

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

In the Matter of	:	
	:	
DOHAN + COMPANY CPA,	:	INITIAL DECISION AS TO
STEVEN H. DOHAN, CPA,	:	EREZ BAHAR, CA ¹
NANCY L. BROWN, CPA, and	:	June 27, 2011
EREZ BAHAR, CA	:	

APPEARANCES: Lloyd A. Farnham and Jason M. Habermeyer for the
Division of Enforcement, Securities and Exchange Commission

Christopher B. Wells of Lane Powell PC for
Respondent Erez Bahar, CA

BEFORE: Carol Fox Foelak, Administrative Law Judge

SUMMARY

This Initial Decision sanctions Erez Bahar, CA (Bahar) in connection with his role as manager of the audit of the 2007 financial statements of International Commercial Television Inc. (ICTV). The Initial Decision denies him the privilege of appearing or practicing before the Securities and Exchange Commission (Commission) as an accountant for a period of two years.

I. INTRODUCTION

A. Procedural Background

The Commission instituted this proceeding with an Order Instituting Proceedings (OIP) on August 9, 2010, pursuant to Section 4C of the Securities Exchange Act of 1934 (Exchange Act) and Rule 102(e) of the Commission's Rules of Practice (Rule 102(e)).

The undersigned held five days of hearings in Seattle, Washington, on January 24-28, 2011. The Division of Enforcement (Division) called eight witnesses from whom testimony was

¹ The proceeding has ended as to the remaining captioned Respondents. Dohan + Company CPA, 100 SEC Docket 37027 (Jan. 20, 2011).

taken, including an expert witness. Respondent Bahar testified in his own case and called two additional witnesses, including an expert witness. Numerous exhibits were admitted into evidence.²

The findings and conclusions in this Initial Decision are based on the record. Preponderance of the evidence was applied as the standard of proof. See Steadman v. SEC, 450 U.S. 91 (1981). Pursuant to the Administrative Procedure Act,³ the following post-hearing pleadings were considered: (1) the Division’s March 1, 2011, Proposed Findings of Fact and Conclusions of Law and Post-Hearing Memorandum of Law; (2) Respondent’s March 18, 2011, Proposed Findings of Fact and Conclusions of Law and March 21, 2011, Revised Post-Hearing Brief with Table of Contents and Table of Authority; and (3) the Division’s March 29, 2011, Reply. All arguments, proposed findings, and conclusions that are inconsistent with this Initial Decision were considered and rejected.

B. Allegations and Arguments of the Parties

Bahar is charged with improper professional conduct, within the meaning of Exchange Act Section 4C and Rule 102(e)(1)(ii) and (iv), in connection with his role as manager of the audit of the financial statements of ICTV, for 2007. Specifically, the OIP alleges that Bahar failed to comply with Public Company Accounting Oversight Board (PCAOB) auditing standards, including what were known as generally accepted auditing standards (GAAS), because he failed to uncover improper revenue recognition by ICTV that materially overstated revenue and net income.⁴ The Division urges that Bahar be denied the privilege of appearing or practicing before the Commission as an accountant for a period of three years. Bahar argues that his supervision as manager of the accountant who performed the fieldwork was reasonable and, further, that he was not acting as an auditor subject to PCAOB standards on the engagement,

² Citations to the transcript of the hearing will be noted as “Tr. ____.” Citations to exhibits offered by the Division and Respondent will be noted as “Div. Ex. ____” and “Resp. Ex.____,” respectively.

³ See 5 U.S.C. § 557(c).

⁴ Pursuant to the PCAOB’s Auditing Standard No. 1, GAAS were adopted as PCAOB standards, subject to being superseded going forward. Pub. Co. Accounting Oversight Bd.; Order Approving Proposed Auditing Standard No. 1, 69 Fed. Reg. 29149 (May 20, 2004). GAAS were the standards prescribed by the Auditing Standards Board of the American Institute of Certified Public Accountants (AICPA) for the conduct of auditors in the performance of an examination of management’s financial statements. See SEC v. Arthur Young & Co., 590 F.2d 785, 788 n.2 (9th Cir. 1979). The ten GAAS are further defined or interpreted by Statements on Auditing Standards (SAS), which are codified in the Codification of Statements on Auditing Standards, as “AU § ____.” “PCAOB Standards” and “GAAS” were used interchangeably in the evidence of record in this proceeding.

such that he did not engage in improper professional conduct within the meaning of Exchange Act Section 4C and of Rule 102(e); he asks that the proceeding be dismissed.⁵

II. FINDINGS OF FACT

A. Respondent and Other Relevant Individuals and Entities

1. Erez Bahar

Bahar has been licensed as a Chartered Accountant (CA) in Canada since 2004 and has worked as an accountant at Davidson & Company LLP (Davidson) for about eleven years, starting as a staff accountant; he is currently a partner. Tr. 766. His role in the ICTV audit as manager was as a supervisor of the fieldwork in the 2007 and previous ICTV audits. Tr. 611-13, 771, 777-78. Since the events at issue, Bahar has taken a number of professional education courses, including on revenue recognition, and supplemented the courses with self-study. Tr. 1145-46; Resp. Ex. 45. He intends to take the U.S. CPA examination in the future. Tr. 1147; Resp. Ex. 45. Bahar continues to audit U.S. public companies as audit manager or engagement partner. Tr. 1210.

2. ICTV

ICTV's business consists of selling products through infomercials and the like. Tr. 37. Its flagship product is the DermaWand, a beauty appliance; 90% to 95% of ICTV's revenues are derived from the sale of DermaWands. Tr. 37-38, 223. Headquartered in Bainbridge Island, Washington, ICTV currently has one employee there, one in Vancouver, British Columbia, Canada, two in Pennsylvania, and one in the Philippines. Tr. 38. ICTV has been a public company since 2002. Tr. 40. According to the Commission's public official records, of which official notice is taken pursuant to 17 C.F.R. § 201.323, ICTV has filed periodic reports since 2002. ICTV settled charges arising out of the events at issue in this proceeding in a civil action brought by the Commission; the court enjoined ICTV from violating the reporting and record-keeping provisions of the Exchange Act. SEC v. Int'l Commercial Television, Inc., No. 3:10-cv-05555-BHS (W.D. Wash. Sept. 8, 2010).

During the time at issue Karl Redekopp (Redekopp) was ICTV's chief financial officer.⁶ Tr. 44. Kelly Willett (Willett) was, and is, director of sales. Tr. 34-35. Richard Ransom

⁵ Bahar also requests an award of costs, legal fees, and damages. Such a request, which is premature, can only be made under the Equal Access to Justice Act (EAJA), 5 U.S.C. § 504, and Sections 201.31-.59 of the Commission's Rules, 17 C.F.R. §§ 201.31-.59. The EAJA and the cited Commission Rules specify the circumstances under which an award of fees and expenses will be made to a party.

⁶ The Commission brought an action arising out of the events at issue against Redekopp, alleging that he violated the antifraud provisions; that action is pending. SEC v. Redekopp, No. 3:10-cv-05557 (W.D. Wash.).

(Ransom) replaced Redekopp, who departed in August 2008. Tr. 215-18. Before he left, Redekopp explained ICTV's accounting system to Ransom and gave him the laptop on which ICTV's accounting files resided – contracts between ICTV and various parties, two years' of accounts payable transactions, and all bank statements. Tr. 218-19. Additional paper files that Ransom identified that were in the Vancouver office were also provided to him. Tr. 372.

3. Dohan + Company CPA

Dohan + Company CPA (Dohan + Co.) is a small accounting firm in Miami, Florida, with only a handful of accountants during the time at issue. Tr. 441-43, 599. Dohan + Co. audited ICTV's financial statements for the years 2004 through 2007. Tr. 445. Nancy L. Brown, CPA (Brown), was the engagement partner on the audits, and Steven H. Dohan, CPA (Dohan), was the concurring partner. Tr. 445, 467-68, 607. Dohan was introduced to ICTV as a potential client by Davidson. Tr. 445, 605-06, 1022-25. Dohan + Co. and Davidson had been collaborating on audits for several years.⁷ Tr. 600-04.

4. Davidson & Company LLP

Davidson is a Canadian chartered accounting firm located in Vancouver, British Columbia, Canada, and is registered with the PCAOB. Tr. 600. Davidson is a much larger firm than Dohan + Co., and had thirty to fifty licensed accountants when it started working on ICTV engagements in 2004. Tr. 1023. Although it was PCAOB-registered and performing audits of U.S. public companies at the time of the 2007 ICTV audit, it was not performing such audits when it first started performing fieldwork for Dohan + Co.⁸ Tr. 447. Davidson introduced Dohan + Co. to ICTV so that Dohan + Co. could sign off as auditor for financial statements that were to be filed with the Commission. Tr. 519. There was no written agreement between the two firms specifying the duties and responsibilities of each. Tr. 452. However, Dohan and Brown considered Davidson personnel to be part of the engagement team and assumed that

⁷ Dohan had become acquainted with Davidson accountants through their membership in an accounting organization. Tr. 602. In their collaboration, Dohan + Co. would be the auditor and engage Davidson to perform the fieldwork for companies that were in Davidson's general geographic area. Tr. 601. Dohan + Co. used Davidson as subcontractors to perform fieldwork, including the review of the fieldwork. Tr. 448. The two firms were not performing joint audits; Dohan + Co. was the primary auditor and subcontracted with Davidson to perform the fieldwork. Tr. 450-51. Davidson performed such work for Dohan + Co. on twenty or thirty audits of ten to fifteen companies. Tr. 454, 602. Dohan + Co. would participate in the planning meetings by telephone or by reviewing Davidson workpapers documenting a planning meeting held at Davidson's office. Tr. 452-53.

⁸ During 2007 ICTV and Davidson discussed replacing Dohan + Co. with Davidson as ICTV's auditor. Tr. 835-36; Div. Ex. 40.

Davidson was to apply U.S. auditing standards, referred to as GAAS or PCAOB auditing standards, to its fieldwork.⁹ Tr. 448, 453-54, 610.

Michael Winstanley (Winstanley), employed at Davidson from September 2003 through October 2010, was licensed as a CA in Canada in 2006 and as a CPA in the U.S. in 2009. Tr. 646-47. He performed the fieldwork on the 2007 engagement and on the previous audits and quarterly reviews as well. Tr. 650-52, 655-56. Bahar was the manager on the engagement and Winstanley was the senior. Tr. 468.

B. ICTV Booked Revenue Improperly

It is undisputed that, throughout 2007 and the first half of 2008, ICTV violated Generally Accepted Accounting Principles (GAAP)¹⁰ by improperly recording revenue. The result was an overstatement of revenues in the 2007 financial statements of about \$2.8 million, which was reversed in two restatements.¹¹ The improper accounting was discovered by Ransom as he prepared for the 2008 third quarter review. Tr. 241-42.

1. ICTV's Sales of DermaWands

The parties generally agree on the following facts concerning ICTV's sales of DermaWands during the period at issue.

The DermaWands are manufactured in Tianjin, China. Tr. 223. ICTV stored them at Christopher Morgan, a public warehouse, also referred to as a fulfillment house, located outside Chicago, Illinois, in New Berlin, Wisconsin. Tr. 43, 223-24. Christopher Morgan shipped the products to the ultimate retail customers who purchased them. Tr. 43-44.

ICTV sold products through two sales channels relevant here: direct response and a partnership with Home Shopping Network (HSN). Tr. 40, 220. For direct response, ICTV created an infomercial, bought television air time, and employed operators to take orders. Tr. 37. ICTV's arrangement with HSN started in 2007. Tr. 146. The first transaction with HSN was a so-called guaranteed sale, for which the purchase order bore the notation "Guaranteed Sale" – ICTV delivered DermaWands to HSN's own warehouse before HSN aired a DermaWand session, HSN took title to the goods on receipt and was required to pay ICTV thirty days after it

⁹ Bahar concedes that he never told Brown or Dohan that PCAOB audit standards and U.S. Generally Accepted Accounting Principles would not apply to his work. Tr. 1155-56.

¹⁰ GAAP are the basic postulates and broad principles of accounting pertaining to business enterprises. These principles establish guidelines for measuring, recording, and classifying the transactions of a business entity. See SEC v. Arthur Young & Co., 590 F.2d at 789 n.4.

¹¹ Official notice is taken of ICTV's Forms 10 and 8 pertaining to the events at issue, which are in the Commission's public official records, pursuant to 17 C.F.R. § 201.323. The Forms are also in evidence as Div. Exs. 78 through 93.

sold the goods to the ultimate customer. Tr. 310-23; Div. Ex. 106. That is, the goods were received into HSN's warehouse but HSN was not obligated to pay, and did not pay, until it sold the goods. Tr. 304. HSN also had 135 days to return any product that the customers returned. Div. Ex. 101 at 2, Div. Ex. 102 at 2. This arrangement was governed by the contract titled Master Terms and Conditions for Purchase Orders with HSN LP (traditional agreement). Div. Exs. 101, 102.

Following the initial guaranteed sale transaction, ICTV and HSN moved to a drop-ship arrangement whereby ICTV guaranteed that sufficient inventory for an upcoming air date would be held at Christopher Morgan for HSN. Tr. 56-58, 236-37, 323-328; Divs. Exs. 103, 104, 115. This arrangement was governed by the contract titled Master Terms and Conditions for Drop Ship Vendors (drop-ship agreement). Div. Exs. 103, 104. HSN and ICTV would communicate ahead of a planned DermaWand air date, and Christopher Morgan would segregate the quantity of goods HSN needed from ICTV's other goods in the warehouse; the quantity and date would be memorialized in what witnesses referred to as a "PO worksheet" that bore the notation "THIS IS NOT A PURCHASE ORDER." Tr. 305-06, 328-30; Div. Ex. 107. With the drop-ship arrangement, HSN never took title or possession of the goods; HSN took orders and sent them to Christopher Morgan, which shipped the goods to the customers; invoices were triggered by shipment. Tr. 235-36, 305-09. At that point HSN became obligated to pay for the goods; terms of payment were thirty days from that date. Tr. 308-09; Div. Ex. 103 at 4, Div. Ex. 104 at 4.

2. ICTV Booked Revenue Improperly

The audited financial statements in ICTV's Form 10-KSB for 2007, which contained a going concern statement, showed net sales of \$11.3 million for 2007, as compared with \$2.97 million for the previous year. Div. Ex. 82 at F-3. The increase coincided with ICTV's new relationship with HSN. Tr. 146. However, the \$11.3 million figure was overstated through improper booking of revenue from both direct response sales and sales through HSN.

ICTV booked revenue related to direct response sales improperly by prematurely recognizing revenue of approximately \$550,000 on orders that were subject to a thirty-day free trial period and by understating returns by approximately \$860,000. Tr. 173-74, 415; Div. Ex. 47, Div. Ex. 87 at F-8, Div. Ex. 91, Div. Ex. 100 at 2.

ICTV also booked revenue related to HSN improperly largely because it recognized revenue under the drop-ship arrangement at the time that it agreed to have a given amount of DermaWands set aside for HSN to sell, rather than at the time that DermaWands sold by HSN were shipped to customers. For example, it booked \$990,000 on December 21, 2007, for the sale of DermaWands that were shipped to customers in 2008, if ever.¹² Tr. 335-36; Div. Exs. 109, 111. Additionally, it booked over \$93,000 in revenue in November 2007 for sale of a new product, Cell Rx, that was rejected by HSN in December 2007 because it failed HSN's quality

¹² There is some conflict in the evidence as to whether this was a guaranteed sale or a drop-ship sale. Tr. 78-81; Div. Ex. 109. However, there is no doubt that the goods were not shipped to any customer in 2007.

assurance test; it was never sold to or by HSN.¹³ Tr. 77-78, 331-34; Div. Exs. 108, 111, 113, 117.

3. Restatements

When Ransom was preparing trial balances for the third quarter of 2008, he found that Redekopp had overbooked HSN sales for 2007 and the first two quarters of 2008 in that Redekopp had recorded sales based on quantities, as specified in PO worksheets, that ICTV was to keep available for drop-shipping. Tr. 240-42; Div. Ex. 47 at 2. Ransom's investigation began because a large accounts receivable as of June 30, 2008, did not match with what Redekopp had told him concerning sales. Tr. 228-31, 366-68; Div. Ex. 47 at 2. He had asked Redekopp for all agreements but was not given either HSN "Master Terms and Conditions" agreement. Tr. 238, 372-73. He cannot recall exactly how he found them, perhaps in an e-mail or computer file. Tr. 238-39, 372, 401-02. He believes that he began looking for the drop-ship agreement after he became aware that ICTV had a drop-ship arrangement. Tr. 381. Ransom never found the drop-ship agreement in hard copy. Tr. 372.

Ransom also found overbooking of accounts receivable in the direct response business due to improper booking of returns and bad debts.¹⁴ Tr. 242-43; Div. Ex. 47 at 1. This came to light in September 2008 when ICTV transitioned from Christopher Morgan to a new fulfillment house, Motivational Fulfillment and Logistics Services. Tr. 249-50. Upon inventorying the goods to be moved, ICTV discovered about 50,000 to 60,000 DermaWands that had been returned. Tr. 249-50. In the first restatement of the 2007 financial statements, the previously reported \$11,323,505 in sales was reduced by about \$2.2 million. Tr. 256; Div. Exs. 48, 86, 91.¹⁵

¹³ Redekopp told Winstanley that HSN would be advertising Cell Rx sometime in 2008. Tr. 674-75. The record also contains evidence that ICTV was overstating revenue intentionally, including for the purpose of obtaining financing from Wells Fargo, which had questioned whether ICTV's revenue recognition was in accordance with GAAP. Resp. Exs. 1, 2, 3.

¹⁴ Additionally, Ransom knew that some payment options for DermaWand purchases included a thirty-day free trial period, but he was not aware that ICTV was accounting incorrectly for such sales. Tr. 292.

¹⁵ Ransom discussed the accounting problems in a phone conversation that included Bahar and a representative of Dohan + Co. Tr. 243-44. Bahar, who had not previously met Ransom and had no understanding of the potential magnitude of the error, asked whether a restatement was necessary or whether the problem accounting could be corrected in a subsequent quarter's filing. Tr. 245, 1132-33. Ransom's view was that the amount was too large and material to adjust in one quarter and that it had to be adjusted in the quarters where the errors occurred, which dated back to the second quarter of 2007. Tr. 245; Div. Ex. 47.

In 2009 ICTV replaced Dohan + Co. with Amper, Politziner & Mattia (Amper),¹⁶ which started by working on the audit of the 2008 financial statements. Tr. 160-63. To obtain information to support the opening balances, Amper reviewed Dohan + Co.'s workpapers for ICTV for the year ended December 31, 2007, and the first two quarters of 2008, as well as for the first restatement. Tr. 164-67; Div. Ex. 96. Amper concluded that it could rely on the prior auditor's work in the areas of cash, prepaid expenses, fixed assets, accounts payable/accrued expenses, taxes, and equity, but that it could not rely on the prior auditor's work in the areas of accounts receivable and inventory due to lack of sufficient documentation in the files. Tr. 167-68; Div. Ex. 96. Amper performed additional procedures in the areas of bad debts, returns, revenue recognition, and inventory. Tr. 168-69. This resulted in additional adjustments. Div. Ex. 94. Eventually, 2007 was restated again and the first two quarters of 2008 were restated. Tr. 267. An additional downward adjustment of approximately \$600,000 in sales for 2007 was taken. Tr. 269; Div. Ex. 87 at F-8, Div. Ex. 100 at 2.

C. The Audit of ICTV's 2007 Financial Statements

As with the previous ICTV audits, Davidson was engaged to perform the fieldwork for the 2007 audit. Tr. 457-59, 607. Winstanley performed the fieldwork, supervised by Bahar as manager; the fieldwork was to include inquiry of the client, understanding of the client, substantive testing, and documenting the work in workpapers, including the steps and tests to be performed, who performed them, and the results. Tr. 459-60, 611-13, 771, 778; Div. Ex. 1-A at 84-85. Bahar reviewed the workpapers and submitted them to Brown for review. Tr. 459, 618-19. Davidson's work program, which outlines the work steps, was used with Dohan + Co.'s approval; it was similar to Dohan's and consistent with GAAS. Tr. 459-60, 652-53, 772-73, 1059. Dohan + Co. understood that Davidson would apply U.S. GAAP and GAAS in its fieldwork. Tr. 460-61, 610.

Davidson personnel spent 133.75 hours on the 2007 audit, including 69.25 by Winstanley¹⁷ and 32.50 by Bahar.¹⁸ Div. Ex. 34 at 10. After the work was completed, Davidson submitted its invoice to Dohan + Co., which billed ICTV for the audit without referring to Davidson; after ICTV paid Dohan + Co., Dohan + Co. paid Davidson the amount it was owed. Tr. 619. ICTV paid \$35,522 to Dohan + Co. for the 2007 audit, which included \$27,250 for Davidson's services.¹⁹ Tr. 514-16; Div. Ex. 124.

¹⁶ Following a merger, the firm is now known as Eisner Amper LP. Tr. 160.

¹⁷ Winstanley spent one or two days of that time at ICTV's Vancouver office. Tr. 716; Div. Ex. 43.

¹⁸ The audit plan for the engagement budgeted fifty-one hours for Winstanley, including six hours for "income," and seventeen hours for Bahar, with \$18,135 as the total dollar budget for Davidson's services. Div. Ex. 66 at 152.

¹⁹ By comparison, ICTV pays Amper approximately \$55,000 for the annual audit, and about \$10,000 for each quarterly review. Tr. 272.

Redekopp was ICTV's exclusive contact person for the fieldwork. Tr. 820. Redekopp signed the HSN drop-ship agreement on behalf of ICTV, and CEO Kevin Claney signed the HSN traditional agreement. Div. Exs. 102, 104. It is undisputed that Redekopp did not provide the HSN agreements to the Davidson accountants, despite a request for all written agreements. Tr. 797-99.

Bahar knew that the audit had to meet PCAOB standards, and both he and Winstanley believe that they took no shortcuts and strove to perform the fieldwork to the level of quality of an audit engagement. Tr. 697-98, 1059-60, 1157. Winstanley considered himself to be an auditor on the engagement, and that PCAOB auditing standards and U.S. GAAP applied to the engagement. Tr. 697, 712; Div. Ex. 23 at 54. However, Bahar maintains that his association with the engagement was not that of an auditor and that he was not required to follow PCAOB standards or apply U.S. GAAP. Tr. 1125; Resp. Ex. 29. Nonetheless, the forms supplied by Davidson that ICTV sent to confirm account balance information with financial institutions included the language "Please return this form directly to our accountants: Attn: Erez Bahar," and those that ICTV sent to related parties to confirm balances due referred to Davidson as "our auditors."²⁰ Tr. 1167-70; Div. Ex. 17. When Ransom was preparing trial balances for the third quarter of 2008, Bahar never told Ransom that he was not an auditor or that he was not part of the audit team or that Ransom should talk about accounting issues with someone else. Tr. 232-33. The workpapers refer to PCAOB standards and U.S. GAAP. Tr. 712-14; Div. Ex. 1-A at 114, 182.

1. Planning

The planning meeting took place at Davidson on March 7, 2008; Brown and Dohan's participation consisted of reviewing the workpapers documenting the planning.²¹ Tr. 480-82, 774-75, 1035; Div. Ex. 1-A at 57-58. Audit planning entails brainstorming on how fraud might be committed, determining what steps and testing will be done, assessing risk, performing walk-throughs, determining materiality, understanding the client business and new material relationships, and performing analytical procedures to identify material accounts. Tr. 479-80. Materiality was determined to be \$85,000. Tr. 775-76; Div. Ex. 1-A at 57; Resp. Ex. 9.

"No" was answered on the fraud risk memo to all listed risk factors related to financial reporting. Tr. 745-46; Div. Ex. 66 at 131-33. "No" was answered on the risk control memo to

²⁰ Bahar testified that these were standard Davidson templates and that he did not have them changed, indicating that to do so would waste time and that "a confirmation template that would have stated our subcontracting auditors could have reduced the value of the confirmation." Tr. 1167-70.

²¹ A separate meeting was held at Dohan + Co. during the planning stage of the audit, on March 3, 2008, in which Brown, Dohan, and others discussed the risk of material misstatement due to fraud and due to error. Resp. Ex. 8. However, there is no indication in the record that the results of the meeting were communicated to Davidson.

the possibility of such risk factors as fictitious sales or unsupported sales recorded, shipment/sales recorded in wrong period, and revenue recognition policies not followed. Tr. 746; Div. Ex. 66 at 136. Bahar did not question Winstanley about these assessments. Tr. 745-47. In commenting on the risk assessment procedures worksheet for workpaper 522 contained in Respondent Exhibit 10, Bahar maintained that there were no significant changes in the corporate structure or personnel, the company was selling similar products as in previous years, and that while sales had increased, the operations of the company and, to the best of their knowledge at the time, the way it was conducting its business was similar to the year before. Tr. 1045-46.

2. Walk-Through

Winstanley did not perform a walk-through of ICTV's revenue system or sales cycle, of HSN, or of Christopher Morgan, and there is no indication in the workpapers that any walk-throughs were performed except for a box checked "yes." Tr. 727-32; Div. Ex. 1-A at 33. Bahar did not instruct him to conduct such walk-throughs. Tr. 731-32. The lack of walk-throughs contributed directly to the accountants' failure to detect the overbooking of revenue. While Bahar maintained that Christopher Morgan did not hold inventory for ICTV, even at the time of the hearing, he was uncertain as to the process by which the DermaWands travelled from the manufacturer to the ultimate customers and where the DermaWands were located when Christopher Morgan shipped them to the customers; he was also unsure as to where product returns were held. Tr. 784-85, 844, 1188-92.

3. Revenue

The workpapers disclose that ICTV entered an agreement with HSN during 2007 to sell ICTV's product.²² Div. Ex. 14, Div. Ex. 20 at 411. The revenue lead sheet, which Bahar reviewed, shows a dramatic 280% increase in revenue over the prior year and states, with respect to HSN sales, "The company records the sale once HSN has placed the order and the order has been shipped. However, HSN does not pay until they have sold the products. This process sometimes takes a few months as HSN will preorder for future shows." Div. Ex. 20 at 411.²³ Bahar did not ask Winstanley about this statement. Tr. 725. Bahar never discussed with him the pertinent accounting guidance concerning revenue recognition.²⁴ Tr. 726. Winstanley tested

²² At the hearing Winstanley did not recall whether he asked ICTV specifically for a copy of the agreement or its terms. Tr. 721, 759. He does not recall whether Bahar asked him about the HSN agreement during the engagement or even at the time of the first restatement. Tr. 722-24.

²³ The revenue lead sheet is at both Division Exhibit 20 and Division Exhibit 1-A at 411, which are the same.

²⁴ The pertinent guidance, SEC Staff Accounting Bulletin No. 101 (SAB 101), "Revenue Recognition in Financial Statements," and the Financial Accounting Standards Board Statement of Financial Accounting Standards No. 48 (FAS 48), "Revenue Recognition When Right of Return Exists," which are found in Division Exhibits Nos. 52 and 53, respectively, is discussed infra in the Conclusions of Law.

sales to a few individuals each month such that a low percentage of actual sales was tested. Tr. 749-54; Div. 20. Winstanley believed that HSN had its own section in the Christopher Morgan warehouse, and for HSN sales, goods were shipped from ICTV's section to HSN's section. Tr. 760. Bahar did not believe there was a written agreement between ICTV and HSN but believed that, essentially, HSN bought product from ICTV and habitually paid late. Tr. 797-810; Div. Ex. 1-A at 259, 411. While the accountants asked ICTV for all written agreements, Bahar did not ask specifically for a copy of any HSN agreement. Tr. 1178-79. Bearing on any attempt to locate an HSN agreement, Winstanley stated that he had reviewed all of the minutes of the board and resolutions. Tr. 705; Resp. Ex. 14 at 1. However, he did not summarize his review of board minutes in the workpapers, which would be a usual procedure to support that audit step. Tr. 754-55.

In the workpaper checklists pertaining to revenue, Winstanley recorded "none noted" concerning "sales recorded before goods are shipped," "large volume of sales transactions around period end," "unusual or long payment terms," and "buyer conditions which must be met in order to complete the sale." Div. Ex. 20 at 411. Bahar never asked him about these. Tr. 737-38.

Bahar never discussed with Winstanley the apparent change in revenue recognition policy between the second²⁵ and third²⁶ quarters of 2007, as memorialized in ICTV's Forms 10-QSB and 10-KSB. Tr. 733-36; Div. Ex. 80 at 8, Div. Ex. 81 at 8, Div. Ex. 82 at F-8. Bahar considers that the revision was a change in wording, not a change in revenue recognition policy. Tr. 821-31.

4. Accounts Receivable

Winstanley did not send an accounts receivable confirmation to HSN. Tr. 742. The accounts receivable lead sheet, which Bahar reviewed, states:

²⁵ "Product sales revenue is recognized upon shipment of the product to the customer." Div. Ex. 80 at 8.

²⁶ After the relationship with HSN commenced, ICTV's Forms 10-QSB for the third quarter and 10-KSB for the year of 2007 stated:

For our direct response television sales generated by our infomercials, product sales revenue is recognized upon shipment of the product to the customer. . . . Revenue related to sales to our wholesale customers is recognized when each of the following conditions is met: Persuasive evidence of an arrangement exists, transfer of the benefit of ownership of the products has occurred, our price to the customer is fixed and determinable and collectability is reasonably assured."

Div. Ex. 81 at 8, Div. Ex. 82 at F-8.

[C]onfirmations were not sent out as the Company has two main customers, Christopher Morgan and Home Shopping Network and both pay their outstanding balances on a regular basis. . . . Therefore it was determined to not be necessary to send out these confirmations. In previous years we have sent confirmations to confirm AR but because of the nature of the customers we did not receive any responses. Therefore we used alternative subsequent procedures testing.

Div. Ex. 18,²⁷ Div. Ex. 66 at 324.²⁸ However, the workpapers do not fully document that alternative procedures were performed. Tr. 747-48; Div. Ex. 1-A at 259-71. To the extent that subsequent cash receipts testing was performed and documented, it covered only a small percentage of the receivables.²⁹ Tr. 747-48; Div. Ex. 1-A at 270-71.

The accounts receivable lead sheet describes Christopher Morgan both as a customer and as the fulfillment agent. Div. Ex. 18, Div. Ex. 66 at 324. Bahar did not ask Winstanley about the discrepancy. Tr. 732-33. Bahar was aware that Christopher Morgan was a fulfillment center for ICTV. Tr. 778-79.

5. Inventory

The inventory lead sheet, which Bahar reviewed, states that inventory is material. Tr. 743; Div. Ex. 1-A at 273, Div. Ex. 19.³⁰ Winstanley did not attend a physical count of inventory, which he believed was held in the United Kingdom and Hong Kong, and he did not send an inventory confirmation to Christopher Morgan. Tr. 743-44; Div. Ex. 19 at 278. Bahar never asked him about this. Tr. 743-44. In Bahar's view, a physical count or confirmation was not necessary because he believed the inventory was not held for resale. Tr. 788-94, 841; Div. Ex. 19 at 292. Bahar did not understand that Christopher Morgan held inventory for ICTV. Tr. 770, 786. However, Bahar concedes the possibility that Christopher Morgan held returns.³¹ Tr. 843-

²⁷ The accounts receivable lead sheet is at both Division Exhibit 18 and Division Exhibit 1-A at 259, which are the same. Division Exhibit 66 at 324 is also the accounts receivable lead sheet with the addition of Brown's initials indicating that she reviewed it as engagement partner.

²⁸ Dohan and Brown agreed that, because of HSN's large size, sending confirmations to HSN would be fruitless and unlikely to generate a response. Tr. 615-16.

²⁹ Indeed, the Receivables Reconciliation worksheet states, as to over \$1 million in HSN receivables, that HSN will pay once the products have been sold. Div. Ex. 1-A at 270-71. Of course, subsequent cash receipts testing cannot be performed on receipts that have not been received.

³⁰ The inventory lead sheet is at both Division Exhibit 19 and Division Exhibit 1-A at 273, which are the same.

³¹ Bahar contends that the Christopher Morgan reports were inaccurate and untimely. However, there is no evidence of record concerning this.

44. Winstanley used alternate procedures in lieu of attending a physical count. Tr. 677-78; Div. Ex. 19 at 292. The alternate procedures consisted of reviewing purchase orders (by which ICTV purchased the inventory) to ensure that ICTV received the inventory before year end and then agreeing ICTV's purchases to sales invoices showing the goods were shipped after year end. Tr. 678-79; Div. Ex. 19 at 292.

6. Returns

There was a discrepancy between the disclosure in ICTV's Form 10-K, which stated that the allowance for customer returns was based on past experience of returns of 11% to 17% of sales, and the revenue lead sheet, which indicates that ICTV provided an allowance of 7% for refunds and 2.5% for chargebacks. Div. Ex. 20 at 411, Div. Ex. 82 at 9, F-8. Bahar never asked Winstanley about this. Tr. 739. Bahar noted that the reported lower return ratio was estimated based on actual returns during the month following December 2007 in light of the company's 30-day return policy, which he considered reasonable. Tr. 883-84, 890-92. Winstanley did not test whether ICTV adhered to the stated 30-day return policy. Tr. 741. Bahar did not ask him to do so; because subsequent cash receipts testing indicated that the receivables were correct,³² there was no indication that ICTV was not following the 30-day policy. Tr. 741, 892-93.

D. Expert Testimony³³

Albert A. Vondra (Vondra), CPA, a partner with PricewaterhouseCoopers (PwC), testified for the Division. Tr. 894-959; Div. Ex. 123. He has been associated with PwC or its predecessor since 1979, has been an auditor, served in a position where he fielded complex accounting and auditing questions from the field, and presently is a member of the forensic services practice where he is involved in investigations of fraud and financial reporting fraud. Tr. 895-96.

Generally, Vondra opined that Bahar was performing auditing work in support of Dohan + Co.'s audit report and was required to follow PCAOB auditing standards. Tr. 900-02; Div. Ex. 123 at 10-15. Referencing SAB 101, pertaining to revenue recognition, FAS 48, pertaining to the right of return, and AU 316, pertaining to fraud, he opined that Winstanley failed to assess their applicability to the engagement and Bahar did not guide him. Tr. 902-08, 913; Div. Ex. 123 at 16-24. Additionally Vondra noted a number of items on the work program that should have been considered but were noted "Not applicable" or "No." He noted a lack of understanding of the roles of Christopher Morgan and HSN. Tr. 932. He opined that insufficient resources were devoted to Davidson's work – 133 hours invoiced for \$27,000. Tr. 934-35. He opined that when things change – in this case, a new contract with HSN, dramatically increased sales, and

³² As noted supra, the workpapers show that subsequent cash receipts testing covered only a small percentage of the receivables and that it could not have been performed as to most of the balance.

³³ To the extent that the experts' evidence does not lead to findings of fact, it will be summarized here and referred to as appropriate in the Conclusions of Law section of this Initial Decision.

increased accounts receivable – the auditor should be alert to an increased risk of misstatements. Tr. 938.

John Curran, CPA (Curran), testified for Bahar. Tr. 970-1016; Resp. Ex. 49. He was accepted as an expert in the topics on which he opined. Tr. 987; Resp. Ex. 49 at 7-8. Curran began his career as an auditor at a “Big 8” firm in 1962; later he became a partner in what is now Ernst & Young, LLP, which he left in 2005 to join Hagen Streiff Newton & Oshiro Accountants P.C. in Seattle, Washington. Tr. 972-75; Resp. Ex. 49 at 3. In addition to auditing engagements, he has prepared or reviewed over 1,000 insurance related business interruption claims for a variety of industries; one of the major considerations in such claims is the volume and timing of actual sales based on prior and post loss revenue recognition and a projection of lost revenues in compliance with GAAP. Tr. 974; Resp. Ex. 49 at 3.

Curran opined that Dohan + Co. was the responsible auditor on the engagement and, in any event, Bahar’s actions were reasonable. Tr. 976, 983-96; Resp. Ex. 49 at 7-16. He specifically opined that in Bahar’s role as supervisor, it was reasonable to review and accept a staff’s statements, testing procedures, audit marks, audit workpapers, and procedure sign-offs rather than duplicate the testing. Resp. Ex. 49 at 7. Curran noted that, as established by the evidence of record, Redekopp did not disclose the drop-ship agreement to Dohan + Co. or Davidson. Resp. Ex. 49 at 10. Curran did not opine as to whether the totality of Bahar’s conduct regarding the 2007 ICTV audit complied with PCAOB standards. Tr. 996-97.

III. CONCLUSIONS OF LAW

Bahar is charged, pursuant to Section 4C of the Exchange Act and Rule 102(e)(1)(ii) of the Commission’s Rules of Practice, 17 C.F.R. § 201.102(e)(1)(ii), with improper professional conduct.³⁴ The charges are based on Bahar’s alleged improper professional practices during the

³⁴ Exchange Act Section 4C, which was added by the Public Company Accounting Reform and Investor Protection Act of 2002, known as the Sarbanes-Oxley law, codified Rule 102(e), which had been in existence for many years, and provided specific statutory authority for its provisions. Because of this history and the precedent concerning Rule 102(e), the discussion herein will cite Rule 102(e) rather than the identical provisions of Exchange Act Section 4C. “It is well established that when Congress revisits a statute giving rise to a longstanding administrative interpretation without pertinent change, the ‘congressional failure to revise or repeal the agency’s interpretation is persuasive evidence that the interpretation is the one intended by Congress.’” CFTC v. Schor, 478 U.S. 833, 846 (1986) (citations omitted); see also Lorillard v. Pons, 434 U.S. 575, 580-81 (1978) (“Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change [and] where, as here, Congress adopts a new law incorporating sections of a prior law, Congress normally can be presumed to have had knowledge of the interpretation given to the incorporated law, at least insofar as it affects the new statute.”) (citations omitted); Cf. Herman & MacLean v. Huddleston, 459 U.S. 375, 384-85 (1983) (Congress’s decision to leave Section 10(b) intact while comprehensively revising the securities laws suggested that Congress ratified the well-established judicial interpretation of the implied private right of action under Section 10(b)); Davis v. Michigan Dep’t of Treasury, 489 U.S. 803, 813 (1989) (“When Congress

audit of ICTV’s 2007 financial statements. The Division argues that his conduct violated PCAOB auditing standards and was reckless, or, in the alternative, highly unreasonable, or, in the alternative, constituted repeated instances of unreasonable conduct. Bahar contends that his participation in the ICTV engagement was not subject to the PCAOB standards, and that, in any event, was within professional standards. In this section it is concluded that his conduct violated PCAOB auditing standards and constituted repeated instances of unreasonable conduct.

A. Rule 102(e)(1)(ii)

Rule 102(e)(1)(ii) provides for sanctions against accountants who “have engaged in . . . improper professional conduct.”

[W]ith respect to persons licensed to practice as accountants, “improper professional conduct” under Rule 102(e)(1)(ii) means:

- (A) intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards; or
- (B) either of 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.
 - (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.

17 C.F.R. § 201.102(e)(1)(iv).

Both the Division and Bahar cite Robert W. Armstrong, III, 85 SEC Docket 3011 (June 24, 2005) in support of their respective positions that Bahar was, or was not, appearing or practicing before the Commission within the meaning of Rule 102(e). Armstrong articulates an expansive reading of Rule 102(e). It is clear that Bahar is subject to Rule 102(e). Id. at 3030-35.

1. Reckless Conduct

The Commission defines recklessness under Rule 102(e) to be the same as recklessness under the antifraud provisions (for the purpose of consistency in the federal securities laws; “professional standards” are not fraud-based). Thus, recklessness is “an extreme departure from the standards of ordinary care, . . . which presents a danger of misleading buyers or sellers that is either known to the [actor] or is so obvious that the actor must have been aware of it.” Amendment to Rule 102(e) of the Commission’s Rules of Practice, 63 Fed. Reg. 57164, 57167 (Oct. 26, 1998) (Rule 102(e) Amendment). It is “a lesser form of intent,” “not merely a heightened form of ordinary negligence.” Id. (internal citations and quotations omitted).

codifies a judicially defined concept, it is presumed, absent an express statement to the contrary, that Congress intended to adopt the interpretation placed on that concept by the courts.”).

Rule 102(e)(1)(iv)(A) codified the Commission's longstanding recklessness standard in 1998. See Russell Ponce, 54 S.E.C. 804, 823 n.52 (2000) (holding that the 1998 amendment adding new subsection (iv)(A) to Rule 102(e)(1) merely codified the Commission's longstanding recklessness standard), aff'd, 345 F.3d 722 (9th Cir. 2003); accord Albert Glenn Yesner, CPA, 54 S.E.C. 414, 417 (1999).

Recklessness is more than a misapplication of accounting principles; the Division must prove that Bahar's "accounting practices were so deficient that the audit amounted to no audit at all, or an egregious refusal to see the obvious, or to investigate the doubtful, or that the accounting judgments . . . were such that no reasonable accountant would have made the same decision if confronted with the same facts"; reasonable accountants can differ, and evidence indicating that questioned accounting decisions were reasonable negates an attempt to establish scienter. See Worlds of Wonder Sec. Litig., 35 F.3d 1407, 1426 (9th Cir. 1994), quoting SEC v. Price Waterhouse, 797 F. Supp. 1217, 1240 (S.D.N.Y. 1992) (internal quotations omitted); accord Software Toolworks Inc., 50 F.3d 615, 627 (9th Cir. 1994) ("The mere publication of inaccurate accounting figures, or a failure to follow GAAP, without more, does not establish scienter.") (citations and internal quotation marks omitted). Violations of GAAP or GAAS in themselves do not constitute recklessness. See Chill v. General Elec. Co., 101 F.3d 263, 270 (2d Cir. 1996) ("Allegations of a violation of GAAP provisions or SEC regulations, without corresponding fraudulent intent, are not sufficient."). "Subjective good faith is inconsistent with a finding of knowing or intentional, including reckless, conduct." Rule 102(e) Amendment, 63 Fed. Reg. at 57170.

2. Highly Unreasonable Conduct

"Highly unreasonable" was first defined in Rule 102(e) Amendment as a new concept. It is higher than ordinary negligence but lower than recklessness. It is measured by the degree of departure from professional standards and not the intent of the accountant. It is not judged by hindsight, but compares actions taken by an accountant at the time of the violation with the actions a reasonable accountant should have taken. Id. at 57167-68. A single instance of highly unreasonable conduct when an accountant knows, or should know, that heightened scrutiny is warranted conclusively demonstrates a lack of competence to practice before the Commission. Id. at 57164. A single judgment error, even if unreasonable when made, may not indicate a lack of competence to practice before the Commission and not pose a future threat to the Commission's processes requiring Commission action. Id. at 57166 & n.28, 57167.

3. Repeated Instances of Unreasonable Conduct

"Unreasonable" connotes an ordinary negligence standard. Rule 102(e) Amendment, 63 Fed. Reg. at 57169. "'[R]epeated' may encompass as few as two separate instances of unreasonable conduct occurring within one audit, or separate instances of unreasonable conduct within different audits [such as] fail[ure] to gather evidential matter for more than two accounts, or certific[ation of] accounting inconsistent with GAAP in more than two accounts." Id. "[Since] 'repeated instances' may not always demonstrate a lack of competence to practice before the Commission . . . this subparagraph requires . . . a specific finding that the conduct indicates a lack of competence." Id.

4. Applicable Professional Standards

An auditor does not guarantee that financial statements are free of material misstatement; his or her “responsibility [is] to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud.” AU § 110.02. During the time at issue, applicable professional standards included GAAP, PCAOB auditing standards, including GAAS, the American Institute of Certified Public Accountants (AICPA) Code of Professional Conduct, and Commission regulations.³⁵ Rule 102(e) Amendment, 63 Fed. Reg. at 57166.

Dohan + Co. was the auditor, while Davidson was a subcontractor, not a co-auditor, on the ICTV engagement. Bahar argues that he was not acting as an auditor and thus was not subject to PCAOB standards. He reasons that, while he was associated with Davidson and Davidson was associated with Dohan + Co., the auditor, he was not associated with Dohan + Co. so as to be subject to PCAOB standards, based on PCAOB Release 2003-011D titled “Frequently Asked Questions Regarding Registration with the Board.” However, that document merely gives guidance on registration,³⁶ not on the standards to apply in audits. Indeed it is not believable that Dohan + Co. would contract with Davidson for fieldwork that was not to be performed according to PCAOB standards. Moreover, Dohan, Brown, Winstanley, and Bahar all assumed that the audit was subject to PCAOB standards, and Winstanley and Bahar attempted to conform to those standards. Further, assuming, *arguendo*, that PCAOB standards did not apply to Bahar, he has not articulated what standards would apply. *Cf. Jean-Paul Bolduc*, 55 S.E.C. 1060, 1062 n.9 (2002), 54 S.E.C. 437 (1999) (ordering a hearing to address the nature of any professional standards to which the controller of a non-public subsidiary of a public corporation, an accountant who was not licensed as a CPA, was subject under Rule 102(e)).

Thus, to conclude that Bahar engaged in improper professional conduct within the meaning of Rule 102(e), it is necessary to conclude, first, that he violated GAAS and, second, that the GAAS violation[s] resulted from reckless or highly unreasonable conduct, or repeated instances of unreasonable conduct by him. A GAAS violation in itself is not improper professional conduct within the meaning of Rule 102(e).

Bahar’s conduct must be compared with actions a reasonable accountant would have taken at the time of the audit, without the benefit of hindsight, and evaluated in light of standards

³⁵ The ten basic GAAS standards are listed in AU § 150.02, and detailed interpretations follow. Those at issue in this proceeding are the third general standard (AU § 230 Due Professional Care) and the third standard of field work, sufficient competent evidential matter (AU § 311, Planning and Supervision; AU § 316, Consideration of Fraud in a Financial Statement Audit; AU § 326, Evidential Matter; AU § 330, The Confirmation Process; and AU § 331, Inventories).

³⁶ PCAOB Release 2003-011D, as applicable here, provides only that an accountant such as Bahar who was associated with Davidson, which had been engaged by Dohan + Co. as an independent contractor, need not himself be registered as an associated person by Dohan + Co.

in effect for calendar year 2007 audits. During the relevant period AU § 316 was based on SAS No. 99, Consideration of Fraud in a Financial Statement Audit.³⁷ SAS No. 99 requires a brainstorming session by the audit team during initial audit planning to determine the different ways the client might perpetrate fraud, with an emphasis on the possibility of improper revenue recognition, which is presumed to be a fraud risk. In essence, SAS No. 99 requires the auditor to assume that the client is engaged in fraud, particularly with regard to revenue recognition.

In sum, it is concluded that Bahar is subject to the provisions of Rule 102(e) and that PCAOB standards applied to his role in the fieldwork of the 2007 ICTV audit.

B. The Audit Violated PCAOB Auditing Standards and Bahar Engaged in Improper Professional Conduct within the Meaning of Rule 102(e)

It is undisputed that ICTV materially overstated revenue in its 2007 financial statements. Bahar's failure to detect this resulted from shortfalls in planning and reviewing the fieldwork. Because of the failure to conduct walk-throughs of ICTV's revenue system or sales cycle, including its relationship with HSN and Christopher Morgan, Bahar and Winstanley did not understand when and to what extent revenue should have been recognized. Any understanding that Bahar may have gained through work on ICTV's previous years' audits did not apply to the new circumstances presented by HSN.

The parties accept that the following guidance applied to revenue recognition by ICTV. Pursuant to SAB 101 the following four criteria must be met before revenue is recognized: (i) persuasive evidence of an arrangement exists; (ii) delivery has occurred or services have been rendered; (iii) the seller's price to the buyer is fixed or determinable; and (iv) collectibility is reasonably assured. FAS 48 requires that sales revenue and cost of sales be reduced to reflect estimated returns. Revenue related to HSN sales was booked improperly as to both the initial guaranteed sale and subsequent drop-ship transactions. Revenue should not have been booked under SAB 101 when the DermaWands were shipped to, or set aside for, HSN because HSN's obligation to pay ICTV was contingent on their resale to the ultimate purchasers. Concerning the direct response sales, revenue was overbooked because of failure to take account of the 30-day free trial period, where applicable, and underestimating returns in violation of FAS 48.

1. Planning Failures

AU § 311 requires the auditor to consider the entity's accounting policies and procedures, to inquire about current business developments affecting the entity, and to obtain a level of knowledge of the entity's business to enable him to obtain an understanding of the events, transactions, and practices that, in his judgment may have a significant effect on the financial statements. AU § 311.03, .04, .06.

³⁷ SAS No. 99, issued in 2002, resulted from the Sarbanes-Oxley law, which mandated procedures to reduce accounting fraud in the wake of Enron and other accounting fraud scandals. It increased the requirement for professional skepticism and required substantial additional procedures to make it more likely that material fraud would be detected.

AU §§ 316.14, .17 provide that key members of the audit team should participate in brainstorming concerning how the financial statements might be susceptible to material misstatement due to fraud, including how management could perpetrate and conceal fraudulent financial reporting. Yet Bahar did not question Winstanley about his “No” answers on the fraud risk memo to all listed risk factors related to financial reporting. Nor did he ask Winstanley about his “No” answers on the revenue checklist. Bahar’s contention is that nothing had changed as compared to previous years except that sales and cost of sales had increased.

Bahar was aware that ICTV had begun an arrangement with HSN during 2007 and that reported revenues had skyrocketed as a result. Had a walk-through been conducted, the accountants would have discovered that revenues were overstated. Bahar was also aware that ICTV had not been asked to produce its agreement or agreements with HSN and did not insist that they do so. The failure to conduct a walk-through and the failure to ask specifically for and obtain the agreement or agreements with HSN constitute significant planning and due professional care failures. Further, because of their failure to understand ICTV’s sales process, the accountants did not understand that ICTV held substantial inventory at Christopher Morgan and thus did not confirm the inventory or attend a physical count there.³⁸ Had Winstanley attended a physical count, he would have observed the large volume of unaccounted-for returns.

AU § 316.12 states, “[E]ven a properly planned and performed audit may not detect a material misstatement resulting from fraud.” Contrary to Bahar’s argument, this was not such an audit. Bahar suggests that Redekopp withheld the drop-ship agreement from the accountants to avoid detection of ICTV’s fraudulent inflation of revenue, intended to deceive Wells Fargo bankers from whom ICTV was seeking financing. This suggestion ignores the fact that Bahar did not ask for, or insist that Winstanley ask for, a copy of ICTV’s agreement with HSN, despite knowledge of the arrangement. Bahar cannot argue that ICTV deceived the accountants by failing to produce a document which they had not specifically requested. While Bahar notes that the accountants asked for all written agreements and were not provided with the HSN agreement, this in itself should have given rise to further inquiry. AU § 316.11 states, “Although fraud usually is concealed and management’s intent is difficult to determine, the presence of certain conditions may suggest to the auditor the possibility that fraud may exist. For example, an important contract may be missing.”

2. Additional “Red Flags”

AU § 230.07-.09 requires “professional skepticism” as part of Due Professional Care. Bahar failed to investigate several red flags that would have led a reasonable accountant to uncover the overstatement of revenue, notwithstanding the planning shortfalls discussed above. The revenue lead sheet, which he reviewed, states “HSN does not pay until they have sold the

³⁸ AU § 331 provides that an auditor must justify the decision not to observe inventories and that if inventories are in public warehouses or other outside custodians, the auditor ordinarily would obtain confirmation from the custodian, and, possibly, observe a physical count. § 330.34, .35. Winstanley and Bahar did neither.

products [which] sometimes takes a few months.” The accounts receivable lead sheet, which Bahar reviewed, states with reference to determining not to send a confirmation to HSN, “In previous years we have sent confirmations to confirm AR but . . . did not receive any responses.”³⁹ This statement could not be true as to HSN since ICTV’s relationship with HSN only began in 2007. Had a confirmation been sent to HSN and had HSN responded, the accountants would have learned that accounts receivable were much lower than ICTV booked since HSN was obligated to pay only for those DermaWands that it had sold to customers.

Bahar also failed to question the change in ICTV’s revenue recognition policy between the second and third quarters of 2007. He now explains it as a change in wording, but a comparison shows that it is not. The earlier version simply states that “revenue is recognized upon shipment of the product to the customer”; the later version adds the new category of sales to “wholesale customers” and copies the criteria of SAB 101 with the important exception of replacing “delivery has occurred” with “transfer of the benefit of ownership of the products has occurred” – a transparent attempt to conceal the non-occurrence of “delivery.” Had Bahar questioned this or instructed Winstanley to do so, they would have uncovered the fact that, under both HSN sales arrangements, revenue should not have been booked until sale of the product to the actual customer.

3. Bahar Engaged in Improper Professional Conduct within the Meaning of Rule 102(e)

In sum, the audit was not performed in accordance with PCAOB standards, and Bahar’s participation in the engagement included “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” within the meaning of Rule 102(e)(iv)(B)(2). The planning failures – failing to consider the possibility of fraud in financial reporting, to conduct a walk-through, or to ask specifically for a copy of any agreement with HSN – constitute one course of such conduct. The failure to respond to red flags on review of the workpapers, specifically the revenue and accounts receivable lead sheets, constitutes a second course of conduct. In the alternative, Bahar’s entire course of conduct regarding Davidson’s failure to detect ICTV’s overstatement of revenue, taken as a whole, constituted “a single instance of highly unreasonable conduct” within the meaning of Rule 102(e)(iv)(B)(1).⁴⁰

³⁹ AU § 326.21(a) provides, “When evidential matter can be obtained from independent sources outside an entity, it provides greater assurance of reliability for the purposes of an independent audit than that secured solely within the entity.” AU § 330 provides that there is a presumption that the auditor will request the confirmation of accounts receivable unless accounts receivable are immaterial, the use of confirmations would be ineffective, or the level of inherent and control risk is low, and that an auditor who has not requested confirmations should document how he overcame this presumption. AU § 330.34, .35. Additionally, although the accounts receivable lead sheet refers to alternative procedures, these are not fully documented in the workpapers or are otherwise insufficient.

⁴⁰ The dramatic increase in revenue in 2007 associated with ICTV’s new relationship with HSN required heightened scrutiny. The Division also argues that Bahar’s conduct was reckless. However, in view of Amper’s conclusion that it could rely on the prior auditor’s work in some

IV. SANCTIONS

The Division asks that Bahar be denied the privilege of practicing or appearing before the Commission for at least three years. Bahar requests that the proceeding be dismissed. For the reasons discussed below, he will be denied the privilege of appearing or practicing before the Commission for two years.

The purpose of Rule 102 sanctions is not to punish, but to protect the public from future reckless or negligent conduct by professionals who practice before the Commission and to encourage more rigorous compliance with auditing standards in future audits. McCurdy v. SEC, 396 F.3d 1258, 1264-65 (D.C. Cir. 2005). Analogizing to the so-called Steadman factors,⁴¹ Bahar's revenue recognition lapses, which were at least negligent, occurred in a single audit. He continues to audit U.S. public companies and intends to take the CPA examination, so his occupation will present opportunities for future violations. Consistent with a vigorous defense of the charges against him, Bahar has not recognized the unreasonable nature of his conduct. Concerning egregiousness, Bahar's conduct fell short of professional standards in two principal ways. The first was a fundamental planning failure that led directly to the failure to uncover the overstatement of revenues: Bahar failed to obtain a basic understanding of ICTV's sales cycle, particularly the effect of ICTV's new relationship with HSN. Despite knowing about the 280% increase in revenues associated with the new HSN relationship, Bahar failed to require that Winstanley obtain and review the HSN agreements. Second, Bahar failed to identify and follow up on red flags contained in workpapers he reviewed, none more obvious to a reasonable accountant than the fact that HSN's obligation to pay for the DermaWands was contingent upon HSN's sale through to the end customer, which should have raised revenue recognition concerns under SAB 101.

Bahar's representation that he will continue professional education, including on revenue recognition, as well as prepare for the CPA examination, is praiseworthy but does not obviate the need for a sanction. Bahar argues that none of the Davidson auditing engagements on which he worked has been the subject of any regulatory complaint; however, a lack of a disciplinary record is not an impediment to imposing sanctions for a respondent's first adjudicated disciplinary violation. See Robert Bruce Lohmann, 56 S.E.C. 573, 582 (2003); Martin R.

areas – cash, prepaid expenses, fixed assets, accounts payable/accrued expenses, taxes, and equity – the undersigned is hesitant to conclude that Bahar's "accounting practices were so deficient that the audit amounted to no audit at all." Worlds of Wonder Sec. Litig., 35 F.3d at 1426.

⁴¹ Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979) (quoting SEC v. Blatt, 583 F.2d 1325, 1334 n.29 (5th Cir. 1978)). The Division cites the Steadman factors in requesting a three-year suspension. It is noted that, while Administrative Law Judges have cited the Steadman factors in Rule 102(e) proceedings against CPAs, the Commission has not. See Horton & Co., 77 SEC Docket 3677 (A.L.J. July 2, 2002); Barry C. Scutillo, CPA, 74 SEC Docket 2497, 2555-57 (A.L.J. May 3, 2001), aff'd in part, 56 S.E.C. 714 (2003); Carroll A. Wallace, CPA, 73 SEC Docket 3969, 4034-37 (A.L.J. Dec. 18, 2000), aff'd, 56 S.E.C. 865 (2003).

Kaiden, 54 S.E.C. 194, 209 (1999). A two-year suspension is an appropriate sanction and consistent with Commission precedent.⁴²

V. RECORD CERTIFICATION

Pursuant to Rule 351(b) of the Commission's Rules of Practice, 17 C.F.R. § 201.351(b), it is certified that the record includes the items set forth in the record index issued by the Secretary of the Commission on April 20, 2011.

VI. ORDER

IT IS ORDERED that, pursuant to Section 4C of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice, 17 C.F.R. § 201.102(e)(1)(ii), EREZ BAHAR, CA, IS DENIED TEMPORARILY the PRIVILEGE OF APPEARING OR PRACTICING BEFORE THE COMMISSION AS AN ACCOUNTANT for a period of TWO YEARS.

⁴² See Gregory M. Dearlove, CPA, 92 SEC Docket 1867 (Jan. 31, 2008) (ordering a bar with right to reapply in four years and cease-and-desist order; engagement partner on audit of Adelphia Communications Corporation failed to detect improper accounting of enormous related party transactions and other matters prior to entity's implosion); James Thomas McCurdy, CPA, 57 S.E.C. 277 (2004), pet. den., 396 F.3d 1258 (D.C. Cir. 2005) (denying CPA privilege of appearing or practicing before the Commission for one year; auditor of a mutual fund failed to obtain sufficient evidence regarding the collectability of a receivable that comprised 25% of the fund's assets); Barry C. Scuttilo, 56 S.E.C. 714 (2003) (ordering a bar with right to reapply in three years; auditor in high risk engagement essentially accepted management's valuation of assets, which consisted of purported gold mining properties and CDs purportedly issued by a Russian bank in an unusual transaction); Russell Ponce, 54 S.E.C. 804 (2000) (ordering a bar with right to reapply in five years and cease-and-desist order; CPA violated antifraud provisions, lacked independence due to unpaid fees, changed properly expensed costs to capitalize them based solely on management representations, and inflated value of intangible asset); Robert D. Potts, CPA, 53 S.E.C. 187 (1997), aff'd, 151 F.3d 810 (8th Cir. 1998), cert. denied, 526 U.S. 1097 (1999) (suspending concurring partner for nine months; accounting for asset not in accord with GAAP and contrary to documentary evidence in file he reviewed); Bill R. Thomas, 48 S.E.C. 1007 (1988) (barring, permanently, CPA who violated antifraud provisions, owned stock in firm he audited, and concealed this from his employer, a national accounting firm); Gary L. Jackson, 48 S.E.C. 435 (1986) (barring, permanently, CPA who aided and abetted firm's filing of materially false reports and knowingly accepted firm's valuation of worthless mining claims and of an asset based on a sham transaction with no economic substance); Russell G. Davy, 48 S.E.C. 138 (1985) (barring, permanently, CPA who violated antifraud provisions, accepted management representations about sham transactions despite red flags and ignored information that he actually knew); Ernst & Ernst, 46 S.E.C. 1234 (1978) (suspending engagement partner for one year, audit manager, for three months, and censuring CPA firm; materially false and misleading financial statements contained sham and improperly accounted for acquisitions, and respondents lacked independence in repeated dependence on management representations concerning significant information despite red flags).

This Initial Decision shall become effective in accordance with and subject to the provisions of Rule 360 of the Commission's Rules of Practice, 17 C.F.R. § 201.360. Pursuant to that Rule, a party may file a petition for review of this Initial Decision within twenty-one days after service of the Initial Decision. A party may also file a motion to correct a manifest error of fact within ten days of the Initial Decision, pursuant to Rule 111 of the Commission's Rules of Practice, 17 C.F.R. § 201.111. If a motion to correct a manifest error of fact is filed by a party, then that party shall have twenty-one days to file a petition for review from the date of the undersigned's order resolving such motion to correct a manifest error of fact. The Initial Decision will not become final until the Commission enters an order of finality. The Commission will enter an order of finality unless a party files a petition for review or a motion to correct a manifest error of fact or the Commission determines on its own initiative to review the Initial Decision as to a party. If any of these events occur, the Initial Decision shall not become final as to that party.

Carol Fox Foelak
Administrative Law Judge