UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF WISCONSIN

UNITED STATES SECURITIES AND EXCHANGE COMMISSION,	)	
Plaintiff,	)	
v.	)	**Civil Action No.:**
KOSS CORPORATION AND MICHAEL J. KOSS,	)	
Defendants.	)	

COMPLAINT

Plaintiff, the United States Securities and Exchange Commission (the "Commission" or "SEC"), alleges the following against Defendants Koss Corporation ("Koss" or "the Company") and Michael J. Koss ("MJK"):

SUMMARY

1. This case involves Koss's preparation of materially inaccurate financial statements, books and records, and lack of adequate internal controls from fiscal years 2005 through 2009. During this period, Sujata Sachdeva ("Sachdeva"), Koss's former Principal Accounting Officer, Secretary and Vice-President of Finance, and Julie Mulvaney ("Mulvaney"), Koss's former Senior Accountant, engaged in a wide-ranging accounting fraud to cover up Sachdeva's embezzlement of over $30 million from Koss. To carry out their fraud, Sachdeva and Mulvaney took advantage of Koss's inadequate internal controls and failures in overseeing the accounting and financial reporting functions by MJK in his roles as Koss's Chief Executive Officer and Chief Financial Officer ("CFO"). As a result, Koss in its interim and annual financial statements materially misstated its income, overstated its assets and understated its liabilities during this period.

2. Sachdeva, with the assistance of Mulvaney, embezzled funds from Koss using numerous fraudulent wire transfers, cashier's checks and petty cash withdrawals, most of which Sachdeva spent on lavish shopping sprees. The yearly amounts stolen were significant relative to Koss's sales and shareholders' equity. For example, during fiscal year 2009, Sachdeva stole approximately $8.5 million, while Koss reported total sales of approximately $41.7 million and retained earnings of approximately $17.1 million at year-end.

3. Sachdeva and Mulvaney were able to hide the substantial embezzlements in Koss's financial records in part because Koss and MJK did not adequately maintain internal controls to reasonably assure the accuracy and reliability of financial reporting.

4. Based on the fraudulent accounting books and records prepared by Sachdeva and Mulvaney, Koss prepared materially inaccurate audited financial statements and filed with the Commission materially inaccurate current, quarterly and annual reports. MJK certified the accuracy of the materially inaccurate financial statements filed by Koss with the Commission.

5 After discovering the embezzlement, Koss amended and restated its financial statements for fiscal years 2008 and 2009, and the first quarter of fiscal year 2010 (through September 2009). Sachdeva subsequently pled guilty to federal wire-fraud charges, and admitted her multi-million-dollar theft from Koss and the scheme to falsify Koss's accounting books and records to hide her embezzlement. Sachdeva admitted in her plea agreement that "[t]o conceal her fraud, Sachdeva made, and directed other Koss employees to make, numerous false entries in Koss's books and records to make it appear that Sachdeva's fraudulent transfers were legitimate business transactions." She also consented to the entry of a judgment against her in a civil action brought against her by the Commission.

JURISDICTION AND VENUE

6. This Court has jurisdiction over this action pursuant to Sections 21(d), 21(e) and 27 of the Securities Exchange Act of 1934 (the "Exchange Act") [15 U.S.C. §§ 78u(d), 78u(e) and 78aa] and 28 U.S.C. § 1331.

7. Koss and MJK, directly or indirectly, made use of the means or instrumentalities of interstate commerce and/or of the mails in connection with the acts, practices and courses of business alleged in this Complaint.

8. Certain of the acts, practices and courses of business constituting the violations alleged herein occurred within this judicial district.

THE DEFENDANTS

9. Koss is a Delaware corporation with a principal place of business in Milwaukee, Wisconsin. Koss designs, manufactures and sells stereo headphones. Koss is an issuer of securities registered pursuant to Section 12 of the Exchange Act [15 U.S.C. § 78l], and its shares are listed on the NASDAQ stock exchange. Koss's fiscal year runs from July 1 to June 30 of the calendar year. It is a "smaller reporting company" for purposes of periodic reporting under the Exchange Act.

10. Michael J. Koss is Koss's Chief Executive Officer, Chief Operating Officer, President and Vice-Chairman of its Board of Directors. He was also CFO during the relevant period. MJK and members of his family own, directly or indirectly, in excess of 70% of the Company's shares.

FACTS

Misconduct in Koss's Accounting Department

11. Koss's accounting department consisted of long-time Koss employees Sachdeva and Mulvaney, as well as a junior accountant and several accounting clerks. Sachdeva and Mulvaney controlled Koss's financial books and records, prepared Koss's monthly and periodic financial reports, and submitted the reports to MJK for review. These reports were incorporated into Koss's quarterly and annual SEC filings, which Sachdeva and MJK both signed.

12. From fiscal year 2005 through the first quarter of fiscal year 2010, Sachdeva stole more than $30 million from Koss. Sachdeva embezzled the funds through a variety of means, including fraudulent cashier's checks, fraudulent wire transfers and unauthorized payments from petty cash.

13. Koss's internal controls policy for accounts payable required MJK to approve all payments of invoices of $5,000 or more, and required him to review and sign the checks to pay those invoices. Nonetheless, the internal controls did not prevent Sachdeva and Mulvaney from ignoring the policy and obtaining cashier's checks to pay for Sachdeva's personal purchases without seeking or obtaining MJK's approval.

14. Sachdeva embezzled more than $15 million by authorizing the use of fraudulent cashier's checks from at least 2005 through December 2009. Mulvaney ordered most of these cashier's checks. Many of the cashier's checks exceeded $5,000, and some exceeded $100,000. None of the cashier's checks were reviewed or approved by MJK.

15. Furthermore, Koss's internal controls policy required the Vice President of Operations to review appropriate documentation for wire transfers to overseas vendors for inventory purchases and to approve those wire transfers before Mulvaney processed them.

However, the internal controls did not prevent Sachdeva and Mulvaney from processing other wire transfers to pay for Sachdeva's personal purchases without seeking or obtaining approval by MJK or the Vice President of Operations.

16. Sachdeva and Mulvaney made more than $16 million in fraudulent wire transfers—all to pay Sachdeva's personal charge card bills. Sachdeva, who had the authority to approve and process wire transfers, authorized Mulvaney to make the fraudulent transfers online. For example, in October 2009, 17 fraudulent wire transfers totaling $1,509,595 were sent to satisfy charges made by Sachdeva on her personal charge card. Two of those transfers alone totaled $1,018,595.

17. None of the fraudulent wire transfers were presented to or reviewed for approval by the Vice President of Operations or MJK. MJK never verified the actual operation, or adequacy, of controls over large wire transfers.

18. Koss had insufficient internal controls over a petty cash account, which Mulvaney maintained at a balance of $5,000 or less. MJK did not review any petty cash replenishments or records of the expenses paid from the petty cash fund because he was not required to approve any payments less than $5,000. As a result, Mulvaney and Sachdeva wrote numerous checks and stole approximately $390,000 from the petty cash account.

19. Sachdeva and Mulvaney used at least three methods to disguise the embezzlements in Koss's books and records. In some instances, false journal entries reclassified cash to sales, thereby masking Sachdeva's thefts of cash as reductions in sales. In some instances, false journal entries were made to eliminate sales and reduce cash balances. In other instances, false journal entries decreased both accrued liabilities and Koss's bank account balance. Finally, false entries increased Koss's bank account balance and the costs of goods sold

and decreased accounts receivable, inventory and finished goods, which kept the inventory balance in check with the false journal entries reducing sales and increasing the costs of goods sold.

20. Sachdeva and Mulvaney entered the false journal entries without any supporting documentation for the transactions, as was required by Koss's internal controls for legitimate transactions. These numerous false entries went undetected in part because of ineffective internal controls, including MJK's failure to review adjusting entries and to verify that reconciliations of accounts were in fact being performed on a regular basis.

Koss's Internal Control Deficiencies

21. Koss has recognized that its internal accounting and disclosure controls were deficient. On June 30, 2010, Koss filed a Form 10K/A with the Commission that included its restated financial statements for the fiscal years ended June 30, 2008 and June 30, 2009, and the periods ended September 30, 2009, December 31, 2009 and March 31, 2010. In its Form 10-K/A, Koss stated "[t]he Company's internal control over financial reporting failed to timely detect and prevent the unauthorized transactions.... The Company's internal controls as of June 30, 2009 were not effective in that they failed to timely detect and prevent the circumvention of the internal controls and procedures relating to the unauthorized transactions." Specific internal control failures included the following.

Segregation of Duties

22. Due to the limited number of people working in Koss's accounting department, many critical duties were combined and given to a few employees. A single individual, Sachdeva, had authority to sign checks; approve and, with Mulvaney's assistance, submit wire

transfers; review and, with Mulvaney's assistance, approve bank reconciliations and maintain the general ledger.

23. Koss did not properly segregate duties or assign someone outside of the accounting function to provide an independent check and balance on employees' integrity and to maintain a sufficiently strong control system. Among other things, different employees should have performed the separate duties of signing checks, processing cash receipts and cash disbursements, and maintaining books of original entry.

Balance Sheet and Bank Account Reconciliations

24. Koss did not regularly perform monthly reconciliations of its bank accounts or balance sheets.

25. Koss did not have someone outside the accounting department, such as MJK as the CFO or the Vice President of Operations, review large wire transfers or the recording of payments on accounts payable when not processed through the accounts payable system.

26. Koss did not adequately periodically review documentation to support the general journal entries to verify that the corresponding transactions were being executed in accordance with Koss's accounting policies and recorded as necessary to permit preparation of financial statements in conformity with Generally Accepted Accounting Principles with respect to completeness, existence, occurrence, right and obligation, measurement and valuation.

27. Many account reconciliations were either not prepared or were not maintained as part of Koss's records. To the extent that reconciliations were conducted, they were improperly performed by the same persons who initiated or recorded the transactions (*i.e.* Sachdeva or Mulvaney), enabling those persons to make modifications to the reconciliations to cover up fraudulent entries. MJK did not review or verify the existence of reconciliations.

28. MJK also did not review or verify the appropriateness of any unusual reconciling items and did not review or authorize any adjusting journal entries. Support for adjusting entries was not documented.

Supervisory Controls and Governance

29. In his review of Koss's monthly financial statements, MJK did not inspect the general ledger detail trial balance (which details all of the posted transactions), significant journal entries and the reconciliations of all subsidiary ledgers or schedules that supported significant account balances. MJK did not investigate unusual or infrequent journal entries on a regular and recurring basis.

30. According to its Form 10-K/A, the most significant total dollar amount of improper journal entries during the relevant period were made to understate sales and overstate cost of sales. Although monthly analytical procedures were performed, the procedures were not sufficient to detect unusual relationships between critical items, inconsistency with trends developed over Koss's operating history, balances which were out of line with expectations or any other unusual items.

31. While Sachdeva provided MJK with reporting certifications for his review, he did not conduct an adequate review of Koss's accounting in connection with these certifications.

Safeguarding of Assets

32. Koss's internal controls over cash were inadequate. While Koss's internal controls policy required MJK to approve invoices of $5,000 or more for payment, its controls did not prevent Sachdeva and Mulvaney from processing large wire transfers and cashier's checks outside of the accounts payable system to pay for Sachdeva's personal purchases without seeking or obtaining MJK's approval. In addition, there was no independent review of the petty cash

account. Although MJK was required to review accounts payable checks before the checks were mailed, MJK and Sachdeva were each authorized to independently withdraw or transfer funds from Koss's bank accounts.

33. As a result, Sachdeva, with Mulvaney's assistance, was able both to initiate and authorize wire transfers of Koss's funds to her personal creditors totaling approximately $16.3 million, and to order cashier's checks payable to credit card companies and her other designated payees totaling approximately $15.5 million.

Information Systems

34. MJK knew that Koss's computerized accounting system was almost 30 years old and he twice deferred proposals for a new system. Koss's and MJK's failure to implement and maintain effective controls over Koss's information systems in part allowed Sachdeva and Mulvaney to carry out the embezzlement and accounting fraud.

35. Because access to the old accounting system could not be locked at the end of the month, Sachdeva and Mulvaney were able to bypass an internal control requiring MJK to authorize changes to the monthly books after they were closed. Sachdeva and Mulvaney thus accessed the accounting system and made improper post-closing entries.

36. MJK did not properly verify that Koss's accounting systems were secure or adequately monitored. Koss's computer system did not have an audit trail of usage, so there was no record of who made entries into the accounting system. Koss did not regularly change the passwords to access the computers, and accounting department terminals were not locked when unattended. Koss did not have IT security policies and controls to log and monitor network and application security violations or to report incidents to management. Without proper access

controls, Koss's financial data could be retrieved and used by unauthorized individuals, accounting data could be lost or changed, and programs could be tampered with or destroyed.

Koss's Amended and Restated Reports

37. Koss filed with the Commission materially false current, quarterly and annual reports for fiscal years 2005 through 2009, and for the first quarter of fiscal year 2010, based on the fraudulent accounting books and records prepared by Sachdeva and Mulvaney.

38. The reports filed by Koss included materially false financial statements. Those financial statements, in turn, incorporated the fraudulent entries made by Sachdeva and Mulvaney on Koss's accounting books and records, entries designed to disguise Sachdeva's multi-million-dollar embezzlement.

39. Among other signatories, MJK signed the annual reports on behalf of Koss for fiscal years 2005, 2006, 2007, 2008 and 2009, and signed Koss's quarterly reports during fiscal years 2005 to 2009, and for the first quarter of fiscal 2010. MJK signed the reports without adequately verifying the accuracy of the information contained in those reports.

40. On December 24, 2009, Koss filed a Form 8-K with the Commission. Koss reported that its Audit Committee had concluded that Koss's "previously issued financial statements on Forms 10-K for the fiscal years ended June 30, 2006, 2007, 2008 and 2009 and on Form 10-Q for the three months ended September 30, 2009 should no longer be relied upon because of the discovery of unauthorized financial transactions." Koss revealed plans to restate its financial statements as necessary, pending its investigation.

41. On June 30, 2010, Koss filed an amended and restated annual report for fiscal year 2009 (the "10-K/A"). Koss's amended annual report included a restated consolidated

balance sheet as of June 30, 2009 and 2008, as well as restated consolidated statements of operations, cash flows and stockholders' equity for those fiscal years.

42. Koss's 10-K/A stated that Sachdeva had misappropriated "approximately $31,500,000 . . . from fiscal year 2005 through December 2009." Koss reported that the "volume of these unauthorized transactions increased significantly over time, from $5,099,900 in 2008, to $8,498,434 in 2009, to $10,286,988 from July 1, 2009 until the unauthorized transactions were discovered in December 2009."

43. In the 10-K/A, Koss restated its financial statements for fiscal years 2008 and 2009 to account for the embezzled funds. Koss reported the misappropriated funds as operating expenses, totaling more than $5 million in fiscal year 2008 and more than $8.4 million in fiscal year 2009. Koss restated its net sales, cost of goods sold, cash and accounts receivable, and corrected many other entries on its financial statements for fiscal years 2008 and 2009.

44. In the 10-K/A, Koss also reported that "[v]arious accounting methods and accounting entries were used to conceal the unauthorized transactions." Among other things, Koss reported that: (1) "[t]he unauthorized transactions were not properly accounted for as losses and disclosed as a separate line item;" (2) "[n]et sales were understated in all years because of journal entries made to conceal certain misappropriations;" (3) "[c]ost of sales was overstated as a result [of] journal entries made to conceal certain misappropriations;" (4) "[a]dministrative expenses were overstated as a result of journal entries made to conceal certain misappropriations;" (5) "[a]ccounts receivable was overstated due to delayed posting of cash, as a method used to conceal certain misappropriations, and failing to provide for an allowance for certain doubtful accounts that was also used to conceal certain misappropriations;" and (6)

"[c]ash was not properly reconciled and was overstated due to the unauthorized transactions at June 30, 2009 and 2008."

45. On June 30, 2010, Koss also filed amended and restated quarterly reports for the first three quarters of fiscal year 2010 (through March 2010). Koss made multiple adjustments to its financial statements to account for the embezzlement of funds by Sachdeva and the fraudulent record-keeping of Sachdeva and Mulvaney.

COUNT I
Violations of Section 13(a) of the Exchange Act and Exchange Act Rules 12b-20, 13a-1, 13a-11 and 13a-13 (Against Koss)

46. The Commission realleges and incorporates by reference the allegations of paragraphs 1 through 45 as if fully set forth herein.

47. Section 13(a), and Rules 13a-1, 13a-11 and 13a-13 thereunder, require issuers of registered securities to file with the Commission factually accurate annual and quarterly reports (Form 10-K and Form 10-Q) and certain current information with the Commission (Form 8-K). Rule 12b-20 further provides that, in addition to the information expressly required to be included in a statement or report, there shall be added such further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they were made, not mislead. As explained above, Koss filed current, quarterly and annual reports with the Commission from fiscal year 2005 to fiscal year 2009, and in the first quarter of fiscal year 2010, that were materially false and misleading.

48. Koss filed current, quarterly and annual reports that included materially false financial statements. The inaccurate financial statements, in turn, were based on inaccurate accounting records prepared by Sachdeva and Mulvaney.

49. Koss subsequently filed amended and restated financial statements for fiscal years 2008 and 2009, and amended and restated quarterly reports for the first three quarters of fiscal year 2010 (*i.e.,* periods ending September 30, 2009, December 31, 2009 and March 31, 2010). Koss explained that prior financial statements should not be relied upon due to material inaccuracies relating to the embezzlement.

50. By engaging in the conduct described above, Koss violated Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder.

COUNT II
Aiding and Abetting Violations of Section 13(a) of the Exchange Act and Exchange Act Rules 12b-20, 13a-1, 13a-11 and 13a-13
(Against MJK)

51. The Commission realleges and incorporates by reference the allegations of paragraphs 1 through 45 and 47 through 50 as if fully set forth herein.

52. By engaging in the conduct described above, MJK knowingly or recklessly provided substantial assistance to Koss in its violations of Section 13(a) of the Exchange Act [15 U.S.C. § 78m(a)] and Exchange Act Rules 12b-20, 13a-1, 13a-11 and 13a-13 [17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-11 and 240.13a-13], thereby aiding and abetting Koss's violations of the aforementioned provisions.

COUNT III
Violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act
(Against Koss)

53. The Commission realleges and incorporates by reference the allegations of paragraphs 1 through 45 as if fully set forth herein.

54. 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 issuer's assets. Section 13(b)(2)(B) of the Exchange Act

requires issuers to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that, among other things, transactions are recorded as necessary to permit the preparation of financial statements in conformity with U.S. General Accepted Accounting Principles and to maintain accountability for the issuer's assets.

55. By engaging in the conduct described above, Defendant Koss violated Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act.

COUNT IV
Aiding and Abetting Koss's Violation of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act (Against MJK)

56. The Commission realleges and incorporates by reference the allegations of paragraphs 1-45, 54 and 55.

57. By engaging in the conduct described above, MJK knowingly or recklessly provided substantial assistance to Koss in its failure to keep accurate books, records and accounts, and in its failure to devise maintain a system of internal accounting controls, thereby aiding and abetting Koss's violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act [15 U.S.C. §§ 78m(b)(2)(A), 78m(b)(2)(B)].

COUNT V
Violations of Exchange Act Rule 13a-14 (Against MJK)

58. The Commission realleges and incorporates by reference the allegations of paragraphs 1 through 45 as if fully set forth herein.

59. As a principal executive officer of Koss, MJK was required to, and did, certify Koss's annual reports on Form 10-K for the years 2005 to 2009, and quarterly reports on Forms 10-Q for the same period and for the first quarter of 2010. Among other things, MJK certified that: (a) the reports did not contain any untrue statement of material fact or omit to state a

material fact necessary to make the statements made not misleading; and (b) the financial statements and other financial information included in the report fairly presented in all material respects Koss's financial condition, results of operations and cash flows. These certifications were materially false.

60. By engaging in the conduct described above, MJK violated Exchange Act Rule 13a-14 [17 C.F.R. § 240.131-14].

PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that this Court enter a final judgment against the Defendants and:

A. find that Koss and MJK each violated the federal securities laws as alleged in this Complaint;

B. permanently enjoin Koss from violating Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act [15 U.S.C. §§ 78m(a), 78m(b)(2)(A), 78m(b)(2)(B)] and Exchange Act Rules 12b-20, 13a-1, 13a-11 and 13a-13 [17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-11, and 240.13a-13];

C. permanently enjoin MJK from violating Exchange Act Rule 13a-14 [17 C.F.R. § 240.13a-14] and from aiding and abetting violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act [15 U.S.C. §§ 78m(a), 78m(b)(2)(A), 78m(b)(2)(B)] and Exchange Act Rules 12b-20, 13a-1, 13a-11 and 13a-13 [17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-11, and 240.13a-13];

D. issue an order directing MJK to reimburse Koss pursuant to Section 304 of the Sarbanes-Oxley Act, 15 U.S.C. § 7243; and

E. grant such further relief as the Court may deem just and appropriate.

Dated: October 24, 2011

Respectfully submitted,

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