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Management conducted its evaluation of the effectiveness of its internal control over financial reporting based on the framework in Internal Control-Integrated Framework issued by the Committee of

Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, the Company's management, including its Chief Executive Officer and Chief Financial Officer, has concluded that the Company's internal controls and operating procedures were circumvented during the fiscal year and the circumvention was concealed from management as previously described in the Form 10-K/A for June 30, 2009. The Company has already implemented the internal control improvements described in Changes in Internal Controls below, and the Company is planning to implement a new computer system towards the end of fiscal year 2011 that will further enhance the segregation of duties within information technology. Based on the criteria set forth by COSO in Internal Control-Integrated Framework, although the Company's management believes that these enhancements and remedial measures have addressed the weaknesses in the Company's disclosure controls and procedures, the Company must allow a sufficient amount of time to elapse to permit testing of these controls in order to confirm their effectiveness. Subject to this testing and confirmation process, management believes that the Company's disclosure controls and procedures will be deemed effective. However, as a result of the Company's inability to complete the testing and confirmation process, management has concluded that the Company's internal controls over financial reporting as of June 30, 2010 were not effective.

Changes in Internal Controls

The Company has identified how its controls over financial reporting were circumvented and how it is addressing these matters below.

- *Auditor review.* The circumvention of the Company's internal controls and procedures was not detected as part of the Company's annual audits and quarterly reviews by its former independent auditor, Grant Thornton, LLP. As described in Item 3 Legal Proceedings, on June 24, 2010, the Company filed an action against Grant Thornton, LLP and Ms. Sachdeva.
- *Wire transfers and cashier's checks.* Approximately \$30,900,000 or 98.1% of the total \$31,500,000 of unauthorized transactions from fiscal year 2005 through December 2009 was misappropriated by circumventing the Company's internal controls and other operating procedures for the payment of Company expenditures by using wire transfers or cashier's checks from the Company's bank accounts to pay for personal expenditures. Of the \$30,900,000, approximately \$8,500,000 was misappropriated by use of these means during 2009. Misappropriations by use of wire transfers or cashier's checks totaled \$10,300,000 during 2010. These unauthorized transactions were processed by circumventing the Company's policy that all invoices over \$5,000 were required to be submitted and approved by Michael Koss as the CEO, and all accounts payable checks generated from the Company's accounts payable system were signed by the CEO. Moreover, wire transfers were to be used only for authorized transactions including certain inventory purchases and transfers of funds between the Company's bank accounts. Wire transfers for inventory purchases and the recurring expense items required the approval by several employees including authorized Vice Presidents, while the wire transfers between the Company's bank accounts were processed and approved by Ms. Sachdeva and one of the other terminated employees in the accounting department. Ms. Sachdeva, by herself and/or by directing other employees in the accounting department, ordered cashier's checks from the Company's bank accounts to pay for personal expenditures directly, thereby circumventing the internal controls and procedures as described above so that these payments would not be submitted through the Company's normal accounts payable system. Ms. Sachdeva, by herself and/or by directing others in the accounting department, processed wire transfers from the Company's bank accounts to pay for personal expenditures directly, thereby circumventing the internal controls and procedures as described above so that these payments would not be submitted through the Company's normal accounts payable system. This has been remediated by: (1) disallowing the use of any cashier's checks;

(2) enforcing that all wire transfers are initiated within the financial function and electronically approved by the CEO; and (3) performing an enhanced review, reconciliation and reporting of cash activities.

- *Petty cash, manual checks and traveler's checks.* The remaining misappropriations of approximately \$600,000 or 1.9% from the total amount of \$31,500,000 from fiscal year 2005 through December 2009 were carried out by circumventing the Company's internal controls and other standard operating procedures involving the Company's petty cash system, manual check system and policy for using traveler's checks. In doing so, the Company's policy requiring that all expense reports be submitted and approved by the CEO was circumvented. Out of the estimated \$600,000 of these types of transactions, approximately \$91,000 occurred during 2009. Approximately \$107,000 of misappropriations involving the use of the Company's petty cash system, manual check system and traveler's checks policy occurred during 2010. Remediation of these issues has been accomplished by: (1) eliminating the petty cash fund so all reimbursements run through normal controlled accounts payable channels; (2) eliminating the use of manual checks so all check disbursements are generated from the Company's accounts payable system check run; and (3) eliminating the use of traveler's checks.

- *Recording of unauthorized transactions.* Ms. Sachdeva and one of the other terminated employees concealed the unauthorized transactions by recording numerous erroneous accounting entries in various accounts to hide the true nature of the transactions. The Company has improved the controls and procedures related to journal entries and account reconciliations to include improved segregation of duties, review and approval of reconciliations, and approval of all manual journal entries.

- *Performance and review of account reconciliations.* The Company's internal controls and procedures included the performance and review of key account reconciliations, including cash, by the accounting department employees including Ms. Sachdeva, who collectively had over 50 years of experience at the Company. Ms. Sachdeva and one of the other terminated employees further concealed the unauthorized transactions by failing to properly perform and review these key account reconciliations on a regular basis, and failing to properly perform the Company's period end financial close and reporting processes that were designed to accurately report the Company's financial information. The account reconciliation process has been improved and includes proper segregation of duties as well as review and approval by another person in the financial function.

- *Corporate standards and whistleblower policy.* The three terminated employees, including Ms. Sachdeva, failed to comply with the Company's established standards of integrity, ethical values and its Code of Conduct, Code of Ethics and Whistleblower policy. The Company has taken steps to reinforce these policies with all of its employees, officers and directors.

- *Application of GAAP.* The terminated employees, including Ms. Sachdeva, as the principal accounting officer in charge of financial reporting failed to properly apply the Company's established accounting policies and adherence with GAAP. As a result, certain established accounting policies were not applied correctly and resulted in inaccuracies, both from the fraudulent activity directed by Ms. Sachdeva and the misapplication of GAAP. The affected accounts include equipment and leasehold improvements, cash surrender value of life insurance, accrued deferred compensation, accrued product warranty obligations and income taxes payable. As part of the restatement of the consolidated financial statements, the accounts

were reviewed in detail and reconciled. Integral to the reconciliation process was a review of all critical accounting estimates.

- *Information Technology.* The Company's internal controls and procedures relating to the Company's computer system for processing financial transactions were manipulated to conceal the unauthorized transactions. The Company expects to implement a new computer system that will be used to improve its processing of financial transactions and overall segregation of duties towards the end of fiscal 2011.

We believe the changes to our system of internal controls resulting from these efforts have enhanced the Company's control over financial reporting. We continue to diligently and vigorously review our financial and reporting controls and procedures. As we continue to evaluate and work to improve our internal control over financial reporting, we may take additional measures to address any additional control deficiencies we may identify.

EXHIBIT INDEX

Exhibit No.	Exhibit Description
3.1	Amended and Restated Certificate of Incorporation of Koss Corporation, as in effect on November 19, 2009. Filed as Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the period ended December 31, 2009 and incorporated herein by reference.
3.2	By-Laws of Koss Corporation, as in effect on September 25, 1996. Filed as Exhibit 3.2 to the Company's Annual Report on Form 10-K for the year ended June 30, 1996 and incorporated herein by reference.
10.1	Death Benefit Agreement with John C. Koss. Filed as Exhibit 10.4 to the Company's Annual Report on Form 10-K for the year ended June 30, 1996 and incorporated herein by reference.
10.2	Stock Purchase Agreement with John C. Koss. Filed as Exhibit 10.5 to the Company's Annual Report on Form 10-K for the year ended June 30, 1996 and incorporated herein by reference.
10.3	Salary Continuation Resolution for John C. Koss. Filed as Exhibit 10.6 to the Company's Annual Report on Form 10-K for the year ended June 30, 1996 and incorporated herein by reference.
10.4	1983 Incentive Stock Option Plan. Filed as Exhibit 10.7 to the Company's Annual Report on Form 10-K for the year ended June 30, 1996 and incorporated herein by reference.
10.5	Assignment of Lease to John C. Koss. Filed as Exhibit 10.7 to the Company's Annual Report on Form 10-K for the year ended June 30, 1988 and incorporated herein by reference.
10.6	Addendum to Lease. Filed as Exhibit 10.8 to the Company's Annual Report on Form 10-K for the year ended June 30, 1988 and incorporated herein by reference.
10.7	Amendment to Lease. Filed as Exhibit 10.22 to the Company's Annual Report on Form 10-K for the year ended June 30, 2000 and incorporated herein by reference.
10.8	Partial Assignment, Termination and Modification of Lease. Filed as Exhibit 10.25 to the Company's Annual Report on Form 10-K for the year ended June 30, 2001 and incorporated herein by reference.
10.9	Restated Lease. Filed as Exhibit 10.26 to the Company's Annual Report on Form 10-K for the year ended June 30, 2001 and incorporated herein by reference.
10.10	1990 Flexible Incentive Plan. Filed as Exhibit 25 to the Company's Annual Report on Form 10-K for the year ended June 30, 1990 and incorporated herein by reference.
10.11	Consent of Directors (Supplemental Executive Retirement Plan for Michael J. Koss dated March 7, 1997). Filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 1997 and incorporated herein by reference.

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- 10.12 Credit Agreement dated May 12, 2010, between Koss Corporation and JPMorgan Chase Bank, N.A. Filed as Exhibit 10.12 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2010 and incorporated by reference herein.
- 10.13 Pledge and Security Agreement dated May 12, 2010, between Koss Corporation and JPMorgan Chase Bank, N.A. Filed as Exhibit 10.13 to the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2010 and incorporated by reference herein.
- 14 Koss Corporation Code of Ethics. Filed as Exhibit 14 to the Company's Annual Report on Form 10-K for the year ended June 30, 2010 and incorporated herein by reference.
- 21 List of Subsidiaries of Koss Corporation.*
- 23 Consent of Baker Tilly Virchow Krause, LLP. Filed as Exhibit 23 to the Company's Annual Report on Form 10-K for the year ended June 30, 2010 and incorporated herein by reference.
- 31.1 Rule 13(a)-14(a)/15(d)-14(a) Certification of Chief Executive Officer *
- 31.2 Rule 13(a)-14(a)/15(d)-14(a) Certification of Chief Financial Officer*
- 32.1 Section 1350 Certification of Chief Executive Officer **
- 32.2 Section 1350 Certification of Chief Financial Officer**

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

KOSS CORPORATION

By:	/s/ Michael J. Koss	Dated: October 12, 2010
	Michael J. Koss	
	Vice Chairman	
	President	
	Chief Executive Officer	
	Chief Operating Officer	

By:	/s/ David D. Smith	Dated: October 12, 2010
	David D. Smith	
	Executive Vice President	
	Chief Financial Officer	
	Principal Accounting Officer	
	Secretary	

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on October 12, 2010.

/s/ John C. Koss
John C. Koss, Director

/s/ Michael J. Koss
Michael J. Koss, Director

/s/ Lawrence S. Mattson
Lawrence S. Mattson, Director

/s/ John J. Stollenwerk
John J. Stollenwerk, Director

/s/ Thomas L. Doerr
Thomas L. Doerr, Director

/s/ Theodore H. Nixon
Theodore H. Nixon, Director