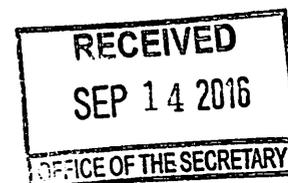


IN THE MATTER OF BIOELECTRONICS., et al, Respondents
ADMINISTRATIVE PROCEEDING



FILE NO. 3-17104

SUPPLEMENTAL EXPERT REPORT OF
ALBERT A. VONDRA, CPA, JD, CFE, CFF

Albert A. Vondra, CPA, CFE, JD, hereby submits this supplemental report in support of the Division of Enforcement of the United States Securities and Exchange Commission in the above-captioned matter. Subsequent to the issuance of my report on August 26, 2016, I received a copy of the report of Colin Linsley PhD, CPA, CVA ("Linsley" or "Dr. Linsley") dated August 22, 2016. I have been asked to review and respond to the Linsley Report.

Dr. Linsley stated the following opinions with regard to standard revenue recognition requirements:

"Thus in my view, all four conditions that constitute realized and realizable as given in SAB 104 were met by December 31, 2009. The correct application of GAAP, in my judgement, is to record cash and receivables totalling \$366,000 and to record revenue of \$366,000."¹

"...it is my professional opinion that delivery has occurred."²

"In my judgement it is reasonable to view the BIEL warehouse as the "site specified by the customer." There were important business and regulatory compliance reasons for both YESDTC and eMarkets to chose (sic) the BIEL warehouse as an intermediate site. Had they specified a third-party site other than BIEL, there would seem to be no concern that delivery had occurred. But clearly there is no obvious good reason to pay the cost of shipping to another third-party compliant warehouse and then again to the final customer when BIEL was willing and able to be the intermediate site."³

Dr. Linsley stated the following opinions with regard to bill and hold revenue recognition requirements:

¹ See Linsley report dated August 22, 2016, page 8.

² Ibid.

³ Ibid.

“Conditions 1-3, and 5-7 have all been considered above, and representations make clear that all have been satisfied. [FN - I note that I have not seen a specific statement that the YesDTC inventory was segregated.]”⁴

“Even if the goods were never shipped, given the facts specific to YesDTC and eMarkets, this would not be an indication that a sale had not taken place.”⁵

Dr. Linsley stated the following opinions with regard to materiality:

“...it is not possible, in my judgement, to see that the recording of \$366,000 of revenue as anything that would change a reasonable investor to reach a conclusion other than that BIEL was a company in very serious financial trouble. As such, in the context of BIEL as at December 31, 2009, the \$366,000 of revenue is not material.”⁶

As discussed below, I disagree with each of these opinions and with Dr. Linsley's overall conclusions. Dr. Linsley's opinions are flawed and based on numerous erroneous and unsupported assumptions.

A. Rebuttal of Linsley Opinions

1. Contemporaneous documentation is an important factor in evaluating the substance of a transaction in conformity with GAAP. To establish that a transaction complies with GAAP, an auditor (and the company controller or CFO who is reporting the transaction) does not just accept representations of management for sales transactions. Professional skepticism is required to consider whether corroborating documentation exists that was exchanged in the ordinary course of business. Under generally accepted auditing standards, an auditor should ordinarily presume that there is a risk of material misstatement due to fraud for revenue since it is considered a high risk financial

⁴ See Linsley Report dated August 22, 2016, page 9.

⁵ See Linsley Report dated August 22, 2016, page 9.

⁶ See Linsley Report dated August 22, 2016, page 13.

statement area, particularly with respect to transactions at the end of the year.⁷ Dr. Linsley's report is based largely on reliance of post-transaction declarations and testimony from various parties involved in the transactions (i.e., BioElectronics, YesDTC and eMarkets). These declarations were generated after the December 31, 2009 year-end. Dr. Lindsey's report does not appear to give consideration to contemporaneous evidence, or the lack thereof, of sales documentation exchanged between the parties in the ordinary course of business, at and before the time the company recorded the transactions with YesDTC and eMarkets.

2. In Dr. Linsley's assessment of the **YesDTC** transaction, he does not consider the impact of the contractual requirement by YesDTC to obtain regulatory clearance in Japan. As stated in Section 1 of the YesDTC Distributor Agreement, "Should Distributor [YesDTC] be unable to gain regulatory clearance within six months of contract execution, this agreement is voidable at the option of Distributor." SAB 101 specifically addresses the existence of additional obligations that could preclude revenue recognition until completion of these requirements; see paragraph 1, question 1. The existence of this contractual obligation precluded revenue recognition until (a) lapse of the six month period or (b) receipt of regulatory Japanese clearance.

⁷ See AU Section 316 –Consideration of Fraud in a Financial Statement, para 41 – A Presumption That Improper Revenue Recognition is a Fraud Risk, "Material misstatements due to fraudulent financial reporting often result from an overstatement of revenues (for example, through premature revenue recognition or recording fictitious revenues) or an understatement of revenues (for example, through improperly shifting revenues to a later period). Therefore, the auditor should ordinarily presume that there is a risk of material misstatement due to fraud relating to revenue recognition.

3. In Dr. Linsley's assessment of the **YesDTC** transaction under the persuasive evidence of an arrangement criteria, he relies on the Distributor Agreement, a \$100,000 payment and the Company's Bill and Hold memo as evidence to support the standard revenue recognition criteria. However, Dr. Linsley fails to appropriately consider all elements and clauses included within the Distributor Agreement. He does not address section 6 of the Agreement that mandates that YesDTC notify BIEL, via electronic communication, of the number of units needed on a monthly basis and BIEL's acknowledgement of receipt of the orders. Dr. Linsley did not consider or review any evidence to support the existence of written (and acknowledged) orders that would qualify this transaction as meeting the standard revenue recognition criteria.

4. Dr. Linsley relies on the \$219,000 payment and the Company's Bill and Hold memo as evidence to support that the **eMarkets** transaction met the persuasive evidence of an arrangement criteria. As with YesDTC, Dr. Linsley fails to consider all elements and clauses included in the Distributor Agreement. As stated in section 4.1, the Distributor [eMarkets] must submit orders in writing to the Company; only those orders accepted and confirmed in writing by the Company will be 'deemed valid and binding on the Parties.' There is no evidence in Dr. Linsley's report that he reviewed any orders from eMarkets for the purchase of BIEL products.

5. Dr. Linsley states in his report that title of the goods for the **eMarkets** transaction transferred to eMarkets as of December 31, 2009. This determination was based on investigative testimony from Mary Whelan. However, he fails to address the lack of contemporaneous documents that may have supported his finding that eMarkets agreed to take title of BIEL products by the end of 2009. He also did not consider investigative testimony from Mary Whelan where she acknowledges that she did not insure the goods she purchased. The lack of contemporaneous evidence of title transfer and lack of insurance raises questions as to whether title of the goods indeed passed to eMarkets as of December 31, 2009. Both the lack of evidence of orders placed and accepted (as highlighted above) and the lack of evidence to support title transfer precluded the transaction from meeting the standard revenue recognition guidance. In addition, by accepting and adopting Mary Whelan's testimony, in the absence of supporting contemporaneous documentary evidence, Dr. Linsley does not appear to treat such after-the-fact testimony by a related party (the sister of BIEL's CEO) with sufficient professional skepticism.

6. Although SAB 101 makes reference to the use of an intermediate or other location for delivery, it does not mean that that a reporting entity can designate the seller's own location as that site. The flawed logic used by Dr. Linsley misses the point of the delivery requirement. If this were the case, any business could generate fictitious 'sales' with customers in which the goods remain in its warehouse/storage facility with no actual delivery to the customer. The use of BIEL's warehouse

for both the YesDTC and eMarkets products resulted in no movement, and therefore, no delivery of the products. The use of the seller's site defeats the notion of delivery under standard revenue recognition criteria. Shipping product from the seller's premises is *essential* for demonstrating delivery as it confirms the validity of the transaction and overcomes the suspect nature of transactions like the ones involved in this proceeding. Dr. Linsley opines that delivery was determined to have occurred for both customers based on the notion of "shipment to a site other than the buyer's place of business." Dr. Linsley references SAB 104 and the ability for customers to specify a different (intermediate) site for delivery of the goods. Dr. Linsley apparently believes it reasonable to view the BioElectronics' warehouse as a 'site specified by the customer.' This is an incorrect and unsupported view of the requirements of SAB 104.

7. Dr. Linsley refers to new revenue recognition rules included in ASU 2014-09 and the 'need of improvement' for revenue recognition standards as of December 31, 2009. The standard, a joint effort between the International Accounting Standards Board and Financial Accounting Standards Board, was created to clarify the principles for recognizing revenue and to develop a common standard for both US GAAP and International Financial Reporting Standards. The standard was released in May 2014 and is not effective until years beginning after December 2016 for public companies and December 2017/2018 for private companies. The new standard is totally irrelevant to the GAAP requirements that BIEL was required to apply for the 2009 bill

and hold transactions. In 2009, SAB 101 and ASC 605 were the required standards for revenue recognition.

8. When opining that the transactions were not material, Dr. Linsley disregards the Company's restatement of the 2009 bill and hold transactions in its December 31, 2010 Financial Statements. BIEL's restatement of the bill and hold transactions confirms the error in the recognition of these items as revenue in 2009. It also validates the materiality of these items to the 2009 financial statements. If the Company had assessed these items as immaterial, a restatement would not have been required under GAAP. Dr. Linsley also ignores the importance of these domestic and international distribution agreements to the growth and ultimate profitability of the company.⁸

* * * * *

This supplemental report summarizes my conclusions and opinions based on the work I have performed to date. This report should be read in conjunction with my prior report dated August 26, 2016. My review of materials relevant to this case is ongoing. As such, to the extent new or additional issues, documents or testimony come to my attention that were not considered in the preparation of this supplemental report (such as additional document

⁸ Refer to the 2009 10-K, Item 7 – Management's Discussion & Analysis of Financial Condition & Results of Operation - Introduction page 17, "The international market is expected to further expand going forward and to eventually constitute two-thirds of our total sales." Refer also to the Item 7 – Results of Operations – Year Ended December 31, 2009 Compared to Year Ended December 31, 2008, page 20 and 21, "International sales increased by approximately \$147,000 in 2009 from 2008 as a result of new distributorship agreements signed in 2009...Veterinary revenues of \$271,047 were recorded in connection with a distribution agreement signed....".

production, deposition testimony, etc.), I may modify this report as necessary. I also may provide further rebuttal to the reports, opinions and testimony of the defendants and their experts, if any. Additional exhibits, charts, summaries or other demonstrative material may be used at trial. The procedures discussed herein were performed solely for the information of legal counsel and assistance with respect to the referenced matter. This report is done solely for this litigation and is not to be reproduced, distributed, disclosed or used for any other purpose with the prior written consent of PricewaterhouseCoopers LLP.

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A handwritten signature in black ink, appearing to read "A. Vondra", written in a cursive style.

By: Albert A. Vondra, CPA, JD, CFE, CFF

September 14, 2016