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UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

SECURITIES AND EXCHANGE COMMISSION,	
Plaintiff,	
v.	**04 Civ. ____ (______)**
MEASUREMENT SPECIALTIES, INC. and KIRK J. DISCHINO,	**COMPLAINT**
Defendants.	

Plaintiff Securities and Exchange Commission for its complaint against defendants Measurement Specialties, Inc. ("MSI") and Kirk J. Dischino (collectively, "Defendants"), alleges as follows:

PRELIMINARY STATEMENT

1. This action arises out of two separate accounting frauds at MSI orchestrated or carried out by Dischino, formerly MSI's chief financial officer. From at least June 2000 until February 2002, MSI, at Dischino's direction, materially overstated its earnings by capitalizing overhead expenses into inventory in a manner that was clearly inconsistent with generally accepted accounting principles ("GAAP") and that Dischino knew or was reckless in not

knowing would mislead investors about MSI's earnings and the value of its inventory. These adjustments had the effect of shifting ever larger amounts of manufacturing costs from MSI's income statement to its balance sheet, thereby overstating MSI's earnings. Dischino made these adjustments over the repeated objections of the heads of MSI's operating divisions and internal accounting personnel, and in some instances despite concerns expressed by the company's outside auditors.

2. Primarily as a result of Dischino's fraudulent inventory accounting, MSI overstated its earnings by material amounts. For example, for the fiscal year ended March 31, 2001, pre-tax income was overstated by 435%; for each of the quarters ended June 30, 2000 and June 30, 2001, the fraudulent inventory accounting converted a loss to again. As a result, MSI's quarterly and year-end financial statements covering the periods ended June 30, 2000 through September 30, 2001 were materially false and misleading. The false and misleading financial statements were contained in the company's periodic public filings, a registration statement, and other public statements.

3. In addition, from at least October 2001 until February 2002, Dischino engaged in a second accounting fraud, in which he concealed MSI's default under its loan agreements. The default, which was triggered by MSI's loss for the quarter ended September 30, 2001, jeopardized the company's continued operations because it gave the lenders the right to, at any time, cease extending further credit and accelerate all MSI's outstanding debt, either of which events could have forced MSI's liquidation. In connection with the preparation of the company's quarterly report for the period ended September 30, 2001, Dischino falsely represented to MSI's senior management, directors, and outside auditors that the lenders had waived the default. To

substantiate his claim, he fabricated a written waiver, purportedly from the lenders, which he then provided to MSI's auditors.

4. Dischino also engaged in insider trading, selling 40,000 shares of MSI stock between December 19 and December 26, 2001, while in possession of material, non-public information about the true facts of MSI's earnings and inventory, and its default.

5. On October 28, 2002, MSI restated its previously reported financial results for the each of the reporting periods from the quarter ended June 30, 2000 through the quarter ended December 31, 2001, to correct for Dischino's erroneous inventory accounting, and other errors (the "Restatement"). Although MSI included other necessary adjustments in its Restatement, the correction of errors in the inventory valuation alone required restatement of the previously reported financial results for the affected periods.

6. Through the foregoing conduct: (a) MSI, directly and indirectly, has engaged, and may be continuing to engage, in violations of Sections 17(a) of the Securities Act of 1933 ("Securities Act"), and Sections 10(b), 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Securities Exchange Act of 1934 ("Exchange Act"), and Rules 10b-5, 12b-20, 13a-1, 13a-11 and 13a-13 thereunder; and (b) Dischino, directly and indirectly, has engaged, and may be continuing to engage, in violations of Section 17(a) of the Securities Act, and Sections 10(b) and 13(b)(5) of the Exchange Act, and Rules 10b-5, 13b2-1 and 13b2-2 thereunder, and, pursuant to Section 20(a) of the Exchange Act, Dischino is liable for MSI's violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, and Rules 12b-20, 13a-1, 13a-11and 13a-13 thereunder as a control person.

7. Defendants MSI and Dischino, unless enjoined and restrained by this Court, will continue to engage in the transactions, acts, practices and courses of business alleged herein, and in transactions, acts, practices, and courses of business of a similar type and object.

8. By this action, the Commission seeks: (a) permanent injunctive relief; (b) disgorgement of all ill-gotten gains plus prejudgment interest; (c) civil penalties; (d) an officer and director bar against Dischino; and (e) such further relief as the Court may deem appropriate.

JURISDICTION

9. The Commission brings this action pursuant to the authority conferred upon it by Sections 20(b) and 20(d) of the Securities Act, 15 U.S.C. §§ 77t(b) and 77t(d), and Sections 21(d) and 21A of the Exchange Act, 15 U.S.C. § 78u(d) and 78u-1.

10. This Court has subject matter jurisdiction over this action pursuant to Sections 20(d) and 22(a) of the Securities Act, 15 U.S.C. §§ 77t(d) and 77v(a), and Sections 21(d)(2), 21(d)(3), 21(e), 21A and 27 of the Exchange Act, 15 U.S.C. §§ 78u(d)(2), 78u(d)(3), 78u(e), 78u-1 and 78aa.

11. Defendants, directly and indirectly, made use of the means or instruments of transportation or communication in, or the means or instrumentalities of, interstate commerce, or of the mails, in connection with the transactions, acts, practices, and courses of business alleged in this complaint.

DEFENDANTS

12. **Measurement Specialties, Inc**. is a New Jersey corporation with its principal place of business in Fairfield, New Jersey. MSI designs, manufactures and markets a variety of sensors for electronic, automotive, military and other uses. MSI's common stock is registered

with the Commission pursuant to Section 12(b) of the Exchange Act, and is listed on the American Stock Exchange ("AMEX"). At all relevant times MSI was a reporting company subject to the provisions Section 13(a) of the Exchange Act. At various times from at least January 1999 through the present, MSI filed periodic and other reports with the Commission. The company's fiscal year ends on March 31. Because of the company's failure to file periodic reports with the Commission, trading in its stock was suspended by the AMEX from February 15, 2002 through May 31, 2002, and again from July 15, 2002 through October 28, 2002.

13. During the period at issue, MSI grew through a series of acquisitions. Specifically, MSI acquired the following manufacturing or distribution facilities on the following dates: (1) Piezo, acquired in 1999 and located in Valley Forge, Pennsylvania; (2) IC Sensors, acquired in February 2000 and located in Milpitas, California; (3) Schaevitz Hampton ("Schaevitz"), acquired in August 2000 and located in Hampton, Virginia; and (4) Schaevitz UK ("Slough"), acquired in August 2000 and located in Slough, UK. MSI also operated the following subsidiaries during the relevant period: (a) Consumers, located in Hampton, Virginia; (b) Microfused, also located in Hampton, Virginia, and (c) Jin Liang, located in Shenzhen, China.

14. **Kirk J. Dischino,** age 45, was the chief financial officer and treasurer of MSI from February 1998 until February 14, 2002, when he was fired. Dischino was responsible for preparing the company's financial statements, and he signed the company's Forms 10-K, 10-Q and 8-K. Dischino, who is, and was at all relevant times, a certified public accountant, resides in Waldwick, New Jersey.

THE INVENTORY ACCOUNTING FRAUD

SUMMARY AND INTRODUCTION

15. From at least as early as June 30, 2000 until February 2002, Dischino knowingly or recklessly made or directed others to make accounting adjustments to the carrying value of MSI's inventory that failed to comply with GAAP, and that had the effect of inflating the company's reported earnings and its inventory. The production credits were topside entries initiated, calculated and controlled by Dischino. The heads of MSI's operating divisions and internal accounting personnel repeatedly told Dischino that his application, and calculation, of production credits were improper, but he disregarded their objections.

APPLICABLE ACCOUNTING PRINCIPLES

16. According to GAAP, inventories are to be stated at the lower of cost or market value. Cost is the actual cost to manufacture or purchase the product and prepare it for sale, and includes costs for material, labor and overhead.

17. GAAP permits companies to use standard costs to value inventory under certain conditions. Standard costs are estimated costs (or budgets) typically established at the beginning of a period. Under GAAP, if a company uses standard costs, it is required to determine at the end of each period whether any differences exist between the standard and actual costs. If so, adjustments must be made to the carrying value of the inventory to reflect the actual costs. In addition, once inventory is valued at actual cost, a company must also assess whether the cost exceeds the market value of its inventory. Market value is the value the company expects to receive for its inventory less the cost to complete and sell the inventory. This is often referred to

as net realizable value, or "NRV." If the market value is less than the actual costs of the inventory, the company must write down the value of its inventory to its NRV.

DISCHINO'S INVENTORY ACCOUNTING FAILED TO COMPLY WITH GAAP

18. MSI used a standard costing system to value its inventory. However, MSI did not have an inventory costing system that could calculate variances between the standard and actual costs to determine if additional costs needed to be allocated to the ending inventory balance. Dischino therefore performed manual calculations that purported to capture the variances between standard costs and actual costs. These manual variance calculations resulted in what Dischino referred to as a production credit – the amount by which the value of inventory on the balance sheet (valued at standard cost) was increased, purportedly to reflect the inventory's actual cost.

19. Dischino's production credit calculations failed to comply with GAAP in several respects. First, Dischino failed to use a consistent methodology to calculate variances – the methodologies he used were inconsistent among locations in any given period, and for the same locations over successive periods. Second, the "actual" costs Dischino used in his variance calculations were incorrect. For example, Dischino included estimated costs when actual costs were available, included costs that were not properly allocable to inventory, and included costs that could not be reconciled to MSI's underlying accounting records. Third, once he had calculated the amount of the production credit, Dischino failed to adjust inventories to the lower of cost or market. Dischino either failed to perform the necessary NRV calculations at all, or performed them incorrectly.

20. As a result of Dischino's production credit calculations, inventory as stated on MSI's balance sheet was valued above actual costs and, at times, above its net realizable value. Accordingly, MSI's valuation of inventory was inconsistent with the GAAP.

21. The overstatement of inventory in turn caused an overstatement of MSI's current period gross profits and net income. The overstatement of inventory also resulted in an overstatement in profits in future periods because each quarter, as the prior period's inventory was sold and the inflated costs were reflected in the current period's income statement as costs of goods sold, Dischino performed new production credit calculations, which, in most cases, purportedly justified shifting even more expenses from the income statement to the balance sheet than the prior period's production credit.

22. The impact of the production credit on MSI's income statement quickly became material as the company became progressively dependent on the production credit to show profitability. For instance, as of March 31, 2000, MSI's inventory was overvalued by $182,976, compared to its reported pre-tax income for the fiscal year of $7.2 million. However, by the end of the fiscal year ended March 31, 2001, largely as a result of improper production credits, the company's inventory was overvalued by $7.5 million, compared to its reported pre-tax income of $2.4 million.

23. Dischino knowingly or recklessly used the production credit to inflate MSI's earnings. In calculating the production credit, Dischino departed widely from GAAP. Moreover, he persisted in adding the production credit to MSI's inventory despite repeated objections from MSI's division heads and internal accounting staff, and concerns expressed by MSI's auditors regarding its inventory accounting.

MSI's Reported Results for the Quarter Ended June 30, 2000

24. In June 2000, MSI's then-controller informed Dischino that Dischino's method of estimating inventory costs did not accurately value inventory, and did not conform to GAAP. MSI's controller insisted that to value inventory properly, it was crucial for MSI to reset the standards of its standard cost accounting system instead of using estimates. Despite this objection, Dischino did not change the inventory accounting for the period.

25. On August 14, 2000, MSI filed its quarterly report on Form 10-Q for the quarter ended June 30, 2000, reporting pre-tax income of $1.59 million, and an inventory balance of $11.3 million. The reported earnings and inventory for this period reflected an undisclosed production credit balance of $3.99 million. Properly accounting for inventory, MSI actually realized a pre-tax loss of $1.7 million for the quarter, and the value of its inventory was $2.07 million less than originally reported. Thus, the use of the production credit – which increased inventory and reduced expenses by an equivalent amount – converted a loss into a gain for the quarter ended June 30, 2000.

MSI's Reported Results for the Quarter Ended September 30, 2000

26. Notwithstanding the controller's objections, during the quarter ended September 30, 2000, Dischino did not reset MSI's standard costs, and instead planned to continue to use the production credit to estimate inventory values for that quarter as well. As a result, the controller resigned in November 2000, before the company reported its quarterly results.

27. On November 14, 2000, MSI filed its quarterly report on Form 10-Q for the quarter ended September 30, 2000, reporting pre-tax income of $3.66 million, and an inventory balance of $19.1 million, up from $11.6 million the prior quarter. The reported earnings and

inventory for this quarter also reflected an undisclosed production credit balance of $3.15 million. Properly accounting for inventory, however, MSI's inventory was $1.75 million, or 10%, less and the company's pre-tax income for the quarter was only $3.35 million, or $309,000, or 9%, less than originally reported.

MSI's Reported Results for the Quarter Ended December 31, 2000

28. Even after MSI's controller's protests and resignation, Dischino continued to shift overhead expenses into inventory, and he continued to receive complaints from MSI's division heads and internal accounting staff about the use of the production credit.

29. For example, Dischino received repeated objections from the general manager of MSI's Schaevitz division, an experienced cost accountant. In January 2001, Schaevitz' general manager was directed by someone on Dischino's staff to book a $1.3 million production credit to inventory on the Schaevitz division's books for the quarter ended December 31, 2000, in order to bring the division's books into conformity with the consolidated corporate books, where the credit had already been booked by Dischino. The general manager then contacted Dischino, and explained to him why Schaevitz' standard cost system was accurate, and why inventory therefore was not undervalued. Dischino ultimately conceded that the division accounting was accurate, told the manager that she did not need book the production credit adjustment, and said that he would reverse the production credit for the division's inventory off the consolidated corporate books. In fact, however, Dischino did not reverse the production credit.

30. On February 14, 2001, MSI filed its quarterly report on Form 10-Q for the quarter ended December 31, 2000, reporting pre-tax income for the fiscal quarter ended of $4.14 million. The company also reported that its inventory balance had increased to $23.8 million, from $19.2

million the previous quarter. As in prior quarters, MSI did not disclose that these amounts included a production credit balance, which by that date amounted to $8.04 million, having nearly doubled over the quarter. Properly accounted for, MSI's inventory was only $18.1 million, and MSI realized pre-tax income of only $392,000 that quarter. Thus, in its original reports, MSI overstated pre-tax income by 957%, and overstated inventory by $5.65 million, or 31%.

MSI's Reported Results for the Year and Quarter Ended March 31, 2001

31. As the effect of the production credit on the book value of MSI's inventory began to snowball, the objections to its use from division accounting staff and managers became increasingly vocal and insistent. The general manager of MSI's facility in Slough, England – an experienced cost accountant – was one of those who protested Dischino's use of the production credit. Slough's general manager first learned that Dischino had been allocating additional value to the Slough inventory, without her consent, soon after Slough had closed its books for the fiscal year ended March 31, 2001. The general manager believed that Slough's inventory properly absorbed all of the division's manufacturing overhead. The manager's confidence in the accuracy of Slough's valuation of its inventory was based, in part, on the fact that Slough's standard costs had been reset in August 2000, and then again in March 2001, and no material variances developed between the first and second revaluation. In addition, MSI's auditor in the United Kingdom had also confirmed the accuracy of Slough's standards in the course of an audit required under United Kingdom regulations.

32. Accordingly, Slough's general manager objected when she discovered in June 2001 that Dischino had increased the value of Slough's inventory on the consolidated corporate

books by approximately $1.9 million for the fiscal year ended March 31, 2001, purportedly for the purpose of absorbing unallocated overhead costs. On June 18, 2001, she sent Dischino an e-mail objecting to the allocation of additional value to Slough's inventory, particularly since she was already selling it at a loss:

> I am clearly not happy with applying further overhead to slow moving inventory. Especially, where the business is faced with strong pressures to reduce pricing. We are currently selling our two volume products at a loss based on full absorb[tion] . . . I hope you take my advice on this. To clarify further, the site is on a cost reduction program – with slow turnover inventory, adding under absorbed costs are highly not recommended.

33. Slough's general manager ultimately refused to report an improperly inflated inventory value to MSI's UK regulators. Because Dischino continued to book the production credit for Slough's inventory on the consolidated corporate books, Slough's books and the consolidated corporate books were inconsistent.

34. Dischino also received similar objections, on several occasions, from the accountant for MSI's IC Sensors division about production credits Dischino used to increase the value of IC Sensors' inventory.

35. MSI's outside auditors also questioned MSI's inventory accounting. For example, in an e-mail dated May 14, 2001, the auditors informed Dischino that, based on their work on the year-end audit for the fiscal year ended March 31, 2001, the auditors had concluded that Schaevitz' general manager's assessment of Schaevitz' inventory value was "reasonable, and that the approximately $1.2 million adjustment recorded at corporate needs to be reversed." The auditors also noted that "the [Slough] U.K. additional overhead capitalization seems to make even less sense then [Schaevitz] Hampton."

36. As part of their June 29, 2001 presentation to MSI's audit committee, the auditors warned that because the "[production credit] component represents a substantial portion of the total inventory value," and because the "company manually prepares the calculations to determine the manufacturing overhead costs that should be capitalized to properly value inventories[,] . . . [t]here is a potential [for an error]." The auditors' report to the audit committee also noted the insufficiency of MSI's financial reporting system, and recommended that "management implement a comprehensive cost accounting system [and] consider creating a cost accountant position in their corporate accounting department." At a subsequent meeting of the audit committee on October 15, 2001, the auditors again cautioned that the use of the production credit posed a risk, and that the company needed to take responsible steps to improve its inventory accounting systems.

37. On July 5, 2001, MSI filed its Form 10-K containing its financial statements for the fiscal year ended March 31, 2001. In its consolidated income statement, MSI reported pre-tax income of $11.79 million for the fiscal year ended March 31, 2001. The company also reported an inventory balance of nearly $32 million as of March 31, 2001, up $22.7 million from the prior year. MSI failed to disclose that its stated income and inventory balance reflected a production credit balance of over $10 million as of March 31, 2001.

38. The financial statement contained in the 2001 Form 10-K overstated pre-tax income for the three months ended March 31, 2001 by $2.22 million, a 1375% overstatement of earnings. Likewise, for the fiscal year ended March 31, 2001, MSI overstated pre-tax income by $9.58 million, a 435% overstatement. MSI also overstated its inventory balance by $7.5 million, or 31%.

39. The effect of these errors on MSI's results for the quarter ended March 31, 2001 is shown in Table 1(a), below. The effect of these errors on the results for the fiscal year ended March 31, 2001 is shown in Table 1(b), below.

Table 1(a)

Selected Results for the Quarter Ended March 31, 2001

(in thousands)	As Reported	As Restated	Overstatement (Understatement)	% Overstated (Understated)
Production Credit Balance	$10,193	$1,986	$8,207	413%
Inventory Balance	$31,868	$24,362	$7,506	31%
Cost of Goods Sold	$13,359	$15,214	$(1,855)	-12%
Pre-Tax Income (Loss)	$2,390	$162	$2,228	1375%

Table 1(b)

Selected Results for the Fiscal Year Ended March 31, 2001

(in thousands)	As Reported	As Restated	Overstatement (Understatement)	% Overstated (Understated)
Production Credit Balance	$10,193	$1,986	$8,207	413%
Inventory Balance	$31,868	$24,362	$7,506	31%
Cost of Goods Sold	$58,782	$ 66,938	$(8,156)	-12%
Pre-Tax Income (Loss)	$11,790	$2,205	$9,585	435%

40. On August 1, 2001, MSI raised approximately $31.2 million through a public offering of 2.5 million shares of common stock. The false financial statements for the fiscal year ended March 31, 2001 were included in the registration statement and prospectus for the public offering.

MSI's Reported Results for the Quarter Ended June 30, 2001

41. Despite all the objections and warnings he had received, Dischino continued to shift expenses into inventory through larger and larger production credits. By the time the company filed its Form 10-Q for the quarter ended June 30, 2001 on August 14, 2001, the inventory balance had grown to $35.58 million, a full 64% of the company's reported total current assets, and 38.3% of total assets. The single greatest contributor to the high level of inventory was the production credit balance, which by June 2001 had grown to $13.1 million.

42. For the quarter ended June 30, 2001, MSI reported pre-tax income of $1.79 million. Properly accounting for inventory, however, MSI had in fact realized a $2.3 million pre-tax loss during the quarter. Accordingly, largely as a result of the improper application of the production credit, MSI overstated pre-tax income by $4.1 million, and thereby converted a loss to a gain.

43. Table 2, below, shows the effect of these errors.

Table 2

Selected Results for the Quarter Ended June 30, 2001

(in thousands)	As Reported	As Restated	Overstatement (Understatement)	% Overstated (Understated)
Production Credit Balance	$13,126	$1,695	$11,431	674%
Inventory Balance	$35,586	$24,099	$11,487	48%
Cost of Goods Sold	$15,172	$19,153	$(3,981)	-21%
Pre-Tax Income (Loss)	$1,799	$(2,308)	$4,107	N/A*

*The percentage overstatement (understatement) cannot be calculated because pre-tax income was converted from a loss to a profit.

MSI's Reported Results for the Quarter Ended September 30, 2001

44. By September 30, 2001, the reported value of MSI's inventory was $44 million, almost $13 million of which was attributable to the production credit balance.

45. By the time the September 10-Q was filed on November 14, 2001, Dischino had received objections to the production credit adjustments from MSI's former controller, division heads and internal accounting staff, and from MSI's outside auditors.

46. In addition, Dischino received objections to the production credit from a financial executive with extensive cost accounting experience who was hired in August 2001 to address MSI's growing inventory problem (the "financial executive"). In a September 24, 2001 e-mail, the financial executive told Dischino that he had concluded that the Schaevitz division's production credit for the quarter ended June 30, 2001, was "significantly overstated and [ ] an

adjustment is required," because in calculating production costs, Dischino had used inflated estimates of important overhead cost components when the actual costs where known. The financial executive also expressed similar objections to Dischino's production credit calculation in meetings in September and October 2001.

47. Notwithstanding all the objections and warnings he had received, Dischino continued to use the production credit to shift expenses to the balance sheet. As a result of his application of the production credit, MSI reported results for the period ended September 30, 2001 that substantially inflated the company's inventory as a result of the large production credit balance. The reported results also understated MSI's quarterly pre-tax loss by almost $800,000.

48. In addition, as discussed at paragraphs 49 through 56, below, as a result of Dischino's concealment of the company's default on its credit agreement, MSI's September 30, 2001 10-Q failed to disclose the default and improperly characterized $7.3 million of its debt as long-term.

THE LOAN DEFAULT FRAUD

49. In early October 2001, Dischino realized that the company would report a loss for the quarter ended September 30, 2001. By virtue of this loss, MSI would breach loan covenants contained in the credit agreement with the bank syndicate holding its debt. The loan covenants required MSI to maintain minimum profitability ratios, and gave the banks the right to accelerate the loans if MSI failed to do so.

50. As a result of the September 30, 2001 default, $7.3 million of MSI's long-term debt was immediately accelerable.[1] As a consequence of MSI's default, the banks could at anytime cease making further advances and demand full repayment of all monies extended under the credit agreement, either of which events could have forced MSI's liquidation.

51. In the period leading up to the filing of MSI's September 30, 2001 10-Q on November 14, 2001, Dischino repeatedly asked the banks to waive the events of default, but they refused.

52. Despite the banks' refusal to waive MSI's default, Dischino assured the company's senior management, independent auditors and outside counsel that the banks had waived the default. Indeed, he falsely represented to them that he had obtained a written waiver from the banks.

53. On November 14, 2001, MSI filed its 10-Q for the quarter ended September 30, 2001. The 10-Q reported a loss for the quarter, but did not disclose the default or its ramifications. In addition, the 10-Q continued to carry the debt on the company's balance sheet as long-term debt, and did not disclose the default, contrary to GAAP.

54. Dischino continued to conceal the banks' refusal to waive the default after the filing of the September 30, 2001 10-Q. On the evening of November 14, 2001, after the 10-Q was filed, the lead bank in the syndicate e-mailed Dischino a draft of the bank's standard reservation-of-rights letter confirming that MSI was in breach of the credit agreement, and stating

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[1] Up to that point in its reporting history, MSI had reported profits for each quarter, although when it restated its results, it reported a pre-tax loss for the quarter ended June 30, 2001. This previously unreported loss – an event of default – had been concealed by Dischino's inflation of reported earnings through his use of the production credit.

that the bank syndicate was reserving all of its rights under the agreement. The following morning, Dischino forwarded the bank's transmittal e-mail to MSI's outside auditors, substituting for the reservation of rights letter a draft letter he had fabricated stating that the banks unconditionally waived the September 30, 2001 default and "any other defaults or any rights and remedies of the Lenders."

55. Several weeks later, Dischino received the final, executed reservation-of-rights letter from the banks. He then fabricated a final, executed waiver letter and forwarded it to MSI's auditors.

56. Dischino acted knowingly or recklessly. He directed the calculation and application of the production credit adjustments, and thus knowingly or ecklessly caused MSI to materially inflate its earnings and inventory. He continued to employ the production credit despite receiving repeated objections from MSI's division heads and accounting staff and warnings from MSI's outside auditor that his manual calculations were prone to error. Dischino knew that MSI was in default under its credit agreements, and knew that, as of the time the September 10-Q was filed, the banks had not waived the default. He lied to MSI's senior management and its auditors to conceal the fact that the default had not been waived, and fabricated a letter to substantiate this lie.

THE DISCOVERY OF DISCHINO'S LOAN DEFAULT FRAUD, MSI'S DISCLOSURES, AND THE RESTATEMENT

57. In February 2002, MSI discovered that the banks had not in fact waived the default, and that Dischino had lied and provided a fabricated document to the auditors. On February 14, 2002, MSI fired Dischino.

58. On February 15, 2002, MSI issued a press release announcing, among other things, that it had fired Dischino, that the filing of its 10-Q for the quarter ended December 31, 2001 would be delayed, and that certain of its results for prior periods might have to be restated, pending an evaluation of its inventory. Before trading began that day, the AMEX halted trading in MSI's stock, because of the company's failure to file its 10-Q.

59. On May 31, 2002, MSI filed its 10-Q for the quarter ended December 31, 2001, disclosing that it was taking a $10.1 million charge to cost of goods sold for the quarter, with a corresponding decrease in earnings, to account for its overstatement of inventory. The company attributed the charge and reduction in earnings primarily to "the effect of [ ] changes in accounting estimates [relating to capitalized overhead calculations] as well as changes in quantities produced and sold and actual costs incurred." In fact, the charge and corresponding decrease in earnings were the result of MSI's erroneous inventory accounting – not changes in estimates – and the errors extended far beyond the quarter. Accordingly, MSI's financials for the quarter ended December 31, 2001 were erroneous, and MSI should have restated its financials for that period and prior periods.

60. On June 18, 2002, MSI filed a Form 10-Q/A in which it restated its balance sheet to reclassify as current $7.3 million of debt that had originally been classified as long-term. The company had already restated its balance sheet for September 30, 2001 to reflect the loan default.

61. Finally, on October 28, 2002, MSI restated its previously reported financial results to correct for Dischino's erroneous inventory accounting, and other errors. The Restatement, contained in the company's 10-K for the fiscal year ended March 31, 2002, covered: (1) the fiscal year ended March 31, 2001; (2) all quarters in the fiscal year ended March 31, 2001; and

(3) the first three quarters of the fiscal year ended March 31, 2002. The Restatement primarily corrected for Dischino's erroneous inventory accounting – specifically his calculation of the production credit. When it restated, the company eliminated almost the entire production credit balance, reducing the value of its inventory by $12.2 million, or 28%.

62. The Restatement corrected errors that had resulted in the overstatement of MSI's pre-tax income by 435% for its fiscal year ended March 31, 2001, converted an actual loss to a reported gain for the quarters ended June 30, 2000 and June 30, 2001, and overstated pre-tax income by 13% for the quarter ended September 30, 2001. The company noted in the 10-K that in June and July 2002 it had retained new auditors and appointed a new chief executive officer and chief financial officer. The company discussed its prior determinations not to restate and stated:

> Based upon the advice of our new auditor and after consultation with the United States Securities and Exchange Commission, our new senior management team determined that it was necessary to conduct a thorough re-examination of our historical determination of inventory values and costs of goods sold. . . . As a result of [the auditor's procedures regarding valuation of inventories], our auditors discovered a number of errors in our inventory valuation calculations. . . . We have determined that these errors in our valuation of inventory were of a sufficient magnitude to require restatement.

DISCHINO'S INSIDER TRADING

63. On April 2, 2001 Dischino exercised 60,000 incentive MSI stock options at $1.75 per share. From December 19, 2001 through December 26, 2001, Dischino sold 40,000 shares of MSI stock at prices ranging from $8.29 to $7.04 per share, for combined proceeds of approximately $297,734.

64. When he sold his MSI stock in December 2001, Dischino was aware that: (1) in its most recent financial statements, and in financial statements of numerous prior periods, MSI had overstated its earnings and inventory as a result of the production credit; (2) as a result of the September 31, 2001 reported loss, MSI was in default under its loan agreement, and its lenders refused to waive the default; and (3) MSI would experience a second default under its loan agreement as a result of another anticipated loss for the quarter ended December 31, 2001. This information was both material and nonpublic.

65. As the company's chief financial officer, Dischino was an MSI insider who owed a duty of trust and confidence to MSI and its shareholders. Dischino violated this duty by selling his MSI shares while in possession of the above-described material non-public information.

FIRST CLAIM FOR RELIEF
[against both defendants]

VIOLATIONS OF SECTION 17(a) OF THE SECURITIES ACT, 15 U.S.C. §§ 77q(a), AND SECTION 10(b) OF THE EXCHANGE ACT, 15 U.S.C. §78j(b), AND RULE 10b-5 THEREUNDER, 17 C.F.R. §240.10b-5

66. The Commission realleges and incorporates by reference herein each and every allegation contained in paragraphs 1 through 65, above.

67. As more fully described in paragraphs 12 through 56, above, Defendants MSI and Dischino knowingly or recklessly made false and misleading statements, or omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, to purchasers and prospective purchasers of MSI's shares regarding: (a) MSI's earnings and the value of MSI's inventory; and (b) MSI's default under its loan agreement.

68. As more fully described in paragraphs 12 through 56, and 63 through 65, above, Dischino, in breach of a fiduciary duty to MSI's shareholders and while in possession of material non-public information regarding MSI's earnings, inventory, and default under its loan agreement, sold 40,000 shares of MSI stock between December 19 and 26, 2001.

69. By reason of the foregoing, MSI and Dischino engaged and, unless enjoined, will continue to engage, directly or indirectly, in transactions, acts, practices and courses of business which constitute violations of Section 17(a) of the Securities Act, 15 U.S.C. §§ 77q(a), and Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5.

SECOND CLAIM FOR RELIEF
[against MSI]

VIOLATIONS OF SECTION 13(a) OF THE EXCHANGE ACT, 15 U.S.C. §78m(a), AND RULES 12b-20, 13a-1, 13a-11, AND 13a-13, 17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-11, and 240.13a-13

70. The Commission realleges and incorporates by reference herein each and every allegation contained in paragraphs 1 through 69, above.

71. As described above, MSI failed to file with the Commission such financial reports as the Commission has prescribed, and MSI failed to include, in addition to the information expressly required to be stated in such reports, such further material information as was necessary to make the statements made therein, in light of the circumstances in which they were made, not misleading.

72. By reason of the foregoing, MSI violated, and unless enjoined, will continue to violate, Section 13(a) of the Exchange Act, 15 U.S.C. § 78m(a), and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder, 17 C.F.R. §§ 240.12b-20, 240.13a.1, 240.13a-11, and 240.13a-13.

THIRD CLAIM FOR RELIEF
[against MSI]

VIOLATIONS OF SECTIONS 13(b)(2)(A) AND 13(b)(2)(B) OF THE EXCHANGE ACT,
<u>15 U.S.C. § 78m(b)(2)(A) and (B)</u>

73. The Commission realleges and incorporates by reference herein each and every allegation contained in paragraphs 1 through 72, above.

74. As described above, MSI failed to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of its assets, and failed to maintain a system of internal accounting controls that permit the preparation of financial statements in conformity with GAAP.

75. By reason of the foregoing, MSI violated, and unless enjoined, will continue to violate, Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, 15 U.S.C. §§ 78m(b)(2)(A) and 78m(b)(2)(B).

FOURTH CLAIM FOR RELIEF
[against Dischino]

CONTROL PERSON LIABILITY FOR MSI's VIOLATIONS OF SECTIONS 13(a), 13(b)(2)(A) AND 13(b)(2)(B) OF THE EXCHANGE ACT, 15 U.S.C. §§ 78m(a), 78m(b)(2)(A) AND 78m(b)(2)(B), AND RULES 12b-20, 13a-1, 13a-11, AND 13a-13,
<u>17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-11, and 240.13a-13</u>

76. The Commission realleges and incorporates by reference herein each and every allegation contained in paragraphs 1 through 75, above.

77. As MSI's chief financial officer, Dischino possessed, directly or indirectly, the power to direct or control MSI's management and policies and was accordingly a control person of MSI pursuant to Section 20(a) of the Exchange Act, 15 U.S.C. § 78t(a).

78. As more fully described in paragraphs 12 through 56, above, Dischino directed the financial fraud that resulted in the materially misleading financial statements issued by MSI, and Dischino signed the company's false filings. Dischino also failed to ensure that MSI had internal accounting controls sufficient to reflect the true impact the production credit adjustment had on MSI's financial statements. Dischino also caused MSI's books and records to inaccurately reflect the company's true financial condition.

79. By reason of the foregoing, Dischino is liable as a controlling person for MSI's violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, 15 U.S.C. §§ 78m(a), 78m(b)(2)(A) and 78m(b)(2)(B), and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder, 17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-11, and 240.13a-13, and unless enjoined, will continue to cause violations of these provisions of the Exchange Act and rules thereunder.

FIFTH CLAIM FOR RELIEF
[against Dischino]

VIOLATION OF SECTION 13(b)(5) OF THE EXCHANGE ACT, 15 U.S.C. § 78m(b)(5), AND RULE 13b2-1 THEREUNDER, 17 C.F.R. § 240.13b2-1

80. The Commission realleges and incorporates by reference herein each and every allegation contained in paragraphs 1 through 79, above.

81. As more fully described in paragraphs 12 through 56, above, Dischino knowingly circumvented or knowingly failed to implement a system of internal accounting controls and knowingly falsified, directly or indirectly, or caused to be falsified books, records and accounts of MSI that were subject to Section 13(b)(2)(A) of the Exchange Act, 15 U.S.C. § 78m(b)(2)(A).

82. By reason of the foregoing, Dischino violated, and unless enjoined, will continue to violate, Section 13(b)(5) of the Exchange Act, 15 U.S.C. § 78m(b)(5), and Rule 13b2-1 thereunder, 17 C.F.R. § 240.13b2-1.

SIXTH CLAIM FOR RELIEF
[against Dischino]

VIOLATION OF EXCHANGE ACT RULE 13b2-2, 17 C.F.R. § 240.13b2-2

83. The Commission realleges and incorporates by reference herein each and every allegation contained in paragraphs 1 through 82, above.

84. As more fully described in paragraphs 12 through 56, above, Dischino made or caused to be made a materially false or misleading statements, or omitted to state, or caused another person to omit to state, a material fact necessary in order to make statements made, in light of the circumstances under which they were made, not misleading to an accountant in connection with the preparation of the audit or examination of required reports or documents.

85. By reason of the foregoing, Dischino violated, and unless enjoined, will continue to violate, Exchange Act Rule 13b2-2, 17 C.F.R. § 240.13b2-2.

PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that this Court:

1. Enter a Final Judgment:

a. permanently restraining and enjoining Defendant MSI, its officers, agents, servants, employees, attorneys, and all persons in active concert or participation with them who receive actual notice of the injunction by personal service, express courier service, facsimile, or otherwise, and each of them, from, directly or indirectly, violating Section 17(a) of the Securities

Act, 15 U.S.C. § 77q(a), Sections 10(b), 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, 15 U.S.C. §§ 78j(b), 78m(a), 78m(b)(2)(A) and (B), and Rules 10b-5, 12b-20, 13a-1, 13a-11 and 13a-13 thereunder, 17 C.F.R. §§ 240.10b-5, 240.12b-20, 240.13a-1, 240.13a-11, and 240.13a-13.

b. permanently restraining and enjoining Defendant Dischino, his agents, servants, employees, attorneys, and all persons in active concert or participation with them who receive actual notice of the injunction by personal service, express courier service, facsimile, or otherwise, and each of them, from, directly or indirectly, violating Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a), and Sections 10(b) and 13(b)(5) of the Exchange Act, 15 U.S.C. §§ 78j(b) and 78m(b)(5), and Rules 10b-5, 13b2-1 and 13b2-2 thereunder, 17 C.F.R. §§ 240.10b-5, 240.13b2-1 and 240.13b2-2;

c. permanently restraining and enjoining Defendant Dischino, his agents, servants, employees, attorneys, and all persons in active concert or participation with them who receive actual notice of the injunction by personal service, express courier service, facsimile, or otherwise, and each of them, from, directly or indirectly, while acting as a control person pursuant to Section 20(a) of the Exchange Act,15 U.S.C. § 78t(a), from violating Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, 15 U.S.C. §§ 78m(a), 78m(b)(2)(A) and 78m(b)(2)(B), and Rules 12b-20, 13a-1, 13a-11and 13a-13 thereunder, 17 C.F.R. 240.§§ 240.12b-20, 240.13a-1, 240.13a-11, and 240.13a-13.

d. directing Defendant MSI to disgorge ill-gotten gains from the fraudulent conduct alleged in this Complaint in the amount of $1.

e. directing Defendant Dischino to disgorge his losses avoided or profits gained from the fraudulent conduct alleged in this Complaint, and to pay prejudgment interest thereon; and

f. directing Defendants to pay civil monetary penalties pursuant to Section 20(d) of the Securities Act, 15 U.S.C. § 77t(d), and Section 21(d)(3) of the Exchange Act, 15 U.S.C. § 78u(d), for the violations alleged herein; and

g. ordering that, pursuant to Section 20(e) of the Securities Act, 15 U.S.C. § 77t(e), and Section 21(d)(2) of the Exchange Act, 15 U.S.C. § 78u(d)(2), Defendant Dischino be prohibited from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act, 15 U.S.C. § 78l, or that is required to file reports pursuant to Section 15(d) of the Exchange Act, 15 U.S.C. § 78o(d).

2. Grant such other and further relief as the Court deems appropriate.

Dated: June 28, 2004
New York, New York

Respectfully Submitted,
MARK K. SCHONFELD
Regional Director

By: ______________________
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