Schick Technologies
(Now called Sirona Dental Systems)

Assignment:

1. Read through the attached Securities and Exchange Commission civil complaint against Schick Technologies, Inc. I have removed certain irrelevant portions of the complaint to condense it down to 20+ pages. You will note the complaint covers about every kind of revenue reporting problem that we have discussed. Do a quick summary of the different type of revenue reporting issues they had.

2. Your job is to go to the web and do a search about the out come of this complaint. What year did it finally conclude and what was the final enforcement action?

3. There was also a securities class action suit brought by nine shareholders against Schick. Do a search for the outcome of that litigation. What year was it settled?

4. Summarize your findings. Why does it take so long for litigation of this type to settle?

NOTE: Some ideas on where to search for information on this company.

- ✓ **Google Schick Technologies.**
- ✓ **Google <u>http://securities.stanford.edu</u> – this is a class action clearing house.**
- ✓ **Google the U.S. Securities and Exchange Commission and do a search on their site for the complaint.**

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UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

Securities and Exchange Commission,	
Plaintiff,	
v.	CV-03-5766 (CBA) (ASC)
SCHICK TECHNOLOGIES, INC., DAVID B. SCHICK and FRED LEVINE,	
Defendants.	

COMPLAINT

Plaintiff Securities and Exchange Commission ("Commission"), for its Complaint against defendants Schick Technologies, Inc. ("STI" or the "Company"), David B. Schick ("Schick") and Fred Levine ("Levine") (collectively, the "Defendants"), alleges as follows:

SUMMARY OF ALLEGATIONS

1. This action concerns a financial reporting fraud perpetrated in 1998 and 1999 by defendant STI, a manufacturer of dental and medical devices, and two of its officers and directors: Defendant Schick, STI's co-founder, chairman, chief executive officer and former president, and defendant Levine, STI's former vice-president of sales and marketing and a former director. The fraud, which led to two restatements, materially affected STI's financial results as reported in Forms 10-Q filed for the quarters ended June 30, September 30 and December 31, 1998, which represented, respectively, the first, second and third quarters of STI's fiscal year ("FY") 1999. The fraud also infected the first restatement, reported in February 1999 (the "First Restatement"), which had reduced revenues for the June and September 1998 quarters by 22 percent and 4 percent, respectively. Overall, Defendants falsely inflated the Company's

revenues in the June, September and December 1998 quarters by 35 percent, 14 percent and 9 percent, respectively.

2. Defendants accomplished the fraud by (i) recording as sales the shipment of product to customers on a trial basis with the express understanding that the customer had no obligation to purchase; (ii) recording consignment shipments as sales; (iii) recording outright bogus sales; (iv) recording sales upon shipment of product to a warehouse leased by the Company; and (v) not recognizing the massive product returns that were occurring. Schick and Levine also misled STI's independent auditors (the "Auditors") by failing to disclose the true nature of two promotional programs under which customers had no obligation to purchase product, by failing to disclose the true facts concerning product shipments to a warehouse and by procuring a false audit confirmation in at least one instance.

3. In mid-1999, at the Auditors' request, STI's audit committee (the "Audit Committee") commissioned an internal investigation that concluded that the First Restatement still materially misstated the Company's financial results for the June and September 1998 quarters. The Auditors formally resigned in August 1999. In September 1999, STI announced that it would restate its financial results for the December 1998 quarter and restate for a second time its results for the June and September 1998 quarters (the "Second Restatement"). STI filed the amended quarterly reports in March 2000. The Second Restatement further reduced revenues for the June and September 1998 quarters by 13 and 9 percent, respectively, and reduced December quarter revenues by 9 percent. Following the First Restatement, the market price of STI stock fell approximately 24 percent, from $5.25 to $4.00. By the time the Second Restatement was announced on September 2, 1999, the stock price had declined to $2.125.

THE DEFENDANTS

9. **STI** is a Delaware corporation with headquarters in Long Island City, NY. It commenced operations in 1992 and is a manufacturer and distributor of digital radiographic imaging systems and devices for the dental and medical markets. STI's common stock is registered with the Commission pursuant to Section 12(g) of the Exchange Act. From the time of its initial public offering on July 1, 1997 ("IPO") until September 15, 1999, STI traded on the NASDAQ. The NASDAQ delisted STI on September 15, 1999, and its common stock was thereafter quoted in the National Quotation Bureau's "pink sheets" until January 29, 2002. Since then, it has been quoted on the OTC bulletin board. According to STI's FY 1999 Form 10-K, STI had 10,136,113 shares of common stock outstanding as of March 7, 2000.

BACKGROUND

12. STI develops, manufactures and markets digital radiographic imaging systems for the domestic and international dental and medical markets. In the relevant period, STI's product line was comprised of two FDA-approved products: the CDR system, a dental radiography device that operated in conjunction with a laptop computer, and the accuDEXA, a peripheral bone densitometer that measured bone density in the hand. The products were sold both by an STI sales force compensated primarily through sales commissions and by distributors. The CDR accounted for about 90% of the Company's FY 1998 reported sales.

13. During the relevant period, STI was controlled by Schick and a tight-knit inner circle, which included Levine. At the time, the Company did not have a chief financial officer. While STI's Director of Finance was nominally in charge of STI's accounting department, the Company's accounting decisions and practices were made and controlled by Schick. Schick was also the point person in dealings with market analysts and he took the lead in the quarterly conference calls announcing the Company's earnings and addressing future prospects. On the basis of analyst forecasts, Schick set the periodic sales goals for STI, which he relayed to Levine.

Overview of STI's Two Restatements

14. On December 10, 1998, just a few weeks after the Auditors had completed their work on the September quarter review, STI issued a press release announcing that the Company intended to write off $5 million in accounts receivable. The press release was prepared by

Schick and came as a surprise to the Auditors. As a result of the announcement, the Auditors undertook a closer examination of the Company's books, which eventually led to the First Restatement.

15. As the Auditors began their examination, they found that STI was awash in returned merchandise. Overall, the Auditors determined that at December 31, 1998, STI had received returns of about $6.2 million not reflected on its books - most relating to revenues recorded in the June, September and December 1998 quarters. About $2.7 million of this total was received or authorized by STI prior to its September 1998 Form 10-Q filing on November 16, 1998. None of this $2.7 million in returns was reflected in the September 1998 quarter filing.

16. On February 19, 1999, STI announced that it would restate its financial statements for the June and September 1998 quarters, which had been originally reported in the Company's Form 10-Qs filed on August 13 and November 16, 1998, respectively. This First Restatement was included in STI's Form 10-Q for the December 1998 quarter, filed on February 23, 1999.

17. On August 20, 1999, STI filed a request for an extension of time to file its Form 10-Q to allow additional time "to investigate possible improper recording or recognition of sales transactions during fiscal 1999." The following day, STI announced the resignations of Levine and another officer, who, along with Schick, ran STI's day-to-day business operations. Five days later, STI announced that the Auditors had resigned. On September 3, 1999, STI announced that it would restate its financial results for the quarter ended December 31, 1998, and that it would restate, for a second time, its financial results for the prior two quarters. Those amended quarterly reports, which included the Second Restatement, were filed on March 22 and 23, 2000, respectively. The Second Restatement reflected merchandise returns affecting the June, September and now December 1998 quarters totaling more than $3.1 million, which were in addition to those recorded in the First Restatement.

18. Although the restatements have a number of components, two of the major ones concerned revenues recorded on promotional programs under which the customer essentially was getting a free trial period with no obligation to buy. One promotion was the so-called "accuDEXA Loaner Program," which was the brainchild of Schick. The other promotion was called "Try and Buy" and related to the CDR product. While 347 accuDEXA units were shipped and recorded as revenue (amounting to about $4.6 million), 160 units were ultimately returned. Similarly, STI recognized revenue of $1.164 million from the "sale" of units in the "Try and Buy" program. However, customers returned more than half of the units recorded as sales. Moreover, to the extent customers eventually purchased product under the two programs, the revenues recognized on those sales were recognized prematurely, i.e., until the customer actually exercised its right to purchase, there was no sale.

19. From the time of STI's IPO in 1997, the Auditors conducted quarterly reviews of STI's interim financial statements in connection with the Company's Form 10-Q filings. In each meeting during the three quarters at issue, the Auditors met with Schick, Levine and other members of management to discuss the quarter and review all new promotional programs that might bear on the accounting. In those meetings the Auditors specifically asked Schick and Levine whether there were any new sales programs. Both Schick and Levine did not tell the Auditors about the sales programs discussed herein.

20. Another major component of the restatements related to revenues recorded on shipments of product to a warehouse. STI reported more than $3 million in revenues on such shipments in the June and September 1998 quarters. The warehouse shipments were Levine's idea, and his purpose was to inflate STI's revenues by having the Company record revenue on orders that were not firm. The Auditors stumbled upon six such shipments during the June 1998 quarter review, totaling about $1.8 million. But when they questioned Levine and Schick about them, both misled the auditors to believe that five of the transactions were bona fide sales, so-called "bill and hold" transactions, that had properly been recorded in the quarter. This was not true. However, the Auditors accepted the explanation and allowed most of the revenue to be booked, about $1.56 million. While these sales were later reversed in the First Restatement and shifted to the September quarter, the Auditors did not learn until the internal investigation that there was at least another $1.2 million in such warehouse shipments that had improperly been recorded as revenue in the June quarter. When the Auditors asked Schick and Levine in the June 1998 quarter review about the warehouse shipments, Schick and Levine failed to raise this additional $1.2 million in shipments. As part of the Second Restatement, this $1.2 million of revenue was reversed and shifted to the September quarter.

21. The restatements and the percentage effects on the originally reported results are summarized as follows:

Description	Quarter Ending June 30, 1998	Quarter Ending Sept. 30, 1998	Quarter Ending Dec. 31, 1998
Revenue Originally Reported	15,979,529	14,236,204	17,089,547
First Restatement			
Total Adjustment to Revenue	(3,520,319)	(605,614)	
Percentage of Adjustment	(22%)	(4%)	
Second Restatement			
Total Adjustment to Revenue	(2,019,290)	(1,321,836)	(1,549,266)
Percentage of Adjustment to Originally Reported Revenue	(13%)	(9%)	(9%)
Total Adjustment to Revenue	(5,539,609)	(1,927,450)	(1,549,266)
Final Reported Revenue	10,349,920	12,308,754	15,540,281
Total Percentage Adjustment to Revenue	(35%)	(14%)	(9%)

A. Shipments to a Warehouse

22. Overall, in the June and September 1998 quarters, STI shipped approximately $6.067 million of merchandise to a warehouse in order to recognize revenue on orders that were not firm, or to recognize bogus sales as revenue. As part of its September 1998 quarter review, the Auditors caught, and caused STI to reverse, about $2.6 million of this amount that had been shipped on the last day of the September quarter. However, Schick and Levine persuaded the Auditors that $1.5 million of warehouse shipments recorded as sales in the June 1998 quarter were bona fide "bill and hold" transactions, which was not true. In addition, they did not tell the Auditors about another $1.6 million in similar warehouse shipments that were improperly recorded as revenue in the June 1998 quarter.

23. The practice of shipping product to a warehouse began at the end of the June 1998 quarter and was Levine's idea. Levine directed STI's coordinator of trade show appearances to arrange to have a freight forwarder (the "Shipper") available on the last day of the quarter to take merchandise from STI to the Shipper's warehouse, which the Shipper was to hold pending further instructions from STI. Levine then directed the National Sales Manager to ship to the warehouse any orders in the pipeline even though the orders were not firm. Levine's admitted purpose was to inflate revenues in order to meet STI's earnings targets.

24. By the September 1998 quarter, STI was shipping to the warehouse all orders that were not yet definite. Definite orders that had financing in place were shipped via overnight courier, while orders with incomplete financing or that were uncertain for some other reason were sent via the Shipper because the Shipper would store the orders until there was disposition of the account.

25. Much of what was shipped to the warehouse was eventually returned to STI.

Revenue Recognition Criteria

26. To recognize revenue in the financial statements, generally accepted accounting principles require that the revenue be realized or realizable and earned. That generally does not occur until all of the following conditions are met: (i) persuasive evidence of an arrangement between the buyer and seller exists; (ii) delivery has occurred or services have been rendered; (iii) the price is fixed or determinable; and (iv) collectibility is reasonably assured. As a general proposition, these criteria are not satisfied when product is shipped to a warehouse because there has been no delivery to the buyer and the buyer has not agreed to accept delivery. The criteria are also not satisfied when the pending order is subject to credit approval because, in such cases, collectibility is not reasonably assured.

27. An exception to the delivery principle is the "bill and hold" transaction. A bill and hold transaction is one in which the buyer commits to purchase merchandise and to pay for it currently, accepting the risk of loss. However, for its own business reasons, it requests that the seller warehouse the goods for delivery at a later date. Revenue from a true bill and hold transaction may be recognized in the period in which all of the bill and hold criteria are met.

Reporting Revenue On Warehouse Shipments

28. In the June 1998 quarter, STI recorded $3.473 million in revenues on account of product shipped to the Shipper's warehouse. In the June quarter review, before the Form 10-Q was filed, the Auditors discovered $1.8 million in such shipments consisting of six customer orders. They allowed STI to book $1.559 million on the basis of Schick's and Levine's false representations that the orders met all of the criteria necessary to be treated as bill and hold sales for accounting purposes.

29. As part of the First Restatement in February 1999, the Auditors caused STI to reverse the bill and hold revenue recognized in the June quarter and to shift it to the September quarter because these transactions did not, in fact, satisfy bill and hold criteria. The First Restatement also reserved $1.133 million against this shifted revenue because of product returns on two orders and a pending litigation with the customer over a third order. In effect, the First Restatement reduced the amount recognized on the so-called bill and hold transactions to about $400,000.

30. The First Restatement did not address the other $1.643 million in revenues STI had booked on product shipped to the Shipper's warehouse in the June quarter because the Auditors were not aware of those shipments. Those shipments were eventually addressed in the Second Restatement.

31. Schick and Levine intentionally or recklessly misled the Auditors both as to the scope of the warehouse shipments and the true nature of the transactions the Auditors had identified, which were not true bill and hold transactions. In addition, in connection with the First Restatement, Schick procured a false audit confirmation from one of the so-called bill and hold customers to persuade the Auditors that revenue had properly been recognized in the transaction. In fact, the transaction was bogus.

The June Quarter Review

32. During the June 1998 quarter review, the Auditors discovered shipping slips in six transactions involving six STI distributors, all dated June 30, 1998, but with notes indicating delivery at later dates. All of these orders were shipped on the final day of the quarter via the Shipper and then warehoused for later delivery. STI had recorded each of these six shipments as a sale in the June 1998 quarter.

33. In the course of the June quarter review, neither Schick nor Levine brought these transactions to the Auditors' attention. Nor did they attempt to justify the revenue recognition of these transactions under bill and hold rules. However, upon finding the shipping documents, the Auditors assumed that STI was recognizing revenue in the June quarter under a bill and hold rationale, and the Auditors began to explore with Schick and Levine whether revenue was properly recognized in these transactions.

34. The Auditors met separately with Schick and Levine and explained to each in detail the bill and hold criteria for reporting revenue from such transactions. The Auditors then asked whether each of the bill and hold criteria was satisfied in each transaction.

35. With full knowledge and understanding about the criteria for recognizing revenue in a bill and hold transaction, Schick and Levine separately confirmed to the Auditors that all of the bill and hold criteria were satisfied in all six transactions. These statements were false. Moreover, Schick and Levine knew, or were reckless in not knowing, that these statements were false.

36. In fact, Schick concocted a false story about the six shipments the Auditors had identified. He told the Auditors that the identified customers had purchased the product in the June

quarter to take advantage of a sales promotion that ended June 30, but had requested delayed shipment of these units and other CDR orders for various reasons including space constraints.

37. On the basis of these representations, the Auditors allowed STI to recognize revenue on five of the six transactions. The revenue from these transactions was reported in the Form 10-Q for the June 1998 quarter and republished in the September quarter Form 10-Q, filed in November 1998.

38. Contrary to Schick's and Levine's representations, the transactions were not bill and hold transactions and should not have been recognized in the June quarter.

39. Indeed, three of the five transactions, involving Distributors A, B and C, were not even orders to purchase. Thus, Schick's representation to the Auditors that these customers had requested delayed shipments because of an expiring STI trade promotion was either knowingl or recklessly false.

40. The revenue from these three transactions accounted for about one-third of the $1.5 million STI recognized on the purported bill and hold transactions in the June quarter. In the case of Distributor A, STI recorded a sale of 32 CDRs, amounting to $314,983. In fact, Distributor A had ordered only four units, not 32 - a fact confirmed in internal STI e-mail. v

41. In the case of Distributor B, STI recognized revenue of $193,550 on a purported sale that did not actually occur until five months later, in November 1998. In June 1998, when STI recorded the revenue, negotiations with Distributor B were just underway. None of the essential terms had been agreed upon. As confirmed in a letter signed by Levine in June 199 any sale was conditioned upon reaching a satisfactory written agreement concerning the term of the order, including warranty, sales support, shipping and even pricing.

42. In the case of Distributor C, STI recorded revenue of $43,080 in the June 1998 quarter o the purported sale of CDR systems. However, Distributor C did not place an order for the unit until July 22, 1998.

43. Not only did Schick and Levine make false representations concerning the six transaction the Auditors specifically identified; when the Auditors asked whether there were any other bi and hold transactions in the June 1998 quarter, Schick and Levine both represented there were none. This was also a false statement, and Schick and Levine knew, or were reckless in not knowing, that it was false. As will be discussed further below, in the June 1998 quarter, STI had recorded another $1.6 million in revenue on shipments to the Shipper's warehouse - shipments that were not discovered until the Audit Committee's internal investigation in mid 1999.

Misrepresentations Concerning September Quarter Warehouse Shipments

44. In the September 1998 quarter review, the Auditors uncovered and disallowed another $2.6 million in revenue that the Company had recorded on shipments to the Shipper's warehouse. As in the June quarter, the Company did not bring these shipments to the Auditors' attention. Rather, the Auditors once again came upon these shipments by accident They determined that:

> all shipments via [the Shipper] were improperly recorded as sales on 9/30/98. STI ha not yet obtained credit clearance for these customers and therefore arranged with [th Shipper] to hold the merchandise until the credit checks were completed [or] until the customer wanted the merchandise. The shipments for those customers that had bad credit were returned to STI in October. For those customers whose credit cleared, ST then authorized [the Shipper] to ship the goods. Many of the shipments still remain w [the Shipper], awaiting instructions from [STI].

45. Accordingly, before reporting its financial results for the September quarter, STI revers all of the sales made on the final day of the quarter and shipped via the Shipper, totaling $2,592,781.

46. On November 4, 1998, Schick conducted the September quarter conference call with market analysts. Analysts originally were expecting STI to report about 17 cents earnings per share ("EPS") for the September quarter, later reduced to about three cents. The actual reported EPS was two cents. Schick addressed the shortfall, stating that the $2.6 million in revenue that the Auditors had disallowed could not be recognized in the September quarter because the product had been shipped by ground carrier and the customer was not able to take custody of those goods before quarter end. This was a false statement.

47. Schick further stated that this "$2.6 million is already reflected in our October numbers as we go forward into this quarter." This was also a false statement.

48. Schick's statements during the conference call were knowingly or recklessly false, intended to provide some explanation to the market for STI's substantial earnings shortfall.

The First Restatement

49. Following Schick's surprise announcement on December 10, 1998 that the Company was planning to write off $5 million in accounts receivables, the Auditors began a closer review of the Company's books as part of their December 1998 quarter review.

50. In February 1999, in connection with the Auditors' work leading to the First Restatement, Schick met with the Auditors to discuss various transactions, including the five purported bill and hold transactions that had been recognized in the June 1998 quarter. To prepare for the meeting, Schick had the Director of Finance put together a booklet of so-called "talking points" summarizing those five transactions and various others. The Director of Finance prepared a draft and gave it to Schick for his review and input. Schick then presented this booklet to the Auditors at the February 1999 meeting.

51. The talking points described the five purported June quarter bill and hold transactions in a manner that falsely portrayed them as involving bill and hold elements. However, this time the Auditors were not persuaded that the sales were valid bill and hold transactions. As part of the First Restatement, the Auditors caused STI to restate the June quarter results by shifting revenue from these transactions to the September quarter and by providing for substantial reserves against this shifted revenue on account of returns and litigation. The reserves covered the full amount of the Distributor A and Distributor C orders reflecting returns. The reserves also included $775,000 against another bill and hold transaction, reflecting the full amount of that order. The reserves did not cover the Distributor B transaction, which continued to be reflected as a real sale.

52. Although the effect of the reserves was to write off most of the revenue previously recognized, the Auditors were still allowing STI to show the revenue from the five purported bill and hold transactions as legitimate "revenue," if now in the September quarter instead of the June quarter. Even in connection with the First Restatement, Schick led the Auditors to believe that the Distributor A and Distributor B transactions, accounting for about $500,000 in recognized revenue, were real sales. Moreover, with respect to Distributor A, Schick personally procured a false audit confirmation to persuade the auditors that revenue was properly recognized. Rather than shifting the revenue from these two transactions to the September quarter and then reserving against it, STI should have simply reversed the revenue.

The False Distributor A Confirmation

53. As discussed above, STI recorded the sale of 32 CDRs to Distributor A in the June 1998 quarter. The sale was essentially bogus. Distributor A had only ordered four units. There never was an order for the other 28 units. On June 30, STI shipped 32 units to the Shipper's warehouse. All but the four units actually ordered by Distributor A were eventually returned to STI.

54. The talking points acknowledged the returns, but spoke about the transaction as if there was an actual order at the time the sale was recorded. According to the talking points summary, which Schick provided to the Auditors: (a) Distributor A asked STI to hold its order while its provider members prepared to receive the goods; (b) but then on July 1, 1998, STI announced a change in technology; (c) at that point, Distributor A sought to exchange its prior

order for product with the new technology, and STI agreed and allowed Distributor A to return the product.

55. The facts related in the talking points summary were false. Although the Auditors determined on the basis of this explanation that the June shipment to the warehouse did not qualify as a bill and hold transaction, the Auditors treated the sale as real. They therefore allowed STI to shift the Distributor A revenue to the September quarter, with STI separately adjusting the reserve to reflect the returns.

56. Schick went out of his way to ensure that the Auditors would not require STI to reverse the revenue, personally procuring from Distributor A a false audit confirmation that the sale was real.

57. In this respect, an STI sales representative sent an email to Distributor A on February 5, 1999, asking Distributor A to draft a letter confirming the June 1998 order. Distributor A refused to send the letter in the form requested.

58. Schick then personally called and asked Distributor A to sign the confirmation. Distributor A told Schick in this conversation that it did not want to sign the confirmation because Distributor A never agreed to purchase this product. Schick responded that it did not matter because the product had already been returned and the confirmation letter was simply so that STI did not have to reverse the order from the June 1998 quarter. Distributor A then signed and sent the confirmation.

The Second Restatement

59. During the Audit Committee's internal investigation, the forensic auditors uncovered an additional $1.6 million in June 1998 quarter shipments to the Shipper's warehouse that were never disclosed to the Auditors and, therefore, were not corrected as part of the First Restatement. Of this amount, approximately $250,000 had already been accounted for as returns in the First Restatement. The forensic auditors determined that another $1.25 million had improperly been recorded as revenue in the June 1998 quarter. In the Second Restatement, STI reversed this revenue and shifted it to the September quarter.

60. Although the Auditors met with Schick and Levine during the June 1998 quarter review and explained the bill and hold accounting criteria, Schick and Levine never informed the Auditors about these additional shipments. Schick's and Levine's representations and omissions were false and misleading, and Schick and Levine either knew they were false and misleading, or were reckless in not determining what the true facts were. Indeed, there is no question that Levine knew about the additional $1.2 million in shipments before the Form 10-for the June quarter was filed. His knowledge is confirmed by an internal STI email exchange at about the time of the June 1998 quarter review.

61. The revenue from these shipments was improperly reported in the Form 10-Q for the Jur 1998 quarter, the September quarter Form 10-Q, filed on November 16, 1998, and in the Fir Restatement, which was included in STI's Form 10-Q for the December 1998 quarter, filed o February 23, 1999.

B. The Free Trial Programs

62. The Second Restatement also addressed about $5.8 million in revenues recorded in the June, September and December 1998 quarters on shipments made under two free trial programs, the accuDEXA Loaner Program and Try and Buy. Under both promotions, the putative buyer was given a 30-day free trial, with no obligation to buy. At the end of the tri period, the purchaser could either return the unit with the customary restocking fee waived enter into an agreement to purchase it. Overall, about half of the units shipped under the t programs was eventually returned. STI treated each shipment as a sale at the time of shipment, even though the putative purchaser was under no obligation to buy.

Revenue Recognition Criteria

63. As discussed above, to recognize revenue in the financial statements, the revenue must be realized or realizable and earned. Financial Accounting Standard ("FAS") 48 provides that if an enterprise sells its product but gives the buyer the right to return the product, revenue from the sales transaction shall be recognized at time of sale only if the buyer is obligated to pay the seller and the risk of loss has passed to the buyer. In other words, there must be an actual sale.

64. With respect to the Try and Buy and the accuDexa Loaner programs in which, among other things, the customers were given 30 day trial periods (during which time they had no obligation to purchase), revenue recognition was precluded at date of shipment because there was no obligation on the purchaser to purchase the product. In such circumstances, a sale could not be recognized until the end user accepted the product and became obligated to pay for it.

The accuDEXA Loaner Program

65. The accuDEXA loaner program took place primarily in the June and September 1998 quarters, with a few units shipped in November. Under the program, the customer was given an unconditional right to return product to STI within 30 days of shipment. Between May and November 1998, 347 units were shipped under the program. Approximately 160 units were returned. Many returns were greater than 60 days after shipment. All shipments made pursuant to this program were recorded as sales and included as revenue in STI's financial reports at the time of shipment. Overall, STI recognized at least $4.6 million in revenues in the two quarters. STI did not inform the Auditors about the program or its sales terms during the June or September 1998 quarter reviews. The details of the program did not come to light until the Audit Committee's internal investigation in mid-1999.

66. About $1.9 million of this revenue was ultimately reversed between adjustments to revenue made in the Second Restatement and adjustments to the reserve for sales returns that had been made in the First Restatement. In the Second Restatement, all revenue recorded on this program in the June quarter was reversed because none of the shipments made in the June quarter had matured into actual sales in the quarter. About $490,000 of this revenue was recognized in the September quarter. In addition, about $522,000 of the revenue recognized in the September quarter was shifted to the December quarter for the same reason.

67. As a result of the accuDEXA Loaner program, STI's publicly filed financial statements for the June and September 1998 quarters and its publicly filed First Restatement were materially false and misleading. Moreover, Schick and Levine knew, or were reckless in not knowing, that they were materially false and misleading.

68. The accuDEXA Loaner program was the brainchild of Schick. According to an internal email, Schick's concept was that the salespersons would leave an accuDEXA at the doctor's office "as a loaner unit for 30 days," after which the doctor would be able to "convert to a sale."

69. The program was launched in the June 1998 quarter. Consistent with Schick's email, an STI salesperson would leave an accuDEXA unit at a doctor's office as a loaner for 30 days. When the doctor agreed to try the accuDEXA unit, the doctor would sign an accuDEXA order form with an option to enter into a lease at the end of the 30-day trial period. Promotional materials described the program as follows: "As of June 15, 1998, for a very limited time, you can have the accuDEXA for 30 days, free of charge, with no deposit, no delivery charge, no re-stocking fee, and no obligation to purchase. You can return the unit at any time within the 30 day period." If the doctor decided to keep the unit, the first year would be "free" after which the doctor would pay in full or sign a three-year lease.

70. At Levine's direction, STI recognized revenue on units involved in the trial program upon shipment. Levine's purpose was to inflate STI's reported revenues. If the doctor decided not to purchase the unit, the Company then recorded a "return" at the time that the unit was returned to STI.

71. Schick was aware that STI was recording substantial revenue under the program and that

it was experiencing substantial returns. In mid-July 1998, Schick put his brother in charge of the program to keep track of units shipped and returned. In August 1998, Schick's brother advised Schick that the "current ratio is about 3 sales to 2 returns. I figure there are at least 220 loaners out there now, probably more."

72. Neither Schick nor Levine told the Auditors about the loaner program in the June or September 1998 quarter reviews. The Auditors asked Schick and Levine in those quarter reviews if there were any sales with terms that deviated from STI's normal sales terms. Schick and Levine told the Auditors that there were no such sales. Schick and Levine knew, or were reckless in not knowing, that this was a false statement. Schick and Levine also failed to disclose the details of the loaner program in connection with the First Restatement. However, the First Restatement did record returns that were processed prior to the date of the First Restatement in February 1999, which included certain loaner program returns.

The Try and Buy Program

73. In the September and December 1998 quarters, STI ran a promotional program for its CDR product with sales terms much like the accuDEXA loaner program. The program, called "Try & Buy," involved STI selling product to its distributor, CDR Distributor, which would then sell the product to end users. Under the program, the customer signed a CDR Distributor registration form for a 30-day trial, during which time there was no obligation to purchase. If the unit was returned prior to the end of the trial period, STI agreed that CDR Distributor couic return the product to STI with no penalties - an absolute right of return. If the customer chose to purchase the unit, then CDR Distributor would issue a purchase order to STI.

74. Levine and another STI employee negotiated the terms of the program with CDR Distributor.

75. As part of the Audit Committee's internal investigation, the forensic auditors concluded: "Although [CDR Distributor] in form was buying from STI and reselling to the end user, the substance of the transaction is that STI agreed to a trial period during which the customers (neither [CDR Distributor] nor the end user) were obligated to purchase and could make returns without paying restocking fees."

76. In the September and December 1998 quarters, STI recognized $1,164,082 of revenue upon shipment of the CDR orders. STI accepted returns of $615,742 and issued credits/refunds. Credits issued for returns received before February 15, 1999, totaling $96,558, had been recorded in the First Restatement, although the Auditors did not know at the time that they pertained to a free trial program. The Second Restatement adjusted for returns processed after February 15, 1999, decreasing revenue in the September and December quarters by another $248,982 and $262,086, respectively. The Second Restateme also reversed an additional $178,422 of revenue out of the September quarter because those shipments had not ripened into sales in the September quarter.

77. As a result of the Try and Buy program, STI's publicly filed financial statements for the September and December 1998 quarters and the publicly filed First Restatement were materially false and misleading. Moreover, Schick and Levine knew, or were reckless in not knowing, that they were materially false and misleading.

78. In September 1998, Levine gave the accounting department specific instructions on how sales under the program were to be recorded.

79. Moreover, in a September 1998 email exchange, which included both Schick and Levine recipients, STI's Vice President of Operations asked Levine if a 500-unit order (roughly $3.4 million) from CDR Distributor was "real," to which Levine replied (with a copy to Schick) tha he estimated 200 units were real. Then in October 1998, Levine sent Schick a high priority message about the substantial number of returns being processed under the Try and Buy program.

80. On January 12, 1999 - before the First Restatement - the Director of Vendor Relations wrote to Schick and Levine as follows:

> We are going to get MANY laptops returned from [CDR Distributor] from their Try & Buy program. We agreed to have the 30 days start after the STI Rep installed the systems. On many occasions the STI rep never followed up. We also assured them that we would accept returns. We did not have an effective way to track and follow up on these Try & Buys, and on our side they were handled like regular sales. I informed them that all returns must happen by the end of January.

81. Neither Schick nor Levine told the Auditors about the Try & Buy program during the September or December 1998 quarter reviews, or in connection with the First Restatement, despite being asked by the Auditors during the quarter reviews about any sales with deviations from normal sales terms.

C. Bogus Sale of 100 CDR Laptop Systems

82. The First Restatement also addressed a bogus sale to CDR Distributor of 100 CDR laptop systems that STI recorded in the September 1998 quarter.

83. In the September 1998 quarter, STI recorded a sale to CDR Distributor, the Company's largest distributor, in the amount of $689,700 for 100 CDR laptop systems. Levine negotiated the order. The idea was that CDR Distributor would "reserve" inventory, but not become obligated to pay for any units until it had a customer willing to purchase units. Levine's purpose was to inflate STI's reported revenue.

84. The purchase order was dated September 29, 1998 and stated that it represented a "reservation of inventory" for the "First 100 Units" of the "Laptop Program." STI's internal invoice and shipping confirmation state that the units were to ship to CDR Distributor "at Schick Technologies, Inc." in Long Island City. The revenue from this purported sale was included in STI's income statement for the September 1998 quarter.

85. The entire transaction was bogus. There was no valid purchase order, the Company did not ship the 100 units to CDR Distributor, and CDR Distributor was under no obligation to purchase any units. Instead, STI recorded the sale in the September quarter to recognize the revenue and then immediately issued a return merchandise authorization ("RMA") for the entire amount on October 15, 1998. A credit memo was issued on November 9, 1998 reversing the entire order.

86. As a result of this bogus transaction, STI's publicly filed financial statements for the September 1998 quarter were materially false and misleading. Moreover, Schick and Levine knew, or were reckless in not knowing, that they were materially false and misleading.

87. Neither Schick nor Levine told the Auditors about the RMA during the September quarter review. Had they done so, the Auditors would have looked more closely at the transaction and determined that it was a sham transaction.

88. The first time the Auditors became aware of the purported CDR Distributor order was during an Audit Committee meeting in January 1999. In the meeting, Schick explained that, at the end of the September 1998 quarter, CDR Distributor asked for a large $700,000 CDR order to be shipped directly to CDR Distributor. Schick stated that CDR Distributor field personnel were to sell the product, but these sales did not occur because STI personnel had to participate in sales and installation.

89. This was a false story, and Schick knew or was reckless in not knowing that it was false. CDR Distributor did not place a large order, no shipment was ever made to CDR Distributor and CDR Distributor never obligated itself to pay for any units.

90. In February 1999, in connection with the First Restatement, Schick further tried to mislead the Auditors by presenting the talking points booklet, which purported to summarize the CDR Distributor transaction. According to the talking points, CDR Distributor placed an order for the 100 CDR laptop systems as part of CDR Distributor's promotion coinciding with the launch of STI's new laptop system. But, CDR Distributor "was unsuccessful in launching this promotion" in part "due to the success [CDR Distributor was] having using the original drop-ship method."

The summary states that "CDR Distributor requested that they be allowed to return the shipment and transfer the invoice to drop-ship sales." It further states that STI accommodate CDR Distributor's request and credited the original invoice and issued invoices for drop-ship purchases directly to CDR Distributor's customers.

91. This was a false story, and Schick knew or was reckless in not knowing that it was false.

92. Despite Schick's efforts to mislead them, the Auditors required the Company to reverse the sale in the First Restatement by adjusting the September 1998 quarter revenues to eliminate the revenue.

D. Consignment Sales

93. The Second Restatement also addressed two purported sales that were at best consignment sales that should not have been recognized as revenue.

Revenue Recognition Criteria

94. Consignment sales do not qualify for revenue recognition until all of the previously allege criteria of FAS 48 are satisfied. Among other things, revenue recognition is not appropriate when the seller retains the risks and rewards of ownership of the product or the buyer's obligation to pay is excused until the buyer resells or consumes the product.

The Consignee A Consignment Sale

95. STI reported $599,700 in revenue in the September 1998 quarter for an order of CDR units shipped to Consignee A. The Audit Committee's internal investigation concluded that th was a consignment sale and, as a result, STI ended up reversing the revenue. Levine understood the true substance of this transaction, but never disclosed it to the Auditors. Levine even coached STI's National Sales Manager to lie to the Auditors about the transactio

96. Consignee A was a sole proprietorship, owned by Dr. W. Consignee A provided dentists with continuing education by conducting two-day seminars for approximately twenty dentists at Dr. W's home about seven or eight times per year. At each seminar, the dentists were abl to speak with sales representatives about purchasing equipment used during the seminar.

97. Between 1996 and September 1998, STI's local CDR sales representative attended seve seminars and successfully sold six or seven CDR units at each seminar. Dr. W received a 10 commission on these sales. When the STI CDR laptop went into production in 1998, Dr. W suggested to STI's salesman that he present each seminar attendee with a unit available to purchase. STI's salesman brought the proposal to the attention of Levine and STI's National Sales Manager.

98. STI's National Sales Manager negotiated the transaction with Consignee A, which involv a "purchase order" for 60 units on net 60-day terms. On the last day of the September 199 quarter, STI shipped 60 CDR units to Consignee A and recorded as revenue the entire sale totaling $599,700. While the transaction was papered to look like a real sale, it was not a re sale. STI orally agreed that Consignee A would have 60 to 90 days to sell the units and wou have the right to return any CDR units during this period. For each unit sold, Consignee A would receive $1,000.

99. The National Sales Manager reported to Levine, and both the National Sales Manager ar the STI salesman kept Levine apprised of the negotiations and the terms of the transaction. mid-September 1998, the STI salesman conveyed the terms of the deal to Levine in a mann that made clear that there was no current sale, but only a commission arrangement for futu sales. The STI salesman then specifically told Levine that the arrangement would allow STI put $600,000 of revenue on its books immediately. Levine replied: "This is brilliant."

100. As it turned out, Consignee A could not sell the CDR units within three months. The National Sales Manager then extended the terms, allowing Consignee A another five to six

months to sell the units.

101. During the September 1998 quarter review, Levine did not tell the Auditors about this order or its special terms. Nor was the order raised with the Auditors in connection with the First Restatement. Moreover, Levine essentially coached the National Sales Manager about what to say should the Auditors question him about the sale. In a conversation in 1999 at about the time the internal investigation was beginning, Levine suggested that the National Sales Manager tell the Auditors that the Consignee A order was a "real order." This was not true, and Levine knew, or was reckless in not knowing, that it was false.

102. As a result of this transaction, STI's publicly filed financial statements for the September 1998 quarter and its publicly filed First Restatement were materially false and misleading. Moreover, Levine knew, or was reckless in not knowing, that they were materially false and misleading.

103. The Consignee A transaction was uncovered and addressed in the Second Restatement by reversing the entire amount from the September quarter and recognizing $239,880 of revenue in the December 1998 quarter as sales to actual end users.

The Consignee B Consignment Sale

104. STI reported $569,800 in revenue in the September 1998 quarter on a purported sale of accuDEXAs to Consignee B. Although the order was papered to look like a sale, an undisclosed side letter made clear that Consignee B had the right to return any units that it was unable to sell. Both Schick and Levine were aware of the side letter. But they did not disclose it to the Auditors in the September quarter review. Indeed, the side letter was not included with the documentation for this sale, so the Auditors would not have discovered it on their own. The side letter eventually came to light in the Audit Committee's internal investigation.

105. By December 1998, Consignee B had not sold through many units. STI, through Levine, began to help Consignee B sell the units by making direct sales to customers and shipping product from Consignee B's inventory.

106. Following the internal investigation, the Audit Committee determined that the transaction should have been treated as a consignment and not recognized in the September quarter. In the Second Restatement, STI reversed the entire amount out of the September quarter and recognized $113,525 in the December quarter representing eventual sales to end users in that quarter.

107. As a result of the transaction, STI's publicly filed financial statements for the September 1998 quarter and its publicly filed First Restatement were materially false and misleading. Moreover, Schick and Levine knew, or were reckless in not knowing, that they were materially false and misleading.

E. Deliberately Inadequate Reserves for Sales Returns

108. The First and Second Restatements made adjustments reflecting returns totaling about $8 million. The failure adequately to reserve for returns in the June, September and December 1998 quarters constitutes an independent material misrepresentation. This failure also demonstrates Schick's intention to overstate falsely net revenues in a very material amount.

109. By October 31, 1998, before Schick signed the September 1998 Form 10-Q, STI had received in-house or authorized about $2.7 million in returns, none of which was reflected in the September 1998 quarter filing.

110. Moreover, Schick's brother alerted Schick in August 1998 that returns under the accuDEXA loaner program were coming in at the rate of two returns for every three sales. Likewise, Levine informed Schick in October 1998 of substantial returns under the Try and Buy program.

111. Notwithstanding this knowledge, Schick signed the September 1998 quarter Form 10-Q on November 16, 1998. At the time, Schick knew, or was reckless in not knowing, that the Form 10-Q was materially misleading because (i) it did not disclose the substantial returns already received, and (ii) it did not account for future returns that Schick knew, or was reckless in not knowing, would be received on the basis of what he had been told by his brother and Levine.

112. Even the First Restatement ended up understating reserves by about $3.1 million.

The Magnitude of the Misstatement

113. In the First Restatement, STI increased the reserve for sales returns for both the June and September quarters by a total of about $2 million. These adjustments were in addition to about $2 million of contract specific adjustments that were separately recorded as part of the First Restatement.

114. In the Second Restatement, STI made an adjustment directly to sales based on credits recorded in the quarter ended June 1999. This adjustment decreased the June, September and December 1998 quarterly revenue by $194,228, $344,644 and $1,200,736, respectively. The internal investigation also determined that a separate adjustment should be made to allocate over the June, September and December 1998 quarters returns received in the December 1998 quarter that exceeded the allowance for returns at the December 1998 quarter-end. This adjustment further reduced the June, September and December quarterly revenues by $88,808, $389,048 and $948,384, respectively. These Second Restatement adjustments were in addition to contract specific adjustments that were separately recorded as part of the Second Restatement.

Schick Knew That Reserves Were Grossly Inadequate

115. Prior to the restatements, Schick misled the Auditors to believe that the reserves were adequate and even persuaded them that additional reserves they were proposing were not necessary. At the end of the June 1998 quarter, STI had total reserves for sales returns of about $300,000. The Auditors proposed increasing the reserve, but Schick persuaded them that an increase was not necessary. Schick specifically told the Auditors that he anticipated that the return rates would decline in the September 1998 quarter due to better quality sensors in the products and his belief that the accuDEXA would increase as a percentage of total sales and would "continue to have low return rates."

116. At the time Schick made this representation concerning the June 1998 quarter reserves, Schick knew or was reckless in not knowing that the reserves were materially understated. Among other things, Schick was aware of the accuDEXA loaner program, under which prospective buyers had a 30-day free trial. Yet he did not inform the Auditors about the program.

117. By the end of August 1998, Schick was clearly aware that the accuDEXA program was experiencing returns of about 40 percent. Likewise, no later than October 1998, Schick was aware of substantial returns under the Try and Buy program. Indeed, by October 31, 1998, before the September 1998 Form 10-Q was filed, STI had received or authorized returns of about $2.7 million.

118. None of this $2.7 million in returns was reflected on STI's books or brought to the Auditors' attention in connection with the September 1998 quarter review.

119. The Company's reserve at the end of the September 1998 quarter was $438,000. While this amount included an adjustment proposed by the Auditors, Schick again persuaded the Auditors that further increases were not necessary.

120. At the time Schick persuaded the Auditors not to increase further the September 1998 quarter-end reserves, he knew or was reckless in not knowing that the reserves were materially understated.