

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 77447 / March 25, 2016**

**ACCOUNTING AND AUDITING ENFORCEMENT**  
**Release No. 3760 / March 25, 2016**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-17180**

**In the Matter of**

**ELLIOT R. BERMAN, CPA**  
**and**  
**BERMAN & COMPANY, P.A.,**

**Respondents.**

**ORDER INSTITUTING PUBLIC  
ADMINISTRATIVE AND CEASE-AND-  
DESIST PROCEEDINGS PURSUANT  
TO SECTIONS 4C AND 21C OF THE  
SECURITIES EXCHANGE ACT OF  
1934 AND RULE 102(e) OF THE  
COMMISSION'S RULES OF  
PRACTICE**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 4C<sup>1</sup> and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) and Rules 102(e)(1)(ii) and (iii)<sup>2</sup> of the Commission’s Rules of Practice against Elliot

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<sup>1</sup> Section 4C provides, in relevant part, that: “[t]he Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications to represent others; (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.”

<sup>2</sup> Rule 102(e)(1)(ii) provides, in pertinent part, that “[t]he Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found . . . to have engaged in unethical or improper professional conduct.”

Rule 102(e)(1)(iii) provides, in pertinent part, that “[t]he Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found . . . to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.”

R. Berman (“Berman”) and Berman & Company, P.A. (“Berman & Co.,” collectively with Berman, “Respondents”).

## **II.**

After an investigation, the Division of Enforcement and the Office of the Chief Accountant allege that:

### **A. Respondents**

1. Elliot R. Berman, a resident of Boca Raton, Florida, has been a CPA licensed in Florida since 2005. Berman is the sole owner of Berman & Co., which he founded in 2006. In October 2014, Berman settled, without admitting or denying, to a Cease-and-Desist and 102(e) proceeding in which the Commission found that he willfully violated Section 10A(j) of the Exchange Act, willfully aided and abetted violations of Rule 2-02 of Regulation S-X, and caused a violation of Section 13(a) of the Exchange Act and Rule 13a-1 thereunder, and engaged in improper professional conduct. Berman was thereafter denied the privilege of appearing or practicing before the Commission as an accountant, with the right to apply for reinstatement after one year. Exchange Act Rel. No. 73427 (Oct. 24, 2014). Berman has not been reinstated by the Commission.

2. Berman & Company, P.A. is an accounting and auditing firm based in Boca Raton, Florida. Berman & Co. has been registered with the Public Company Accounting Oversight Board (“PCAOB”) since 2006. In October 2014, Berman & Co. settled, without admitting or denying, to a Cease-and-Desist and 102(e) proceeding in which the Commission found that the firm willfully violated Section 10A(j) of the Exchange Act, Rule 2-02 of Regulation S-X, and caused a violation of Section 13(a) of the Exchange Act and Rule 13a-1 thereunder, and engaged in improper professional conduct. Exchange Act Rel. No. 73427 (Oct. 24, 2014).

### **B. Related Issuer**

3. MusclePharm Corporation (“MSLP”) is a Nevada corporation with its principal place of business in Denver, Colorado. Since 2010, MSLP has had a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). MSLP engaged Berman & Co. as its auditor in January 2011 and dismissed Berman & Co. in September 2012.

### **C. Summary**

4. Berman & Co. and Berman engaged in improper professional conduct and failed to exercise due professional care and professional skepticism including a critical assessment of the audit evidence as shown by repeated deficiencies during the audits of the 2010 and 2011 financial statements of MSLP. Specifically, Respondents (1) audited MSLP’s 2010 and 2011 financial statements and also issued audit reports knowing Berman & Co. was not independent; (2) ignored audit evidence demonstrating that

MSLP's largest customer in 2011 was a related party requiring disclosure in conformity with Generally Accepted Accounting Principles ("GAAP") and inappropriately relied on management representations; (3) failed to recognize MSLP improperly accounted for sales incentives, advertising, and promotions ("Sales Incentives"), and inappropriately relied on management representations as sufficient audit evidence regarding the accounting of those Sales Incentives; and (4) failed to recognize that MSLP did not disclose its sponsorship commitments and international sales as required by GAAP.

#### **D. Facts Related to Respondents' Audits of MSLP's Financial Statements**

5. Berman & Co. issued audit reports containing unqualified opinions on MSLP's financial statements for fiscal years ended December 31, 2010 and December 31, 2011 (the "MSLP Audits").

6. Berman served as the engagement partner on the MSLP Audits. Berman, as the engagement partner, was responsible for the audit engagement team's compliance with professional standards and adequate documentation in the work papers of the findings, analysis, and information on which they relied in forming the audit opinion. Berman also had final authority over the planning, execution, and supervision of the audits and had full responsibility for Berman & Co.'s audit reports. Berman approved the issuance of audit reports containing unqualified opinions.

7. In each of the MSLP Audits, Berman & Co. represented that the audits were conducted by an independent auditor in accordance with PCAOB standards. Berman signed the audit reports for the MSLP Audits on behalf of Berman & Co. MSLP included these audit reports in its Commission filings.

8. Berman & Co., however, was not independent and Berman and Berman & Co. failed to conduct the MSLP audits in accordance with PCAOB standards, as described below.

#### **Independence**

9. Berman & Co. failed to comply with Rule 2-01(b) of Regulation S-X, PCAOB Rule 3520, and PCAOB standards (*see* AU §§ 220, 230 and AS 9), and was not independent from MSLP during the MSLP Audits because of indemnification provisions Berman included in Berman & Co.'s engagement letters. Despite not being independent, Berman & Co. issued audit reports that represented that Berman & Co. was independent. As a result, Berman & Co. willfully violated, and Berman willfully aided and abetted and caused violations of, Rule 2-02(b)(1) of Regulation S-X.

10. Berman claims to have researched the use of indemnification provisions in engagement letters with SEC registrants around the time he founded Berman & Co. in 2006, including reviewing PCAOB Rule 3520, PCAOB Rule 3500T, and Rule 2-01 of Regulation S-X.

(a) PCAOB Rule 3520, Auditor Independence, provides that a “registered public accounting firm and its associated persons must be independent of the firm’s audit client throughout the audit and professional engagement period.” Note 1 to PCAOB Rule 3520 states that *“a registered public accounting firm or associated person’s independence obligation with respect to an audit client encompasses not only an obligation to satisfy the independence criteria applicable to the engagement set out in the rules and standards of the PCAOB, but also an obligation to satisfy all other independence criteria applicable to the engagement, including the independence criteria set out in the rules and regulations of the Commission under the federal securities laws.”* (Emphasis added)

(b) PCAOB Rule 3500T(b), Interim Ethics and Independence Standards, provides in part that “in connection with the preparation or issuance of any audit report, a registered public accounting firm, and its associated persons, shall comply with independence standards (1) as described in the AICPA’s Code of Professional Conduct Rule 101, and interpretations and rulings thereunder, as in existence on April 16, 2003 (AICPA Professional Standards, ET §§ 101 and 191 (AICPA 2002)), to the extent not superseded or amended by the Board.” The Note to this rule provides: *“The Board’s Interim Independence Standards do not supersede the Commission’s auditor independence rules. See Rule 2-01 of Reg. S-X, 17 C.F.R. § 210.2-01. Therefore, to the extent that a provision of the Commission’s rule is more restrictive – or less restrictive – than the Board’s Interim Independence Standards, a registered public accounting firm must comply with the more restrictive rule.”* (Emphasis added)

(c) Rule 2-01(b) of Regulation S-X provides that the “Commission will not recognize an accountant as independent, with respect to an audit client, if the accountant is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant’s engagement. In determining whether an accountant is independent, the Commission will consider all relevant circumstances, including all relationships between the accountant and the audit client, and not just those relating to reports filed with the Commission.” 17 C.F.R. § 210.2-01(b). Preliminary Note 2 to the rule provides in part: “The rule does not purport to, and the Commission could not, consider all circumstances that raise independence concerns, and these are subject to the general standards in Rule 2-01(b). *Preliminary Note 3 to the rule provides: “registrants and accountants are encouraged to consult with the Commission’s Office of the Chief Accountant before entering into relationships, including relationships involving the provision of services, that are not explicitly described in the rule.”* (Emphasis added)

11. The Commission has published its interpretation and guidance on auditor indemnification provisions in Codification of Financial Reporting Policies Section 602.02f.i (“Indemnification by Client”) (the “Codification”). The Codification provides in part that when “an accountant and his client, directly or through an affiliate, have entered into an agreement of indemnity which seeks to assure the accountant immunity from liability for his own negligent acts, whether of omission or commission, one of the

major stimuli to objective and unbiased consideration of the problems encountered in a particular engagement is removed or greatly weakened.”

12. Berman also claims to have reviewed the Office of the Chief Accountant: Application of the Commission’s Rules on Auditor Independence, Frequently Asked Questions, Other Matters, Question 4, dated December 13, 2004 (the “OCA FAQ”). The OCA FAQ notes the “Commission’s long standing view” that “when an accountant enters into an indemnity agreement with the registrant, his or her independence would come into question.” The OCA FAQ provides that when “an accountant and his or her client, directly or through an affiliate, enter into an agreement of indemnity which seeks to provide the accountant immunity from liability for his or her own negligent acts, whether of omission or commission, the accountant is not independent.” The OCA FAQ additionally states that “including in engagement letters a clause that a registrant would release, indemnify or hold harmless from any liability and costs resulting from knowing misrepresentations by management would also impair the firm’s independence.”

13. The PCAOB Office of the Chief Auditor released the PCAOB Standing Advisory Group briefing paper, titled “Emerging Issue – The Effects on Independence of Indemnification, Limitation of Liability, and Other Litigation Related Clauses in Audit Engagement Letters,” dated February 9, 2006 [http://pcaobus.org/News/Events/Documents/02092006\\_SAGMeeting/Indemnification.pdf](http://pcaobus.org/News/Events/Documents/02092006_SAGMeeting/Indemnification.pdf) The briefing paper was developed “by the staff of the Office of the Chief Auditor to foster discussion among members of the Standing Advisory Group” and is not a statement of the Board. The briefing paper discusses the Codification and OCA FAQs. The briefing paper also discusses Ethics Ruling Number 94 under Rule 101 of the American Institute of Certified Public Accountants’ (“AICPA”) Code of Professional Conduct (included in the PCAOB’s interim independence standards), which provides that the auditor’s independence would not be impaired for indemnification language. However, the briefing paper notes that auditors must “...comply with the SEC’s auditor independence requirements as well as those of the Board in an audit of a public company” and concludes that “[b]ecause SEC independence requirements prohibit indemnification agreements in audit engagement letters, Ethics Ruling Number 94 has no practical effect with respect to audits of public companies.”

14. The PCAOB has also highlighted that indemnification provisions will impair an audit firm’s independence under Commission rules. For example, in 2007, the PCAOB issued a report on its inspection findings noting that indemnification provisions violate the SEC independence rules. *See* pages 16-18 of the Report on the PCAOB’s 2004, 2005, and 2006 Inspections of Domestic Triennially Inspected Firms, PCAOB Rel. No. 2007-2010 (Oct. 22, 2007) [http://pcaobus.org/Inspections/Documents/2007\\_10-22\\_4010\\_Report.pdf](http://pcaobus.org/Inspections/Documents/2007_10-22_4010_Report.pdf).

15. Other agencies have also issued guidance recognizing the SEC’s position that auditors that use indemnification provisions are not independent. *See* Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions in External Audit Engagement Letters,

<http://www.federalreserve.gov/boarddocs/srletters/2006/sr0604a1.pdf> (2006).

16. After his claimed research, and despite his claims that he specifically read the PCAOB and Commission rules on independence and the Commission and Commission staff's specific guidance that indemnification provisions impaired an auditor's independence, Berman drafted Berman & Co. engagement letters for use with SEC registrant audit clients that included indemnification provisions.

17. MSLP signed Berman & Co. engagement letters, dated January 5, 2011 and January 1, 2012, relating to the MSLP Audits (the "MSLP Engagement Letters"). Berman drafted the MSLP Engagement Letters and signed the MSLP Engagement Letters on behalf of Berman & Co.

18. The MSLP Engagement Letters contained the following indemnification provisions:

- (a) "The Company agrees to release, indemnify, and hold Berman & Company, P.A. (its partners, affiliates, heirs, executors, personal representatives, successors, and assigns) harmless from any liability and costs resulting from known misrepresentations by management."
- (b) "The Company agrees to release, indemnify, and hold Berman & Company, P.A. (its partners, affiliates, heirs, executors, personal representatives, successors, and assigns) harmless from any liability and costs resulting from fraud caused by or participated in by the management of the Company."
- (c) "Reasonable costs and time spent in legal matters or proceedings arising from our engagement, such as subpoenas, testimony or consultation involving private litigation, arbitration or government regulatory inquiries at your request or by subpoena will be billed to you separately and you agree to pay the same."

19. Berman & Co. completed an "Engagement Acceptance Form" for the 2010 MSLP Audit (the "2010 Form"). Berman reviewed and approved this form. Berman & Co. completed an "Engagement Acceptance and Continuance Form" for the 2011 MSLP Audit (the "2011 Form"). Berman reviewed and approved this form.

20. Item 11 of the 2010 Form and Item 7 of the 2011 Form provided that the "SEC expects accountants to comply with the independence requirements established by the PCAOB, Independence Standards Board, and the accounting profession (the AICPA), *as well as the requirements promulgated by the Commission and the staff.*" (Emphasis added) As noted above, Berman specifically read the guidance by the Commission and the staff that provided indemnification provisions impaired an auditor's independence.

21. Item 11.h of the 2010 Form and item 7.h of the 2011 Form specifically questioned "Are there any relationships with the client or conflicts of interests that might impair independence? ... vii. Indemnification?" Despite having included indemnification provisions in the MSLP Engagement Letters, Respondents incorrectly responded "no" to

this question both years.

22. Aside from the 2010 Form and 2011 Form, there is no evidence in the work papers that Respondents considered Berman & Co.'s independence in relation to the indemnification provisions in the MSLP Engagement Letters for the MSLP Audits.

23. Berman & Co. invoked the indemnification provisions in the MSLP Engagement Letters and required MSLP to pay approximately \$272,000 of costs Berman & Co. incurred related to an SEC investigation. In fact, Berman provided testimony to the SEC on April 2, 2014 and April 3, 2014, where he was directly questioned about the sufficiency of the MSLP Audits. On August 7, 2014, Berman sent an invoice to MSLP seeking reimbursement for time spent preparing for his testimony, and the testimony itself.

#### Related Party Transactions

24. From 2010 through 2012, one customer served as MSLP's largest customer for each year based on the percentage of sales ("MSLP's Largest Customer").

25. In May 2011, MSLP hired a new chief marketing officer ("CMO"). The CMO was a former executive and co-founder of MSLP's Largest Customer. The CMO's brother remained the CEO of MSLP's Largest Customer and a greater than 10% indirect owner of the major customer. In 2011, GAAP required MSLP to disclose transactions with MSLP's Largest Customer as related party transactions in its financial statements. (*See* ASC 850)

26. Respondents informed MSLP that transactions with MSLP's Largest Customer were required to be disclosed as related party transactions in its financial statements. Berman testified that MSLP's Largest Customer was a related party due to the family relationship. Berman sent an email to MSLP in which he stated: "I have spoken to the SEC, AICPA, concurring partner, and 2 other accountants. Everyone has concluded this is a disclosure." The work papers do not include this information.

27. MSLP disagreed with Respondents that transactions with MSLP's Largest Customer were required to be disclosed as related party transactions in its financial statements. Respondents agreed to accept MSLP's position that disclosure was not required if MSLP provided Respondents with a memo supporting its reasoning and a representation in the management representation letter. Berman emailed MSLP that the memo had to be "top notch" because "this is a huge deal for me to let this go."

28. A few days later, MSLP provided Respondents with a memo purporting to support its position that MSLP's Largest Customer was not a related party requiring disclosure and a management representation letter. The MSLP memo was prepared by a non-accountant executive and signed by the CFO, who Respondents had previously determined lacked accounting experience, as well as other MSLP executives. No other accountant signed the MSLP memo.

29. The MSLP memo did not accurately evaluate the necessity of disclosure in accordance with GAAP. The memo incorrectly focused on disclosure only being required if influence was actually present (rather than whether a family member might control or influence or if there is the opportunity to significantly influence) and failed to adequately address the guidance found in ASC 850 regarding immediate family relationships.

30. The memo also contained facts that Respondents knew or should have known to be red flags and/or that the information in the memo was not accurate. For example, MSLP management represented in the memo that the CMO “refrained from direct involvement” with MSLP’s Largest Customer. Respondents, however, knew or should have known this statement was false because the CMO position was to oversee all sales and marketing activities and the CMO’s bonus was dependent upon MSLP’s revenue growth, which was significantly affected by sales to MSLP’s Largest Customer. There is no evidence, however, that Respondents attempted to corroborate this representation or any other representation in the memo.

31. The memo also concluded that MSLP “is entitled to the presumption that these are arm’s-length transactions and that the ability or opportunity to influence does not exist.” ASC 850, however, specifically provides that transactions cannot be presumed to be carried out on an arm’s-length basis. ASC 850-50-5 provides that “[T]ransactions involving related parties cannot be presumed to be carried out on an arm’s length basis, as the requisite conditions of competitive, free-market dealings may not exist. Representations about transactions with related parties, if made, shall not imply that the related party transactions were consummated on terms equivalent to those that prevail in arm’s length transactions unless such representations can be substantiated.”

32. The work papers do not support that Respondents relied on any evidence for the related party disclosure determination aside from the MSLP memo and management representation letter.

33. MSLP failed to make the required GAAP disclosure of related party transactions with MSLP’s Largest Customer in its 2011 financial statements. Berman & Co. expressed an unqualified opinion despite this material omission of which it was aware.

#### MSLP Sales Incentives

34. Under GAAP, sales incentives, advertising, and promotions (collectively “Sales Incentives”) must be accounted for as a reduction of revenue, absent evidence of a specific identifiable benefit in which case they can be recorded as an expense. (See ASC 605-50-45-2) Without evidence of an identifiable benefit, MSLP improperly recorded Sales Incentives as an expense instead of a reduction of revenue, resulting in it overstating revenues in its financial statements by \$845,000 or 26% in 2010 and \$3.6 million or 21% in 2011.

35. Berman & Co. and Berman identified revenue recognition as significant and a fraud risk area for the MSLP Audits.



36. During the planning of the 2010 audit and throughout the MSLP Audits, Respondents also identified weak internal controls at MSLP, due in large part to the CFO. Berman & Co.'s 2010 audit planning memo provided that the "CFO lack[ed] requisite technical accounting expertise." Indeed, after the 2010 audit, Berman & Co. specifically warned MSLP that "the CFO is not trained in areas that support SEC financial reporting" and "[t]he potential shortfall in this knowledge base is an internal control matter that should be rectified immediately as it directly affects financial reporting."

37. Despite designating revenue recognition as a fraud risk and determining the CFO lacked the requisite accounting experience, Respondents failed to plan or perform audit procedures to obtain sufficient audit evidence supporting MSLP's accounting for Sales Incentives. Respondents' audit work for the MSLP Audits consisted of reliance upon a memo that MSLP's CFO signed and provided to Berman & Co. in 2010, which stated that advertising credits are issued to customers as a way to increase business and the "credits are typically booked as advertising expenses." The memo did not reference ASC-605-50. Berman & Co.'s 2011 work papers did not contain a similar memo with a representation from MSLP (such as was provided in connection with the 2010 audit mentioned above). Berman also testified that he relied on oral representations that the Sales Incentives were accounted for correctly from the MSLP CFO, however, this is not documented in the work papers. Respondents could not reasonably rely as sufficient audit evidence on either the memo or oral statements of the CFO that they determined was not qualified or trained in areas of SEC financial reporting.

38. Aside from this single memo identified in paragraph 37, Berman & Co.'s 2010 and 2011 work papers are devoid of any audit procedures designed to test if MSLP properly accounted for Sales Incentives. There were no steps in Berman & Co.'s audit program or otherwise performed by Berman & Co. that evaluated if advertising and promotional credits met the requirements of ASC 605-50 to be expensed. There is not a single reference to ASC 605-50 in Berman & Co.'s 2010 or 2011 audit work papers.

39. The lack of documentation in the work papers should have caused Berman to question whether Berman & Co. tested MSLP's Sales Incentive accounting. The staff auditor who performed some of the test work on the 2011 MSLP audit had no prior experience testing Sales Incentives under ASC 605-50 and did not recall receiving any instruction from anyone at Berman & Co. on how to test Sales Incentives.

40. MSLP filed an amended Form 10-K on July 2, 2012, for the year ended December 31, 2011, restating its 2010 and 2011 financial statements because Sales Incentives were not accounted for properly.

41. While Respondents did not perform any work to evaluate if Sales Incentives met the requirements of ASC 605-50 to be expensed, the Respondents' 2010 and 2011 work papers showed that Respondents had reviewed approximately 50 Sales Incentives during the MSLP Audits for other objectives (such as the existence of the sales, the accuracy of the sales amount, and that the sales were recorded in the proper period). Respondents failed to identify that MSLP's accounting for Sales Incentives was incorrect

for 45 of the 50 items reviewed. These 45 Sales Incentives were ultimately restated in MSLP's 2012 restatement.

### Sponsorship Commitments

42. In 2011, MSLP had three continuing sponsorship commitments, which required it to make future payments in 2012 and 2013 totaling approximately \$5.3 million (\$2.8 million in 2012 and \$2.5 million in 2013). Contrary to GAAP, MSLP failed to disclose these commitments in its 2011 financial statements. (*See* ASC 440)

43. During the 2011 audit of MSLP, Respondents failed to recognize and properly plan the audit to consider whether MSLP was required to disclose its sponsorship commitments. Berman & Co.'s disclosure checklist, which Berman reviewed and approved and which was used during the MSLP audit, was marked "N/A" for commitments. The audit work papers do not contain any procedures evaluating whether MSLP's sponsorship commitments should or should not be disclosed. Moreover, if any audit work was performed relating to sponsorship commitments, Respondents failed to adequately document that they performed a procedure, obtained evidence, or reached an appropriate conclusion.

### International Sales

44. ASC 280-10-50-41 requires the disclosure of all revenues from external customers attributed to all foreign countries in total from which the public entity derives revenue if material.

45. MSLP failed to disclose in its 2011 financial statements that a material amount, approximately 23%, of its sales were to customers located outside of the United States ("International Sales") as required by GAAP. (*See* ASC 280-10-50-41)

46. Berman was aware that MSLP had International Sales. Berman, however, failed to properly plan the 2011 audit to obtain sufficient audit evidence regarding the disclosure of International Sales. Berman & Co.'s 2011 work papers did not contain evidence that Respondents considered whether MSLP was required to disclose its International Sales in conformity with GAAP. Berman & Co.'s disclosure checklist is marked "item not present" for International Sales. No documentation relating to why disclosure of International Sales was not required is in the work papers.

47. Berman knew MSLP was trying to grow internationally, but because MSLP's CFO and CEO told him International Sales were nominal, Berman & Co. did not require testing. However, no documentation relating to discussions with management relating to International Sales or that International Sales were "nominal" is in the work papers.

## **E. Respondents' Improper Professional Conduct**

48. Rule 102(e)(1)(ii) provides, in pertinent part, that “[t]he Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have engaged in unethical or improper professional conduct.”

49. Rule 102(e)(1)(iv)(A) defines “improper professional conduct” under Rule 102(e)(1)(ii) to mean “intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards.” Rule 102(e)(1)(iv)(B) defines “improper professional conduct” under Rule 102(e)(1)(ii) to include the following two types of negligent conduct (1) a single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted; or (2) repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards that indicate a lack of competence to practice before the Commission.

50. Respondents engaged in improper professional conduct, as defined in Rule 102(e)(1)(iv)(A) and Rule 102(e)(1)(iv)(B) as explained herein.

51. Rule 102(e)(1)(iii) provides, in pertinent part, that “[t]he Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.”

52. Respondents willfully violated and willfully aided and abetted violations of the federal securities laws as explained herein.

### **Berman & Co. was Not Independent for the MSLP Audits**

53. Rule 2-01(b) of Regulation S-X provides in part that “the Commission will not recognize an accountant as independent, with respect to an audit client, if the accountant is not, . . . capable of exercising objective and impartial judgment on all issues encompassed within the accountant’s engagement.” As a result of the indemnification language in the MSLP Engagement Letters, Berman & Co. was not independent pursuant to Rule 2-01(b) of Regulation S-X. By submitting audit reports to MSLP that were filed with the Commission that provided Berman & Co. was independent and the audits were conducted in accordance with PCAOB standards, Berman & Co. violated Rule 2-02(b)(1) of Regulation S-X.

54. The Commission in the Codification and the Commission staff in the OCA FAQ have provided guidance relating to Rule 2-01(b) of Regulation S-X that indemnification provisions in engagement letters impair an auditor’s independence.

55. Both PCAOB Rule 3520 and Rule 3500T have notes which state the

Commission independence rules and regulations must be followed. The note to PCAOB Rule 3520 provides “a registered public accounting firm or associated person’s independence obligation with respect to an audit client encompasses not only an obligation to satisfy the independence criteria applicable to the engagement set out in the rules and standards of the PCAOB, but also an obligation to satisfy all other independence criteria applicable to the engagement, including the independence criteria set out in the rules and regulations of the Commission under the federal securities laws.” The note to PCAOB Rule 3500T provides “The Board’s Interim Independence Standards do not supersede the Commission’s auditor independence rules. See Rule 2-01 of Reg. S-X, 17 C.F.R. § 210.2-01. Therefore, to the extent that a provision of the Commission’s rule is more restrictive – or less restrictive – than the Board’s Interim Independence Standards, a registered public accounting firm must comply with the more restrictive rule.”

56. The PCAOB has also provided public guidance that indemnification provisions will impair an audit firm’s independence under Commission rules, as identified in paragraph 14.

57. Berman included indemnification provisions in the MSLP Engagement Letters. As a result of the indemnification provisions in the MSLP Engagement Letters, Berman & Co. was not independent as required by Rule 2-01(b). By submitting audit reports to MSLP, which were filed with the Commission, that provided Berman & Co. was independent and the audits were conducted in accordance with PCAOB standards, Berman & Co. violated, and Berman aided and abetted violations of, Rule 2-02(b)(1) of Regulation S-X.

58. AU § 220, Independence, requires “that the auditor be independent; aside from being in public practice (as distinct from being in private practice), he must be without bias with respect to the client since otherwise he would lack that impartiality necessary for the dependability of his findings, however excellent his technical proficiency may be.” (See AU § 220 ¶ 2)<sup>3</sup>

59. AS 9, Audit Planning, ¶ 6 provides that the auditor should determine compliance with independence requirements at the beginning of the audit.

60. As a result of including indemnification provisions in the MSLP Engagement Letters, Respondents also violated professional standards because Berman & Co. was not independent during the MSLP Audits and the work papers do not contain sufficient evidence that independence was evaluated. (See AU § 220, AS 9)

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<sup>3</sup> References to PCAOB standards (“AS” and “AU”) in this Order are to the standards in effect at the time the audit work was performed. The AU standards were initially adopted by the PCAOB in 2003 following passage of the Sarbanes-Oxley Act of 2002, which authorized the PCAOB to establish auditing and related professional practice standards to be used by registered public accounting firms. After initial adoption of these standards, the PCAOB began issuing updated standards that replaced some of the standards then in effect. As a result, the applicable 2010 and 2011 professional standards in effect may be different for each period discussed in the Order, and both are included.

### **Respondents Failed to Properly Plan the MSLP Audits**

61. The auditor is required to properly plan the audit, which includes the planned nature, timing, and extent of procedures to be performed. (AU § 311, Planning and Supervision, ¶¶ 1, 5; AS 9 ¶ 4, 10) Professional standards state the auditor should design and perform audit procedures to address the assessed risks of material misstatement due to fraud. (AU § 316, Consideration of Fraud in a Financial Statement Audit, ¶ 52)

62. Despite identifying revenue recognition as a fraud risk area, Respondents failed to properly plan the MSLP Audits to obtain sufficient audit evidence supporting MSLP's accounting for Sales Incentives. (See, e.g., AU §§ 311, 316, AS 9) Respondents also failed to properly plan the 2011 MSLP audit relating to sponsorship commitments and International Sales. (*Id.*)

### **Respondents Failed to Obtain Sufficient Appropriate Audit Evidence**

63. Auditors are required to obtain sufficient audit evidence. In 2010, AU § 326, Evidential Matter, ¶ 22 required auditors to obtain sufficient competent evidential matter to afford a reasonable basis for an opinion regarding the financial statements. Once effective for 2011, AS 15, Audit Evidence, ¶ 4 requires auditors to plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for his or her opinion. AS 13, The Auditor's Response to the Risks of Material Misstatement, ¶ 7 further requires the auditor to exercise professional skepticism critically assessing the appropriateness and sufficiency of audit evidence. AU § 316 ¶ 13 further provides that professional skepticism requires an ongoing questioning of whether the information and evidence obtained suggests that a material misstatement due to fraud has occurred, and the auditor should not be satisfied with less-than-persuasive evidence because of a belief that management is honest.

64. Oral and written representations from management are part of the evidential matter the auditor obtains, but are not a substitute for the application of auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit. (AU § 333, Management Representations, ¶ 2) If an audit area is at increased risk of material misstatement, particularly fraud risks, the auditor needs to obtain more reliable evidence regarding relevant assertions and obtain evidence corroborating management's explanations or representations concerning important matters. (AS 13 ¶ 7; AS 15 ¶ 17) Auditors should obtain more persuasive audit evidence from substantive procedures when they have identified pervasive weaknesses in the company's control environment. (AS 13 ¶ 6)

### **Related Party Disclosures**

65. After an auditor identifies a related party transaction, the auditor is required to consider whether he has obtained sufficient appropriate evidential matter; evaluate all the information available to him; and satisfy himself that it is adequately disclosed in the

financial statements. (AU § 334, Related Parties, ¶ 11) Professional standards require the auditor to perform procedures to obtain and evaluate sufficient appropriate evidential matter beyond inquiry of management. (AU § 334, Related Parties, ¶¶ 2 and 9) AS 14, Evaluating Audit Results, ¶ 8 further provides that the auditor should obtain corroboration for management’s explanations regarding significant unusual relationships.

66. Respondents violated professional standards and failed to obtain sufficient audit evidence in the 2011 MSLP Audit related to related party disclosures. (See AU §§ 333, 334; AS 13, 14, 15) After Respondents identified a related party, Respondents failed to obtain sufficient appropriate evidence supporting MSLP’s position that disclosure of the related party transactions was not required. (See *id.*) Respondents improperly relied upon management representations in MSLP’s memo and management representation letter. (See AU §§ 333, 334; AS 14) The memo, which was prepared by a non-accountant and signed by a CFO who Respondents determined “lacked requisite accounting experience,” did not appropriately evaluate GAAP. Respondents also failed to corroborate MSLP’s management’s underlying representations in the memo, even when they had information contradicting or, at the very least, calling into question, those representations.

#### Sales Incentives

67. Respondents violated professional standards and failed to obtain sufficient audit evidence in the 2010 and 2011 MSLP Audits related to Sales Incentives. (See AU §§ 316, 326, 333; AS 13, 15) Respondents designated revenue recognition as a fraud risk. However, aside from a single memo from 2010, the work papers lacked any audit procedures designed to test if MSLP properly accounted for Sales Incentives. (See AU § 326, AS 13, 15). Moreover, Respondents improperly relied on management representations without corroborating statements made by the CFO, who Respondents had determined lacked accounting experience. (See AU § 333, AS 13, 15)

#### Sponsorship Commitments and International Sales

68. AS 14 ¶ 31 requires that “[a]s part of the evaluation of the presentation of the financial statements, the auditor should evaluate whether the financial statements contain the information essential for a fair presentation of the financial statements in conformity with the applicable financial reporting framework.” Evaluation of the information disclosed in the financial statements includes consideration of the “content of the financial statements (including the accompanying notes). . . .”

69. In violation of professional standards, Respondents were aware of sponsorship commitments and International Sales at MSLP that required disclosure in the 2011 financial statements but were not disclosed. (See AS 14)

70. Respondents violated professional standards and failed to obtain sufficient audit evidence in the 2011 MSLP Audit related to sponsorship commitments. (See AS 13, 15) The disclosure checklist was marked “N/A” for commitments and the audit work

papers do not contain any procedures evaluating whether MSLP's sponsorship commitments should be disclosed.

71. Respondents violated professional standards and failed to obtain sufficient audit evidence in the 2011 MSLP Audit related to International Sales. (*See* AU § 333; AS 13, 15) Berman & Co.'s disclosure checklist is marked "item not present" for International Sales and no documentation relating to why disclosure of International Sales was not required is in the work papers. (*Id.*) Additionally, no references to discussions with management relating to International Sales are in the work papers, and, even if Respondents did rely on representations of management regarding International Sales, this was insufficient audit evidence. (*See* AU § 333)

### **Respondents Failed to Adequately Document the MSLP Audits**

72. AS 3 requires an auditor to prepare and retain documentation that provides a written record of the basis for its significant conclusions. (AS 3 ¶¶ 4 and 5) Audit documentation must clearly demonstrate that the work was in fact performed. (AS 3 ¶ 6) Among other items, the audit documentation must contain sufficient information to enable an experienced auditor, having no previous connection with the engagement (1) to understand the nature, timing, extent, and results of the procedures performed, evidence obtained, and conclusions reached and (2) to determine, among other items, the person who reviewed the work and the date of such review. (AS 3 ¶¶ 4, 5 and 6) Additionally, audit documentation must include information the auditor has identified relating to significant findings or issues that is inconsistent with or contradicts the auditor's conclusions. (AS 3 ¶ 8)

73. Respondents violated professional standards and failed to adequately document the work performed in the MSLP Audits. (*See* AS 3) Specific conduct that violated AS 3 includes:

- a) Respondents failed to document in either the 2010 or 2011 MSLP work papers if and how they concluded Berman & Co. was independent when the MSLP Engagement Letters included indemnification provisions;
- b) Respondents failed to document the information in Berman's email to MSLP that stated: "I have spoken to the SEC, AICPA, concurring partner, and 2 other accountants. Everyone has concluded this is a disclosure," which contradicted Berman & Co.'s later conclusion that disclosure was not required;
- c) Respondents failed to document representations from management relating to Sales Incentives, which Berman claims to have relied upon;
- d) Respondents failed to document representations from management relating to International Sales, which Berman claims to have relied upon; and

- e) Berman & Co.'s MSLP audit work papers do not contain documentation evidencing sufficient audit evidence was obtained over Sales Incentives, sponsorship commitments, or International Sales. If Respondents did perform any audit work in these areas, then Respondents violated AS 3 because the work papers do not document any work, including the procedures performed, evidence obtained, or conclusions reached.

### **Berman Failed to Properly Supervise the MSLP Audits**

74. AS 10 provides that the “engagement partner is responsible for the engagement and its performance,” including “proper supervision of the work of engagement team members and for compliance with PCAOB standards.” (See AS 10 ¶ 3) The engagement partner should review the work of engagement team members and evaluate whether the work was properly performed and documented, the objectives of the procedures were achieved, and the results of the audit work support the conclusions reached. (See AS 10 ¶ 5)

75. Berman, the engagement partner on the MSLP Audits, failed to properly supervise those audits. Berman failed in his supervision duties because he reviewed all of the audit work papers and failed to recognize that the MSLP Audits were not compliant with PCAOB standards. Berman failed to properly evaluate whether the nature and extent of audit procedures performed over Sales Incentives, sponsorship commitments, and International Sales were sufficient under PCAOB standards. In addition, Berman failed to supervise the documentation of the firm’s audit procedures in accordance with AS 3.

76. Additionally, Berman failed to inform his staff of their responsibilities about how to audit Sales Incentives. Berman reviewed the audit work papers and failed to recognize that Berman & Co. did not perform any procedures to test whether MSLP properly accounted for Sales Incentives under ASC 605-50. Consequently, Berman failed to recognize that the results of Berman & Co.’s audit work did not support its conclusion that MSLP properly accounted for Sales Incentives.

77. Additionally, while Berman reviewed the disclosure checklist he failed to recognize that it incorrectly marked sponsorship commitments and International Sales as “N/A” and “item not present,” respectively.

78. Berman also reviewed the Engagement Acceptance Forms and failed to address that they incorrectly stated that there were no indemnification provisions.

### **Respondents Failed to Issue Accurate Audit Reports**

79. The auditor is required to evaluate its audit results and whether the financial statements “contain the information essential for a fair presentation of the financial statements in conformity with the applicable financial reporting framework.” (AS No.14 ¶¶ 4 and 31) AU § 508 ¶ 7, Reports on Audited Financial Statements, adds that the auditor may state in his standard report that the financial statements present fairly, in all material



respects, an entity's financial position, results of operations, and cash flows in conformity with GAAP only when the auditor has conducted the audit in accordance with standards set forth by the PCAOB.

80. Berman & Co. and Berman violated PCAOB standards and failed to issue accurate audit reports for the MSLP Audits. (*See* AS 14, AU § 508) Berman & Co.'s March 31, 2011 and April 13, 2012 audit reports, signed by Berman for the firm and provided to MSLP, wrongly stated that Berman & Co. audited MSLP's December 31, 2010 and 2011 financial statements (1) as an independent auditor; (2) in accordance with the standards of the PCAOB, and (3) in its opinion the financial statements present fairly, in all material respects, the financial position of, and the results of its operations and its cash flows, in conformity with accounting principles generally accepted in the United States of America. Berman approved the issuance of audit reports containing unqualified opinions.

### **Respondents Failed to Exercise Due Care and Professional Skepticism**

81. PCAOB standards require auditors to exercise due professional care in the planning and performance of the audit. (AU § 230 ¶ 1) Due professional care concerns "what the independent auditor does and how well he or she does it," requiring the auditor to exercise professional skepticism, including an attitude that includes a questioning mind and a critical assessment of audit evidence. (*See* AU § 230 ¶¶ 4, 7, 8) Additionally, the auditor's responses to the assessed risks of material misstatement, particularly fraud risks, should involve the application of professional skepticism in gathering and evaluating audit evidence. (*See* AS 13) Examples of the application of professional skepticism in response to the assessed fraud risks are "obtaining sufficient appropriate evidence to corroborate management's explanations or representations concerning important matters, such as through third-party confirmation, use of a specialist engaged or employed by the auditor, or examination of documentation from independent sources." (*See* AS 13 ¶ 7, AU § 230 ¶ 7)

82. Respondents violated professional standards and failed to exercise due care and professional skepticism during the MSLP audits. (*See* AU § 230, AS 13) Respondents' failures are evidenced by the repeated deficiencies previously set forth herein, including:

- a) Respondents issued audit reports for the MSLP Audits purporting to be from an independent audit firm when the firm was not independent because it had indemnification provisions in the MSLP Engagement Letters;
- b) Respondents failed to recognize MSLP inappropriately accounted for Sales Incentives and failed to express a qualified or adverse opinion despite knowing that MSLP failed to disclose related party transactions, sponsorship commitments, and International Sales as required by GAAP;
- c) Respondents ignored audit evidence demonstrating that transactions with MSLP's Largest Customer were related party transactions requiring disclosure; and

- d) Respondents failed to obtain sufficient audit evidence regarding MSLP's accounting for Sales Incentives, related party transactions, and International Sales by inappropriately relying on management representations.

## **F. Violations**

1. As a result of the conduct described above, Berman & Co. willfully violated, and Berman willfully aided and abetted and caused Berman & Co.'s violations of, Rule 2-02(b)(1) of Regulation S-X, which provides in part that the accountant's report shall state "whether the audit was made in accordance with generally accepted auditing standards."

2. As a result of the conduct described above, Berman & Co. and Berman willfully aided and abetted and caused MSLP's violations of Section 13(a) of the Exchange Act and Rule 13a-1 thereunder, which require issuers with securities registered under Section 12 of the Exchange Act to file annual reports with the Commission and to keep this information current.

3. As a result of the conduct described above, Respondents engaged in improper professional conduct under Rule 102(e)(1)(ii) as defined in Rule 102(e)(1)(iv)(A) of the Commission's Rules of Practice. The audit failures by Respondents related to independence, related party transactions, Sales Incentives, sponsorship commitments, and International Sales were the result of knowing or reckless conduct that resulted in a violation of applicable professional standards.

4. As a result of the conduct described above, Respondents engaged in improper professional conduct under Rule 102(e)(1)(ii) as defined in Rule 102(e)(1)(iv)(B)(1) of the Commission's Rules of Practice. The audit failures by Respondents related to independence, related party transactions, and Sales Incentives were the result of highly unreasonable conduct that resulted in a violation of applicable professional standards in circumstances in which Respondents knew or should have known that heightened scrutiny was warranted.

5. As a result of the conduct described above, Respondents engaged in improper professional conduct under Rule 102(e)(1)(ii) as defined in Rule 102(e)(1)(iv)(B)(2) of the Commission's Rules of Practice. Respondents' unreasonable conduct included failures with respect to independence, related party transactions, and Sales Incentives discussed herein, as well as unreasonable conduct related to Respondents' failures during the 2011 MSLP Audit relating to sponsorship commitments and International Sales.

6. As a result of the conduct described above, Respondents willfully violated and willfully aided and abetted violations of provisions of the federal securities laws and rules and regulations thereunder pursuant to Rule 102(e)(1)(iii).

### III.

In view of the allegations made by the Division of Enforcement and the Office of the Chief Accountant, the Commission deems it appropriate that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate against Respondents pursuant to Section 4C of the Exchange Act and Rule 102(e) of the Commission's Rules of Practice, including, but not limited to, censure or denying, temporarily or permanently, the privilege of appearing or practicing before the Commission;

C. Whether, pursuant to Section 21C of the Exchange Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Section 13(a) of the Exchange Act and Rule 13a-1 thereunder and Rule 2-02(b)(1) of Regulation S-X, whether Respondents should be ordered to pay a civil penalty pursuant to Section 21B(a) of the Exchange Act, and whether Respondents should be ordered to pay disgorgement pursuant to Sections 21B(e) and 21C(e) of the Exchange Act.

### IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondents fail to file the directed answer, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against Respondents upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondents as provided for in the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields  
Secretary