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Report on

2012 Inspection of KGS LLP
(Headquartered in Jericho, New York)

Issued by the

Public Company Accounting Oversight Board

October 1, 2013

THIS IS A PUBLIC VERSION OF A PCAOB INSPECTION REPORT

PORTIONS OF THE COMPLETE REPORT ARE OMITTED FROM THIS DOCUMENT IN ORDER TO COMPLY WITH SECTIONS 104(g)(2) AND 105(b)(5)(A) OF THE SARBANES-OXLEY ACT OF 2002

PCAOB RELEASE NO. 104-2013-214

Notes Concerning this Report

1. Portions of this report may describe deficiencies or potential deficiencies in the systems, policies, procedures, practices, or conduct of the firm that is the subject of this report. The express inclusion of certain deficiencies and potential deficiencies, however, should not be construed to support any negative inference that any other aspect of the firm's systems, policies, procedures, practices, or conduct is approved or condoned by the Board or judged by the Board to comply with laws, rules, and professional standards.

2. Any references in this report to violations or potential violations of law, rules, or professional standards are not a result of an adversarial adjudicative process and do not constitute conclusive findings of fact or of violations for purposes of imposing legal liability. Similarly, any description herein of a firm's cooperation in addressing issues constructively should not be construed, and is not construed by the Board, as an admission, for purposes of potential legal liability, of any violation.

3. Board inspections encompass, among other things, whether the firm has failed to identify financial statement misstatements, including failures to comply with Securities and Exchange Commission ("SEC" or "Commission") disclosure requirements, in its audits of financial statements. This report's descriptions of any such auditing failures necessarily involve descriptions of the apparent misstatements or disclosure departures. The Board, however, has no authority to prescribe the form or content of an issuer's financial statements. That authority, and the authority to make binding determinations concerning whether an issuer's financial statements are misstated or fail to comply with Commission disclosure requirements, rests with the Commission. Any description, in this report, of financial statement misstatements or failures to comply with Commission disclosure requirements should not be understood as an indication that the Commission has considered or made any determination regarding these issues unless otherwise expressly stated.

PCAOB Release No. 104-2013-214

2012 INSPECTION OF KGS LLP

In 2012, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm KGS LLP ("the Firm"). The Board is issuing this report of that inspection in accordance with the requirements of the Sarbanes-Oxley Act of 2002 ("the Act").

The Board is making portions of the report publicly available. Specifically, the Board is releasing to the public Part I of the report and portions of Part IV of the report. Part IV of the report consists of the Firm's comments, if any, on a draft of the report.[1/]

The Board has elsewhere described in detail its approach to making inspection-related information publicly available consistent with legal restrictions.[2/] A substantial portion of the Board's criticisms of a firm (specifically criticisms of the firm's quality control system), and the Board's dialogue with the firm about those criticisms, occurs out of public view, unless the firm fails to make progress to the Board's satisfaction in addressing those criticisms. In addition, the Board generally does not disclose otherwise nonpublic information, learned through inspections, about the firm or its clients. Accordingly, information in those categories generally does not appear in the publicly available portion of an inspection report.

1/ The Board does not make public any of a firm's comments that address a nonpublic portion of the report unless a firm specifically requests otherwise. In addition, pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(b), if a firm requests, and the Board grants, confidential treatment for any of the firm's comments on a draft report, the Board does not include those comments in the final report at all. The Board routinely grants confidential treatment, if requested, for any portion of a firm's response that addresses any point in the draft that the Board omits from, or any inaccurate statement in the draft that the Board corrects in, the final report.

2/ See Statement Concerning the Issuance of Inspection Reports, PCAOB Release No. 104-2004-001 (August 26, 2004).

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's inspection staff ("the inspection team") conducted primary procedures for the inspection from November 12, 2012 to November 15, 2012. These procedures were tailored to the nature of the Firm, certain aspects of which the inspection team understood at the outset of the inspection to be as follows:

Number of offices	1 (Jericho, New York)
Ownership structure	Limited liability partnership
Number of partners	3
Number of professional staff[3/]	6
Number of issuer audit clients[4/]	None at the outset of the inspection; however, the Firm had issued at least one audit report with respect to an issuer since the preceding inspection

[3/] "Professional staff" includes all personnel of the Firm, except partners or shareholders and administrative support personnel. The number of partners and professional staff is provided here as an indication of the size of the Firm, and does not necessarily represent the number of the Firm's professionals who participate in audits of issuers or are "associated persons" (as defined in the Act) of the Firm.

[4/] The number of issuer audit clients shown here is based on the Firm's self-reporting and the inspection team's review of certain information for inspection planning purposes. It does not reflect any Board determination concerning which, or how many, of the Firm's audit clients are "issuers" as defined in the Act. In some circumstances, a Board inspection may include a review of a firm's audit of financial statements and internal control over financial reporting ("ICFR") of an issuer that ceased to be an audit client before the inspection, and any such former clients are not included in the number shown here.

Board inspections are designed to identify and address weaknesses and deficiencies related to how a firm conducts audits.[5/] To achieve that goal, Board inspections include reviews of certain aspects of selected audits performed by the firm and reviews of other matters related to the firm's quality control system.

In the course of reviewing aspects of selected audits, an inspection may identify ways in which a particular audit is deficient, including failures by the firm to identify, or to address appropriately, respects in which an issuer's financial statements do not present fairly the financial position, results of operations, or cash flows of the issuer in conformity with Generally Accepted Accounting Principles ("GAAP").[6/] It is not the purpose of an inspection, however, to review all of a firm's audits or to identify every respect in which a reviewed audit is deficient. Accordingly, a Board inspection report should not be understood to provide any assurance that the firm's audits, or its issuer clients' financial statements or reporting on internal control, are free of any deficiencies not specifically described in an inspection report.

In addition, inclusion of a deficiency in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. Under PCAOB standards, when audit deficiencies are discovered after the date of the audit report, a firm must take appropriate action to assess the importance of the deficiencies to the firm's present ability to support its previously expressed audit opinions.[7/] Depending upon the circumstances, compliance with these standards may

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[5/] This focus on weaknesses and deficiencies necessarily carries through to reports on inspections and, accordingly, Board inspection reports are not intended to serve as balanced report cards or overall rating tools.

[6/] When it comes to the Board's attention that an issuer's financial statements appear not to present fairly, in a material respect, the financial position, results of operations, or cash flows of the issuer in conformity with GAAP, the Board's practice is to report that information to the SEC, which has jurisdiction to determine proper accounting in issuers' financial statements.

[7/] See AU 390, *Consideration of Omitted Procedures After the Report Date,* and AU 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* (both included among the PCAOB's interim auditing standards, pursuant to PCAOB Rule 3200T), and PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over* require the firm to perform additional audit procedures, or to inform a client of the need for changes to its financial statements or reporting on internal control, or to take steps to prevent reliance on previously expressed audit opinions. A Board inspection does not typically include review of a firm's actions to address deficiencies identified in that inspection, but the Board expects that firms are attempting to take appropriate action, and firms frequently represent that they have taken, are taking, or will take, action. If, through subsequent inspections or other processes, the Board determines that the firm failed to take appropriate action, that failure may be grounds for a Board disciplinary sanction.

A. Review of Audit Engagement

The inspection procedures included a review of aspects of the Firm's auditing of financial statements of one issuer. The scope of this review was determined according to the Board's criteria, and the Firm was not allowed an opportunity to limit or influence the scope.

The inspection team identified what it considered to be audit deficiencies. The deficiencies included failures by the Firm to perform, or to perform sufficiently, certain necessary audit procedures.

In some cases, an inspection team's observation that a firm failed to perform a procedure may be based on the absence of documentation and the absence of persuasive other evidence, even if a firm claims to have performed the procedure. PCAOB Auditing Standard No. 3, *Audit Documentation* ("AS No. 3"), provides that, in various circumstances including PCAOB inspections, a firm that has not adequately documented that it performed a procedure, obtained evidence, or reached an appropriate conclusion must demonstrate with persuasive other evidence that it did so, and that oral assertions and explanations alone do not constitute persuasive other evidence. See AS No. 3, paragraph 9 and Appendix A to AS No. 3, paragraph A28. For purposes of the inspection, an observation that the Firm did not perform a procedure, obtain evidence, or reach an appropriate conclusion may be based on the absence of such documentation and the absence of persuasive other evidence.

Financial Reporting That Is Integrated with An Audit of Financial Statements ("AS No. 5"), ¶ 98.

The deficiencies identified in the audit reviewed included deficiencies of such significance that it appeared to the inspection team that the Firm, at the time it issued its audit report, had not obtained sufficient appropriate audit evidence to support its opinion on the issuer's financial statements. Those deficiencies were –

(1) the failure to perform sufficient procedures to test the existence and valuation of revenue, including the inadequate performance of substantive analytical procedures;

(2) the failure to perform sufficient procedures to test the valuation of the reserve for cooperative advertising; and

(3) the failure to perform sufficient procedures to test the valuation of the reserve for sales returns.

B. Review of Quality Control System

In addition to evaluating the quality of the audit work performed on a specific audit, the inspection included review of certain of the Firm's practices, policies, and procedures related to audit quality. This review addressed practices, policies, and procedures concerning audit performance, training, compliance with independence standards, client acceptance and retention, and the establishment of policies and procedures. Any defects in, or criticisms of, the Firm's quality control system are discussed in the nonpublic portion of this report and will remain nonpublic unless the Firm fails to address them to the Board's satisfaction within 12 months of the date of this report.

END OF PART I

PARTS II AND III OF THIS REPORT ARE NONPUBLIC
AND ARE OMITTED FROM THIS PUBLIC DOCUMENT

PART IV

RESPONSE OF THE FIRM TO DRAFT INSPECTION REPORT

Pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(a), the Firm provided a written response to a draft of this report. Pursuant to section 104(f) of the Act and PCAOB Rule 4007(b), the Firm's response, minus any portion granted confidential treatment, is attached hereto and made part of this final inspection report.[8/]

[8/] In any version of an inspection report that the Board makes publicly available, any portions of a firm's response that address nonpublic portions of the report are omitted. In some cases, the result may be that none of a firm's response is made publicly available.

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PUBLIC RESPONSE

June 24, 2013

Public Company Accounting Oversight Board
1666 K Street
Washington, DC 20006

To Whom It May Concern:

We have reviewed the Draft Report of Inspection of the PCAOB.

Although we do not agree with the conclusion reached by the inspection team that "the Firm, at the time it issued its audit report, had not obtained sufficient appropriate audit evidence to support its opinion on the issuer's financial statements"; in the future we will document the thought processes of our 1) expectations, 2) assumptions, and 3) conclusions, to clearly show why we performed the procedures we performed, what our conclusions from the results of those procedures were, and why we feel the conclusions are justified. The documentation will enable an independent third party to fully understand the steps taken and conclusions reached in our audits and demonstrate the gathering of sufficient audit evidence to support our opinions.

As expressed in our response to the comments from the PCAOB, we believe that the procedures we performed sufficiently tested the existence of revenue and that that our substantive analytical procedures were adequate. We provided the PCAOB staff with several tests that we performed during the interim quarters as well as showing them historical workpapers from prior year's audits which allowed us to determine certain expectations and analyze any variations from prior year's results. The company has been in business for 30 years and has operated fairly consistently over those years, so it was reasonable for us to use prior years' results to form the current year's expectations. We also disagree that we did not perform sufficient procedures to test the Issuer's valuation of Reserves for Cooperative Advertising and Sales Returns. Our analysis in prior years, averages several years' worth of data to understand how certain reserves are arrived at by the issuer and based on our understanding of the results of the many years of audits we performed on the company and discussions with the issuer's Chief Financial Officer and several other staff, we determined that the calculation of their reserves was reasonable and any additional procedures we might perform, in addition to the testing we did perform in the current year, would not result in any material adjustment. We believe the tests we did perform in the current year along with our historical analysis from prior years allowed us to properly arrive at our opinion. Below we discuss each of the deficiencies specifically and explain why we believe that we had sufficient audit evidence to support our opinion.

Existence and Valuation of Revenue:
As part of the planning stage, KGS LLP, the "Firm", considered the audit procedures that would be best suited for auditing revenue, and concluded that performing substantive analytical procedures would have a better result than a test of details. The Practitioners Publishing Company ("PPC") PCAOB audit program lists specific analytical procedures to be performed related to revenue. The Firm uses the PPC PCAOB audit program in gathering sufficient audit evidence to support the assertions of existence, completeness and cut-off for revenue.

The audit program calls for performing the following substantive analytical procedures:

1. Compare amounts to those of prior periods by product line, geographic location and in total (Exhibit A).
2. Compare monthly and quarterly amounts to amounts for the period in the current and prior year. (Exhibit B and C).
3. Compare actual amounts to budgeted amounts by product line, geographic location and in total (Exhibit D).
4. Investigate any unexpected results, considering known changes in the client or industry operations or business conditions, such as price and volume changes, seasonal fluctuations, trends, etc. (Exhibit A, B, C & D).

We obtained the company's product sales forecast that reflected approximately $62.4 million for 2011 (Exhibit D). This forecast for 2011 of $62.4 million was consistent with the actual results of $64.4 million for 2010. In addition we compared the gross profits over a 4 year period and explained large fluctuations (Exhibit E), sales from the top 10 customers for 2011 & 2010 and noted that approximately 75% of the revenues come from mainly the same customers in both years (Exhibit F). Our expectations therefore for the current year's results was that the gross profit would also stay consistent, as had been the case in prior years.

Issuer A's sales department prepared flexible sales forecasts which were updated monthly (Exhibit D). As part of our planning process we obtained the August forecast (updated through July) and reviewed their forecasted annual sales by product line, checking on a random basis that the prices used in their forecast were in-line with their published price list and that the mathematical calculation of sales based on the units being sold was correct. We also confirmed that the 6 months sales per the forecast were approximately equal to the actual gross sales for that period, as well as that the forecasted sales through August were approximately equal to the gross sales reported through August. The sales forecasts reflected the actual units sold by SKU through July and projected sales for the balance of the fiscal year.

In addition, we performed various test work with regard to the cost of sales by auditing the beginning and ending inventory (Exhibit G) and performing purchase cut-off procedures (Exhibit H) on a quarterly basis to verify that purchases were recorded accurately throughout the year. Based on our testing, as well as the internal SOX report performed by external auditors for the year 2011 (Exhibit I), which did not mention any exceptions with regard to purchases and cost of sales, we determined that the Company properly classified and recorded the cost of sales. For the inventory cost test we verified approximately 12% of the inventory cost by tracing the various components of items to the respective invoices and receiving documents. We also looked at the gross profit percentage on a quarterly and annual basis and investigated and documented any unexpected fluctuations (Exhibits A, B, C, E, & J).

As part of our cost of sales analytics, we tested the costs of various products, tracing to the actual delivery receipts and invoices from the vendors (Exhibit G). We also compared the product of a) the average cost of sales per unit for 6 different product lines and b) the units sold per the Production Forecasts, and compared it to the cost of sales for those product lines as per Issuer A's trial balance. The test accounted for approximately $13.3 million of cost of sales, representing approximately 65% of the total cost of sales (Exhibit K), and the results were comparable. With the use of this information, we then calculated the Gross Profit percentage for each of those 6 product lines and found it to be consistent with our expectations based on prior years and prior quarters. Therefore based on the result of the substantive analytic procedures performed we were able to conclude that the revenue had been recorded properly.

In performing our substantive analytics, our walkthrough procedures, and reviewing the internal SOX report, we concluded that we had an adequate understanding of their internal controls and the way that Issuer A processes transactions, sufficient to form a predictive expectation regarding revenue, cost of sales and gross profit.

Additionally, we performed audit procedures during the course of the year as part of our quarterly reviews of the issuer's Form 10Q's, which included sales cut-off (Exhibit L), purchase cut-off (Exhibit H), and analytical procedures (Exhibit J). Each quarter we evaluated the revenue stream by product line by comparing the actual revenues for the quarter and year to date to the same periods in the prior year and investigated any unexpected results. Any unexpected results by revenue stream are explained based on increases and decrease in customer purchasing trends (Exhibit J).

For our sales cut-off procedures, which were performed quarterly and at year-end, we took a sample of sales transaction immediately before and after the period end and agreed them to the invoice, shipping documentation and general ledger to determine that the sales did indeed take place and that it was recorded in the proper period. On a quarterly basis (Exhibit L) we looked at 20 transactions each quarter and at year-end (Exhibit M) we looked at 40 transactions.

Making use of this test of transactions and the SOX report, when we performed the roll-forward procedures (Exhibit N) we traced to the invoice, rather than other supporting documentation. This allowed us to verify the sales transactions, since we did not find any exceptions when performing the sales cut-off testing and nothing was noted in their SOX report.

In testing the accounts receivable for existence, we used the representative sample approach to the testing of the September 30, 2011 accounts receivable balance of $8,504,688 (Exhibit O). This meets the assertion of existence for the entire balance and therefore the entire balance, and not just the test selections, should be included in the percentage of revenue tested.

Therefore the testing of transactions, roll-forward procedures and confirmation procedures resulted in our substantiating approximately 34.5% of revenue as opposed to the "5%" referenced in the report.

The firm reviewed the journal entries for the year, including making a selection of entries for testing (Exhibit P), to determine if there were any entries that were made that would have had an effect on revenue, cost of sales or gross profit that were not supported. None were noted.

We believe that the expectations we developed based on our various analyses were precise enough to provide the necessary level of assurance that any material differences would be identified and that we obtained adequate corroboration of any significant differences. The testing we do throughout the year as well as the testing done by their independent consultant who issued their SOX report adequately tested the completeness and accuracy of the system generated information used in our testing procedures. Therefore, since we verified the existence of 34.5% of the sales, performed substantive analytics and testing on the cost of sales to ascertain its accuracy, and performed substantive analytics with regard to the gross profit percentage; we believe that we obtained sufficient data (based on the fact that the cost of sales divided by the gross profit percentage would equal the sales) to determine that the sales were properly recorded in 2011.

Valuation of the Reserve for Cooperative Advertising:

The Reserve for Cooperative Advertising actually consisted of two different calculations. In 2010, the company changed its co-op advertising policy where it entered into contracts with customers for specified dollar amounts and there was no longer a general co-op advertising portion. In prior years, the company would enter into some contracts but also have a general co-op advertising budget from which they would run certain advertising programs with its customers. It was this general co-op that was reserved against by the company in the prior years as they were not sure if the customers would run all of the programs originally anticipated. The reserves established on the initial co-op amounts were based on their past experience and the original reserve would be reduced by any credits submitted during the year with the remaining balance continuing to be reserved until it was determined that there would no longer be any claims for co-op submitted against a particular prior year. Historically, 80% - 90% of the co-op was utilized within the first two years. The Company's ability to forecast the true co-op that would actually be claimed was reasonably accurate as shown by having approximately 1.75% still open after 5 years with regard to 2007 and approximately 1% still open after 4 years with regard to 2008. Our analysis in 2010 (Exhibit Q) showed that although claims were still submitted in the 4th and 5th years, the percentage of the original co-op submitted after 3 years was negligible. It was the 2010 analysis that we used to help reach our conclusion that the valuation of the reserve for advertising was adequate. For 2011 and 2010, the $2.7 million in open co-op, represented specific contracts that were still open on advertising run by the customer but for which they had not submitted sufficient support to the company in order to take the credit.

Since the company has a legal liability to honor the balance of these contracts, and the Company "trued up" the balances for 2010 and 2011 with their customers on a quarterly basis, it was concluded that these contracts would all be claimed and should be valued at 100%. The open contracts from years 2007-2009 were based on the contracts audited in those years which included testing a sample of the contracts and the credits taken in that year to the actual receipts from the customers claiming the applicable credit. A reserve was placed on the "estimated" portion of the open contracts. Any co-op not claimed after 5 years would be picked up as income in the 6th year. Our analysis in 2010 showed that there were still claims submitted in the 3rd, 4th, and 5th years after the contracts were entered into, so the balances representing 1-1.75% still outstanding for 2007 and 2008 seemed reasonable, as does the 6.25% still outstanding for 2009 after 2 years. The Inspection Team's comment refers to testing the validity of the total open contracts for each year, but that does not seem appropriate since the Company never expected to have to honor those open contracts and there was no identifiable evidence that a liability existed. Based on our 2010 analysis, the possibility that the "Reduction" amounts would be claimed four to five years hence was remote.

From a "professional skepticism" prospective, we believed that there was little chance that the Company would overstate its liabilities/reserves since it had motivation in both 2010 and 2011 to show as much earnings as possible. 2010 represented the last year of the employment contracts of the Founding shareholders whereby they received a bonus based on profits, so the motivation in 2010 would have been to maximize those profits not to overstate an estimated liability/reserve. Contrastingly, with the Founders stepping down, management had an incentive to show their own capabilities by showing good numbers in 2011.

The history of the Issuer's estimate of the amount of open co-op that would never be claimed and our analysis of the amounts ultimately under or overstated allowed us to evaluate the assumptions they used to determine the estimated percentage of the original cooperative advertising that would not be claimed. The comment that we did not test the changes recorded to contract balances related to the open contracts from the prior four years is not relevant since there were no specific changes and those that might have been made are simply part of the reserve to begin with. We believe the analysis done in 2010 which we relied upon in our 2011 audit provided sufficient procedures to test the valuation of the reserve for cooperative advertising and to conclude that based on our analysis, the possible overstatement of the 2007-2009 open co-op would have fallen below our materiality threshold.

Valuation for the Reserve for Sales Returns:

The calculation for the Reserve for Sales Returns is based on the historical % of returns applied to the sales for the 5 month period preceding the year end after applying an adjustment for the cost of those returns which would be put back into inventory. The assumptions used by the Company are based on many years of history and have been consistently applied over the years. Issuer A's estimates are not performed every year but are tested within a 3 year period. The procedures performed, relating to the 2011 audit, were actually performed during the 2010 audit. Since the Company's business has stayed consistent over many years and the "5 month" parameter has been used by them for close to 20 years, it was determined that it was not necessary to test the 5 month methodology for determining the reserve for returns every year. Instead, every couple of years, the 5 months of sales is tested to determine if it still is the appropriate methodology for determining the year-end reserve for returns. Since we look at a 4 year average to analyze the reasonableness, a fluctuation in any one year would not alter our conclusion. Prior to actually testing the validity themselves, Issuer A began using the "5 month" standard 20 years ago based on a conversation with the CFO of Revlon's parent company that they used that at the time as the basis for their own estimate for calculating their reserve for returns.

Based on the testing that was done in 2010 (Exhibit R), it was determined that by using the 5 months of sales, there was the smallest deviation between the highest and lowest return percentage over a 4 year period. This showed them that the "5 month" period was still the best parameter to use. Over the past 3 years, the overall sales returns and certain allowances have been between 10.1% to 11.6% of gross sales, demonstrating the consistency of their returns over the years. The years where the returns were slightly higher was due to recalls and various markdown contracts that were entered into by the company with certain customers rather than getting returns from those customers.

Using the average return percentage over the prior 12 months and applying it to the sales of the 5 months prior to year end best represents the estimate of what the returns would be. If the Company used a shorter period (i.e. only one to three months) the return % as a basis for calculating the amount of returns would subject its estimate to anomalies found in using a random short period. Similarly, using the return percentage of only the last 5 months would cause the Company to base its reserve on historical information for a portion of the year that was not necessarily representative of the 5 months subsequent to year end. If they chose to simply use the historical percentage for the 5 months subsequent to the prior year end, although more representative of seasonal changes, it would not take into account the more current "sell through" of its products as of year end and any new trends being affected by new product launches or consumer preferences. Therefore, averaging the returns over the entire year seemed to provide the best percentage to apply to the 5 month worth of sales. The actual return as recorded on the books were deemed to be accurate based on the testing we performed quarterly of credits being issued and the substantive A/R testing performed at year end, as well as the analysis of the fact that the % was consistent with our expectations based on prior years.

The 5 months which has consistently been used over the years has resulted in a predictive return percentage over those years. Since other possible cumulative sales periods resulted in larger possible variances in the return analysis, which would cause the calculation to be less reliable, it was determined that 5 months still represented the best estimate of the time lag between most of the sales and any possible returns. The 12 month average percentage which takes into account the seasonality and current trend of the returns and the 5 month period seem to be the most accurate factors to use.

Based on our understanding of the methodology used to determine the reserve for returns and the reasoning behind the factors used which were consistent with prior years, we believe that the reserve sufficiently represented the net cost of the actual returns that Issuer A would get back for sales that took place prior to year end.

We believe that the Inspection Team reached their conclusion, in part, due to concentrating on reviewing the revenue section of our year end workpapers when many of the schedules included in our exhibits were actually found in other sections or other periods. Due to Hurricane Sandy, and the necessity for the team to stay at a hotel about a half hour to an hour away and being subjected to poor weather conditions making travelling difficult, the Team opted to do much of their work remotely. We therefore did not always realize what they were looking at and what they felt they were missing. We thought the information they found was adequate and when they informed us that they believed there were deficiencies we told them about the workpapers they had most likely not seen. We were prepared to present those workpapers at our conference call at the end of the Inspection but were told that the call was just to discuss the procedures from that point forward and that we would need to submit any additional documents with our response to the comments. The exhibits submitted herewith were submitted with our responses, but we believe the team had already concluded that the audit evidence was lacking and could not properly reevaluate the value of the newly presented workpapers without having someone from the audit team walk them through the thought process, assumptions, and conclusions arrived at. Had we had time to present the papers during the inspection and sit with the Team we believe they would have arrived at a different conclusion. Unfortunately, Hurricane Sandy prevented this from happening.

Very truly yours,

Mitchell Kahn
Managing Member