

# Star Electronics, Inc.: An Excel Based Case Using Financial Statement Analysis To Detect Fraud

Joseph M. Ragan, Saint Joseph's University  
Andrew J. Hadley, Saint Joseph's University  
Alexander P. Raymond, Saint Joseph's University

## ABSTRACT

*The demand for forensic accounting within the corporate world is continually increasing. The services performed by forensic accountants help detect and prevent fraud within companies. This case is a study of forensic accounting that utilizes fraud methodology and detection techniques through a simulation engagement. Those who complete this case will proceed through a series of procedures that will lead to the formulation of potential fraudulent activity within the discussed company. The addressed procedures include: understanding the business, determining the areas that may be susceptible to fraud, performing analytical procedures to detect fraud, and creating a report to the board of directors as a follow up to any potential red flags found during the performed testing.*

## INTRODUCTION

Star Electronics, Inc., a large national electronics retailer, has been trying to acquire its largest competitor, United Electronics. Star Electronics' board of directors requires that the books of United Electronics be audited before the acquisition is authorized. The board of directors has reason to believe potential unethical business decisions are being made by United Electronics' management. As a result, you and your team of forensic accountants have been asked to perform a comprehensive analysis of the financial statements, along with due diligence with regards to the structure and operations of management.

## THE TARGET COMPANY

United Electronics is an electronics company that produces high end audio/video equipment. The company was formed in a small southern town. The three founders have previously worked together for a small electronics retailer, and had little experience with the production aspect of the audio/video industry. Robert Hadley became the chairman and chief executive officer, and Luke Raymond became the company's president and chief operating officer. The third person, Chris Reagan, became the controller and treasurer. Two of the three founders own, together, over 21% of the company's stock. The board of directors had a total of seven members, all of whom were related to, or close friends with, the founders. Excited about the new company, the officers were always excited about the prospects of their start-up company.

United Electronics is an entity that produced a net income of \$49 million last year. There average accounts payable at year-end for the past two years were around \$6 million. The organizational structure, in terms of payroll, is segmented into two divisions, salary and hourly employees. Salary employees are administrative positions responsible for the non-production activities of the business, and, on the other hand, the hourly employees make up the production personnel within United. The company operates one major productions facility, making various electronic products for sale at major retail locations.

## **INTERNAL CONTROL ENVIRONMENT**

The two primary owners of the business, Hadley and Raymond, take a pretty hands-off approach when it comes to managing their business. They, and their families, take frequent vacations to various destinations in Europe, and rarely take the time to examine the business' books. They are most happy to leave Chris run the show, noting that there is little, if anything, to worry about as the bottom line steadily increases year after year. Reagan is very much hands-on in all aspects of the business. As he is always busy, Reagan is constantly concerned about the efficiency of the accounting system. In order to facilitate quicker purchases and obtain deals with vendors, Chris left his cashier a stack of blank, pre-signed checks. Anyone in the purchasing department has access to these checks, and may use them as needed. When it comes to payroll, United uses a one-write system to pay its employees, and checks are distributed to the employee mailing addresses at the end of every two weeks. In order to manage internal controls within the sales cycle transactions, Chris personally approves all credit given to customers. Chris insists that it is best for one person to be in charge.

## **INVESTMENT DECISION**

The acquisition of United would give Star Electronics the number one position within their industry. What attracted Star to United was the remarkable growth of the company, and the issuance of a major recommendation to buy from a large brokerage firm. The recommendation was specifically based on 35% earnings per share growth, and comparable product line growth in the low double digit range over the past two years. As a result of the acquisition, Star Electronics would strengthen their relationships with existing vendors, and expand their already extensive customer base. In attempting to negotiate a reasonable purchase price, Star Electronics has asked its analysts to review financial statements prior to negotiation. Star asked the analyst to ensure that United's assumptions were reasonable and realistically attainable given the current market for consumer electronics.

## **THE TEAM CHALLENGE**

Star Electronics would like to hire you and your team to conduct a financial statement review for the past two years of their operations. Although fraud is unlikely, your detection efforts should be thorough. Here is some guidance for the analytical procedures that should be performed:

- Unusual sales increase, especially at the end of each quarter.
- Large amount of receivables that have aged over sixty days.
- Sharp decreases in accrued expenses, particularly at the end of the quarters.
- Sudden shifts in unearned revenue accounts.
- Due to their weak internal control environment, United's vendors and customers should be thoroughly checked for validity and existence.
- A search for vendors with unusual names and sequential invoices.
- Trend analysis of revenue flow should be performed.
- Thorough review of payroll records provided for all salary employees should be conducted.

Financial statements are the end product of the accounting cycle. They can be viewed as summaries of all transactions that occur within a company during a period of time. Financial statement fraud can occur anywhere along the way. Many large frauds are detected through financial statement comparisons. Smaller frauds are usually detected by focusing on individual ledgers and source documents.

At the conclusion of your analytical procedures, you and your team should compile a comprehensive report to the board of directors that displays any potential fraudulent activity that was found. This information will be used by the board of directors to determine if further investigation and/or legal action needs to be taken. This analysis conducted by you and your team is extremely important to the outcome of this pending acquisition.

## TEACHING NOTES

### Synopsis

This case was created as a means to further student's overall understanding of fraudulent activities within a company through means of hands on investigation. Students receive two years of financial statements, along with a payroll register, and schedules of Accounts Receivable and Accounts Payable. They are asked to examine each of these documents thoroughly and search for potential red flags. In addition to finding red flags, students are required to create a detailed report on their findings, simulating a real life investigation. Some of the issues that occur are specific to each document, while there are others that require students to look at the bigger picture. An answer guide is included for the instructor, along with a set of journal entries and a graph that may be given to the students after completing the case to promote further discussion. Selected References have been incorporated into the teaching notes as a basis for the type of course in which this case would fit. The case has been successfully utilized in a forensic accounting special topics graduate accounting course and in an undergraduate forensic accounting course. In both cases, students worked in groups of three or less.

### Analysis

The analysis of this case can be broken down into 4 parts. These parts include:

1. Analysis of the Balance Sheet and Income Statement
2. Analysis of Accounts Receivable
3. Analysis of Accounts Payable
4. Analysis of Payroll Register

In each of these areas, there are multiple issues that will focus on several concepts of a forensic investigation.

*In the Balance Sheet and Income Statement the following issues are included:*

1. Increasing Sales with no increase in Inventory or Cost of Goods Sold
2. Artificial Increasing in Sales Revenue by decreasing Accrued Expenses
3. An increase in Assets offset by a decrease in costs
4. A decrease in Unearned Revenues, specifically at the end of quarters, to help inflate Sales
5. A graph is included to show a trend in Sales increase that may be used in further discussion

*In Accounts Receivable the following issues are included:*

1. There is an issue with the total value of A/R not tying to the Balance Sheet. This relates to the Balance Sheet and Income Statement matters listed above, and a set of journal entries is included for use by the instructor in providing further clarification to students about the entries used in creating fraudulent transactions.
2. There are a large number of Receivables in the "over 90 days" category

*In Accounts Payable the following issues are included:*

1. A company having two invoices with identical invoice numbers, falling in two different aging categories.
2. Companies having the same addresses as employees.

*In the Payroll Register the following issues are included:*

1. Multiple Employees with the same address
2. Multiple Employees with the same Social Security Number

3. Employees with slightly different names having the same PO Box
4. Employees whose ages would make them too young to legally work
5. Employees with odd names that could be fictitious

### **Answer Guide**

The answer guide has been created as a means for instructors to see the key points of concern within the financial statements. Students may not be required to find each specific potential fraud, and likewise it is possible that other issues may exist other than those which are noted.

#### *Inventory*

-Although Sales Increase in 2006 (especially in the end of the quarters), Inventory and Cost of Goods Sold remain fairly constant. December 2006 is an example of this.

#### *Accrued Expenses*

-Accrued Expenses decreased sharply starting in the 2<sup>nd</sup> quarter of 2006 in order to artificially inflate sales (Please see attached Journal Entries).

#### *Other Current Assets*

-In December of 2006, Other Current Assets increase. There is a corresponding decrease in Engineering and Marketing Costs.

#### *Unearned Revenue*

-Balances decrease at the end of the first and second quarter of 2006. Amounts were reversed to help inflate sales (See attached Journal Entries).

#### *Accounts Receivable*

-There are a large number of “Over 90 days” Receivables.  
-The totals of A/R do not tie to the Financial’s totals of A/R for 2006. They are off by \$11 million, the amount of two “topside” journal entries to Bob Smith, used to inflate sales. (See attached Journal Entries)

#### *Accounts Payable*

-The payables for IDX have two invoices with the same number in different aging buckets.  
-Nelson's Consulting and Nelson's Temp Agency have the same address as the Nelson employees (see Payroll Register section for the issues pertaining to the Nelson employees).  
-Y Ask For Anything More’s invoice numbers are out of sequence compared to the aging schedule.  
-John’s Electric Surplus and Timmy’s Electronic Shop have the same address and the same invoiced dollar amounts.  
-Cam’s Exotic Cars- Why is the company spending money at an exotic car dealership?

#### *Payroll Register*

-Stealing, I.M. is a curious name that should draw a red flag.  
-Hollywood, L. is too young to work as he was born in 1997. Also his date of employment is in 1990, seven years before his birth.  
-Hafer, F., and Szurgot, Z. have the exact same address.  
-Osmond, E., and Weicicoskie, C. have the same Social Security Number.  
- Nelson, M., Nellson, M., and Nelse, M. have very similar names and have an Identical PO Box.  
This PO Box is also shared with Nelson’s Consulting and Nelson’s Temp Agency on the Accounts Payable Aging Report.

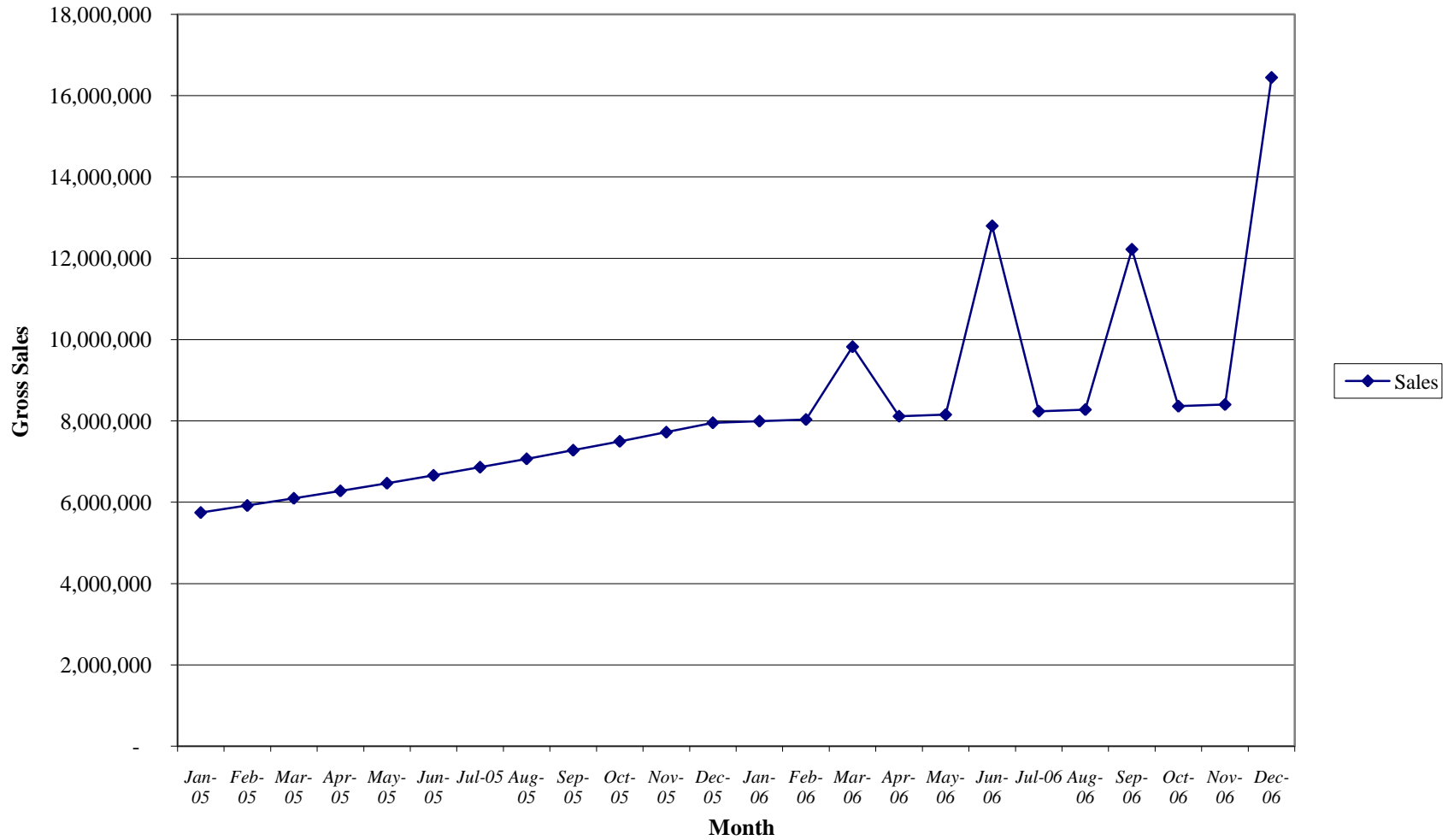
*Sales*

-Sales were artificially inflated at the end of each quarter of 2006 using reversals of Accrued Expenses and Unearned Revenues, as well as through inflation of Accounts Receivable. (See attached Journal Entries)  
 -By graphing monthly sales, a clear trend is created showing spurratic sales increases at the end of each quarter (Please see attached graph).

**Journal Entries**

<b>1st Quarter</b>	Unearned Revenue	1,750,000	
	Sales		1,750,000
<b>2nd Quarter</b>	Unearned Revenue	3,100,000	
	Sales		3,100,000
<b>2nd Quarter</b>	Accrued Expenses	1,500,000	
	Sales		1,500,000
<b>3rd Quarter</b>	Accrued Expenses	900,000	
	Sales		900,000
<b>3rd Quarter</b>	A/R- Bob Smith	3,000,000	
	Sales		3,000,000
<b>3rd Quarter</b>	Other Current Assets	365,000	
	Engineering		161,097
	Marketing		203,904
<b>4th Quarter</b>	A/R- Bob Smith	8,000,000	
	Sales		8,000,000
<b>4th Quarter</b>	Other Current Assets	380,000	
	Engineering		168,597
	Marketing		211,404

### Monthly Sales Graph



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Appendix 1: 2005 Financial Statements

2005 Income Statement	12/31/05	Dec-05	Nov-05	Oct-05	Sep-05	Aug-05	Jul-05	Jun-05	May-05	Apr-05	Mar-05	Feb-05	Jan-05
	<u>Consolidated</u>												
SALES													
Gross Sales	81,533,210	7,952,424	7,720,800	7,495,922	7,277,594	7,065,625	6,859,830	6,660,030	6,466,048	6,277,717	6,094,871	5,917,350	5,745,000
Discounts	(2,445,996)	(238,573)	(231,624)	(224,878)	(218,328)	(211,969)	(205,795)	(199,801)	(193,981)	(188,331)	(182,846)	(177,521)	(172,350)
Returns & Allowances	(1,630,664)	(159,048)	(154,416)	(149,918)	(145,552)	(141,313)	(137,197)	(133,201)	(129,321)	(125,554)	(121,897)	(118,347)	(114,900)
NET SALES	77,456,549	7,554,802	7,334,760	7,121,126	6,913,714	6,712,344	6,516,839	6,327,028	6,142,746	5,963,831	5,790,127	5,621,483	5,457,750
COST OF SALES													
Standard Cost of Sales	12,229,981	1,192,864	1,158,120	1,124,388	1,091,639	1,059,844	1,028,975	999,004	969,907	941,657	914,231	887,603	861,750
Manufacturing Variances	407,666	39,762	38,604	37,480	36,388	35,328	34,299	33,300	32,330	31,389	30,474	29,587	28,725
Total Cost of Sales	12,637,648	1,232,626	1,196,724	1,161,868	1,128,027	1,095,172	1,063,274	1,032,305	1,002,237	973,046	944,705	917,189	890,475
GROSS MANUFAC PROFIT	64,818,902	6,322,177	6,138,036	5,959,258	5,785,687	5,617,172	5,453,565	5,294,723	5,140,508	4,990,785	4,845,422	4,704,293	4,567,275
OPERATING EXPENSES													
Engineering	1,630,664	159,048	154,416	149,918	145,552	141,313	137,197	133,201	129,321	125,554	121,897	118,347	114,900
Marketing	2,038,330	198,811	193,020	187,398	181,940	176,641	171,496	166,501	161,651	156,943	152,372	147,934	143,625
Salary Expenses	6,127,500	617,500	617,500	617,500	475,000	475,000	475,000	475,000	475,000	475,000	475,000	475,000	475,000
Depreciation Expense	601,032	61,578	59,210	56,932	54,743	52,637	50,613	48,666	46,794	44,995	43,264	41,600	40,000
Total Operating Expenses	10,397,527	1,036,937	1,024,146	1,011,749	857,234	845,590	834,305	823,367	812,767	802,492	792,533	782,881	773,525
OPERATING PROFIT	54,421,375	5,285,240	5,113,890	4,947,509	4,928,453	4,771,582	4,619,260	4,471,356	4,327,742	4,188,293	4,052,889	3,921,413	3,793,750
NON-OPERATING INCOME													
Interest Expense	(163,066)	(15,905)	(15,442)	(14,992)	(14,555)	(14,131)	(13,720)	(13,320)	(12,932)	(12,555)	(12,190)	(11,835)	(11,490)
Other	(40,767)	(3,976)	(3,860)	(3,748)	(3,639)	(3,533)	(3,430)	(3,330)	(3,233)	(3,139)	(3,047)	(2,959)	(2,873)
Total Non-Operating Inc/Exp	(203,833)	(493,797)	(493,797)	(493,797)	(493,797)	(493,797)	(493,797)	(493,797)	(493,797)	(493,797)	(493,797)	(493,797)	(493,797)
PRETAX INCOME	54,217,542	4,791,442	4,620,093	4,453,712	4,434,656	4,277,785	4,125,463	3,977,559	3,833,945	3,694,496	3,559,092	3,427,615	3,299,953
PROVISION FOR INCOME TAXES	21,144,841	1,868,663	1,801,836	1,736,948	1,729,516	1,668,336	1,608,931	1,551,248	1,495,238	1,440,853	1,388,046	1,336,770	1,286,982
NET INCOME	33,072,701	2,922,780	2,818,257	2,716,764	2,705,140	2,609,449	2,516,532	2,426,311	2,338,706	2,253,642	2,171,046	2,090,845	2,012,971

2005 Balance Sheet	12/31/05	Dec-05	Nov-05	Oct-05	Sep-05	Aug-05	Jul-05	Jun-05	May-05	Apr-05	Mar-05	Feb-05	Jan-05
	<u>Consolidated</u>												
CASH AND ST INVESTMENTS	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000
ACCOUNTS RECEIVABLE													
Gross Accounts Receivable	1,590,485	1,590,485	1,544,160	1,499,184	1,455,519	1,413,125	1,371,966	1,332,006	1,293,210	1,255,543	1,218,974	1,183,470	1,149,000
Reserve for Doubtful Accounts	(159,048)	(159,048)	(154,416)	(149,918)	(145,552)	(141,313)	(137,197)	(133,201)	(129,321)	(125,554)	(121,897)	(118,347)	(114,900)
Net Accounts Receivable	1,431,436	1,431,436	1,389,744	1,349,266	1,309,967	1,271,813	1,234,769	1,198,805	1,163,889	1,129,989	1,097,077	1,065,123	1,034,100
INVENTORIES	6,992,071	6,992,071	7,208,321	7,431,259	7,661,091	7,898,032	8,142,301	8,394,125	8,653,737	8,921,379	9,197,298	9,481,750	9,775,000
OTHER CURRENT ASSETS	2,300,000	2,300,000	2,300,000	2,300,000	2,300,000	2,300,000	2,300,000	2,300,000	2,300,000	2,300,000	2,300,000	2,300,000	2,300,000
TOTAL CURRENT ASSETS	20,723,507	20,723,507	20,898,065	21,080,525	21,271,058	21,469,845	21,677,071	21,892,930	22,117,626	22,351,368	22,594,374	22,846,873	23,109,100
FIXED ASSETS													
Land and Buildings	8,966,667	8,966,667	8,983,334	9,000,001	9,016,668	9,033,335	9,050,002	9,066,669	9,083,336	9,100,003	9,116,670	9,133,337	9,150,004
Machinery and Equipment	1,558,333	1,558,333	1,566,666	1,574,999	1,583,332	1,591,665	1,599,998	1,608,331	1,616,664	1,624,997	1,633,330	1,641,663	1,649,996
Construction in Progress													
Accumulated Depreciation	976,032	976,032	909,454	845,244	783,312	723,569	665,932	610,319	556,653	504,859	459,864	416,600	375,000
Net Fixed Assets	11,501,032	11,501,032	11,459,454	11,420,244	11,383,312	11,348,569	11,315,932	11,285,319	11,256,653	11,229,859	11,209,864	11,191,600	11,175,000
OTHER ASSETS	875,000	875,000	875,000	875,000	875,000	875,000	875,000	875,000	875,000	875,000	875,000	875,000	875,000
TOTAL ASSETS	33,099,540	33,099,540	33,232,519	33,375,769	33,529,370	33,693,414	33,868,003	34,053,249	34,249,279	34,456,226	34,679,238	34,913,473	35,159,100
CURRENT LIABILITIES													
Accounts Payable	5,752,500	5,752,500	5,608,688	5,468,470	5,331,759	5,198,465	5,068,503	4,941,790	4,818,246	4,697,790	4,580,345	4,465,836	4,354,190
Accrued Expenses	1,900,000	1,900,000	1,900,000	1,900,000	1,900,000	1,900,000	1,900,000	1,900,000	1,900,000	1,900,000	1,900,000	1,900,000	1,900,000
Unearned Revenue	4,771,454	4,771,454	4,632,480	4,497,553	4,366,556	4,239,375	4,115,898	3,996,018	3,879,629	3,766,630	3,656,922	3,550,410	3,447,000
Accrued Compensation	2,200,000	2,200,000	2,200,000	2,200,000	2,200,000	2,200,000	2,200,000	2,200,000	2,200,000	2,200,000	2,200,000	2,200,000	2,200,000
TOTAL CURRENT LIABILITIES	14,623,954	14,623,954	14,341,167	14,066,023	13,798,315	13,537,840	13,284,401	13,037,808	12,797,875	12,564,419	12,337,267	12,116,246	11,901,190
LONG TERM DEBT	-	-	-	-	-	-	-	-	-	-	-	-	-
STOCKHOLDERS' EQUITY													
Class A Common Stock (268,885 shares)	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000
Additional Paid-In Capital	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000
Retained Earnings	16,475,586	16,475,586	16,891,352	17,309,745	17,731,055	18,155,574	18,583,601	19,015,441	19,451,404	19,891,807	20,341,971	20,797,227	21,257,910
Less: Treasury Stock	(500,000)	(500,000)	(500,000)	(500,000)	(500,000)	(500,000)	(500,000)	(500,000)	(500,000)	(500,000)	(500,000)	(500,000)	(500,000)
TOTAL EQUITY	18,475,586	18,475,586	18,891,352	19,309,745	19,731,055	20,155,574	20,583,601	21,015,441	21,451,404	21,891,807	22,341,971	22,797,227	23,257,910
TOTAL LIABILITIES & CAPITAL	33,099,540	33,099,540	33,232,519	33,375,769	33,529,370	33,693,414	33,868,003	34,053,249	34,249,279	34,456,226	34,679,238	34,913,473	35,159,100

Appendix 2: 2006 Financial Statements

2006 Income Statement	12/31/06	Dec-06	Nov-06	Oct-06	Sep-06	Aug-06	Jul-06	Jun-06	May-06	Apr-06	Mar-06	Feb-06	Jan-06
	<u>Consolidated</u>												
SALES													
Gross Sales	116,838,105	16,442,912	8,400,907	8,359,112	12,217,524	8,276,143	8,234,968	12,793,998	8,153,232	8,112,669	9,822,307	8,032,147	7,992,186
Discounts	(3,505,143)	(493,287)	(252,027)	(250,773)	(366,526)	(248,284)	(247,049)	(383,820)	(244,597)	(243,380)	(294,669)	(240,964)	(239,766)
Returns & Allowances	(1,971,762)	(168,858)	(168,018)	(167,182)	(166,350)	(165,523)	(164,699)	(163,880)	(163,065)	(162,253)	(161,446)	(160,643)	(159,844)
NET SALES	111,361,200	15,780,766	7,980,862	7,941,156	11,684,648	7,862,336	7,823,220	12,246,298	7,745,571	7,707,035	9,366,192	7,630,539	7,592,576
COST OF SALES													
Standard Cost of Sales	14,788,216	1,266,437	1,260,136	1,253,867	1,247,629	1,241,421	1,235,245	1,229,100	1,222,985	1,216,900	1,210,846	1,204,822	1,198,828
Manufacturing Variances	492,941	42,215	42,005	41,796	41,588	41,381	41,175	40,970	40,766	40,563	40,362	40,161	39,961
Total Cost of Sales	15,281,156	1,308,651	1,302,141	1,295,662	1,289,216	1,282,802	1,276,420	1,270,070	1,263,751	1,257,464	1,251,208	1,244,983	1,238,789
GROSS MANUFAC PROFIT	96,080,044	14,472,115	6,678,721	6,645,494	10,395,432	6,579,534	6,546,800	10,976,229	6,481,820	6,449,572	8,114,984	6,385,557	6,353,788
OPERATING EXPENSES													
Engineering	1,641,428	-	168,018	167,182	4,875	165,523	164,699	163,880	163,065	162,253	161,446	160,643	159,844
Marketing	2,050,817	-	210,023	208,978	5,125	206,904	205,874	204,850	203,831	202,817	201,808	200,804	199,805
Salary Expenses	10,605,276	883,773	883,773	883,773	883,773	883,773	883,773	883,773	883,773	883,773	883,773	883,773	883,773
Depreciation Expense	571,469	11,245	22,533	22,533	22,533	61,578	61,578	61,578	61,578	61,578	61,578	61,578	61,578
Total Operating Expenses	14,868,990	895,018	1,284,347	1,282,466	916,306	1,317,778	1,315,925	1,314,081	1,312,247	1,310,421	1,308,605	1,306,798	1,305,000
OPERATING PROFIT	81,211,053	13,577,097	5,394,374	5,363,028	9,479,126	5,261,756	5,230,875	9,662,148	5,169,573	5,139,151	6,806,379	5,078,759	5,048,788
NON-OPERATING INCOME													
Interest Expense	(197,176)	(16,886)	(16,802)	(16,718)	(16,635)	(16,552)	(16,470)	(16,388)	(16,306)	(16,225)	(16,145)	(16,064)	(15,984)
Other	(49,294)	(4,221)	(4,200)	(4,180)	(4,159)	(4,138)	(4,117)	(4,097)	(4,077)	(4,056)	(4,036)	(4,016)	(3,996)
Total Non-Operating Inc/Exp	(246,470)	(21,107)	(21,002)	(20,898)	(20,794)	(20,690)	(20,587)	(20,485)	(20,383)	(20,282)	(20,181)	(20,080)	(19,980)
PRETAX INCOME	80,964,583	13,555,989	5,373,372	5,342,130	9,458,332	5,241,066	5,210,288	9,641,663	5,149,190	5,118,869	6,786,199	5,058,678	5,028,808
PROVISION FOR INCOME TAXES	31,576,187	2,175,873	2,162,910	2,149,815	2,136,976	2,124,200	2,111,485	2,098,832	2,086,240	2,073,708	2,061,237	2,048,826	2,036,475
NET INCOME	49,388,396	11,380,116	3,210,462	3,192,315	7,321,355	3,116,866	3,098,802	7,542,831	3,062,950	3,045,161	4,724,962	3,009,853	2,992,333

2006 Balance Sheet	12/31/06	Dec-06	Nov-06	Oct-06	Sep-06	Aug-06	Jul-06	Jun-06	May-06	Apr-06	Mar-06	Feb-06	Jan-06
<u>Consolidated</u>													
CASH AND ST INVESTMENTS	10,200,000	10,200,000	10,200,000	10,200,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000	10,000,000
ACCOUNTS RECEIVABLE													
Gross Accounts Receivable	12,688,582	12,688,582	1,680,181	1,671,822	4,663,505	1,655,229	1,646,994	1,638,800	1,630,646	1,622,534	1,614,461	1,606,429	1,598,437
Reserve for Doubtful Accounts	(168,858)	(168,858)	(168,018)	(167,182)	(166,350)	(165,523)	(164,699)	(163,880)	(163,065)	(162,253)	(161,446)	(160,643)	(159,844)
Net Accounts Receivable	12,519,724	12,519,724	1,512,163	1,504,640	4,497,154	1,489,706	1,482,294	1,474,920	1,467,582	1,460,280	1,453,015	1,445,786	1,438,593
INVENTORIES	5,947,255	5,947,255	6,007,329	6,068,009	6,129,302	6,191,214	6,253,751	6,316,921	6,380,728	6,445,180	6,510,283	6,576,043	6,642,468
OTHER CURRENT ASSETS	2,645,000	2,645,000	2,265,000	2,265,000	2,265,000	1,900,000	1,900,000	1,800,000	1,700,000	1,700,000	1,700,000	2,500,000	2,300,000
TOTAL CURRENT ASSETS	31,311,980	31,311,980	19,984,492	20,037,649	22,891,456	19,580,920	19,636,046	19,591,840	19,548,310	19,605,460	19,663,298	20,521,829	20,381,061
FIXED ASSETS													
Land and Buildings	8,750,000	8,750,000	8,766,667	8,783,333	8,800,000	8,816,667	8,833,333	8,850,000	8,866,667	8,883,333	8,900,000	8,916,667	8,933,333
Machinery and Equipment	1,450,000	1,450,000	1,458,333	1,466,667	1,475,000	1,483,333	1,491,667	1,500,000	1,508,333	1,516,667	1,525,000	1,533,333	1,541,667
Construction in Progress													
Accumulated Depreciation	1,614,080	1,614,080	1,596,257	1,567,724	1,539,191	1,510,658	1,443,079	1,375,501	1,308,923	1,242,345	1,175,767	1,109,189	1,042,610
Net Fixed Assets	11,814,080	11,814,080	11,821,257	11,817,724	11,814,191	11,810,658	11,768,079	11,725,501	11,683,923	11,642,345	11,600,767	11,559,189	11,517,610
OTHER ASSETS	875,000	875,000	875,000	875,000	875,000	875,000	875,000	875,000	875,000	875,000	875,000	875,000	875,000
TOTAL ASSETS	44,001,059	44,001,059	32,680,748	32,730,372	35,580,647	32,266,577	32,279,125	32,192,341	32,107,233	32,122,805	32,139,065	32,956,018	32,773,671
CURRENT LIABILITIES													
Accounts Payable	6,200,000	6,200,000	6,200,000	6,200,000	6,200,000	6,200,000	6,200,000	6,200,000	6,200,000	6,200,000	6,200,000	6,200,000	6,200,000
Accrued Expenses	46,486	46,486	46,026	45,570	45,119	935,761	926,496	917,323	2,393,389	2,369,692	2,346,230	2,323,000	2,300,000
Unearned Revenue	92,477	92,477	91,561	90,654	89,757	88,868	87,988	87,117	3,155,561	3,124,318	3,093,384	4,819,288	4,795,311
Accrued Compensation	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000
TOTAL CURRENT LIABILITIES	8,738,963	8,738,963	8,737,587	8,736,224	8,734,876	9,624,629	9,614,485	9,604,440	14,148,951	14,094,011	14,039,614	15,742,288	15,695,311
LONG TERM DEBT	-	-	-	-	-	-	-	-	-	-	-	-	-
STOCKHOLDERS' EQUITY													
Class A Common Stock (268,885 shares)	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000
Additional Paid-In Capital	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000
Retained Earnings	33,262,096	33,262,096	21,943,162	21,994,148	24,845,771	20,641,948	20,664,641	20,587,901	15,958,282	16,028,794	16,099,450	15,213,730	15,078,360
Less: Treasury Stock	(500,000)	(500,000)	(500,000)	(500,000)	(500,000)	(500,000)	(500,000)	(500,000)	(500,000)	(500,000)	(500,000)	(500,000)	(500,000)
TOTAL EQUITY	35,262,096	35,262,096	23,943,162	23,994,148	26,845,771	22,641,948	22,664,641	22,587,901	17,958,282	18,028,794	18,099,450	17,213,730	17,078,360
TOTAL LIABILITIES & CAPITAL	44,001,059	44,001,059	32,680,748	32,730,372	35,580,647	32,266,577	32,279,125	32,192,341	32,107,233	32,122,805	32,139,065	32,956,018	32,773,671

Appendix 3: 2006 Payroll Register

Salary Payroll Register

SSN	Name	Sex	DOB	DOE	Address	City	State	Zip	Annual	Bi-weekly	Employer Withholdings	Individual Withholdings
556-27-5184	Hollywood, L.	F	5/21/1997	4/30/1990	100 Plum St	Norristown	PA	19402	35,330.00	1,358.85	6,253.41	3,533.00
180-56-8467	Watts, M.	F	3/29/1971	10/6/1997	104 Iverson Lane	Drexel Hill	PA	19155	28,380.00	1,091.54	5,023.26	2,838.00
200-62-7967	Reagan, C.	M	12/28/1970	6/27/1988	198 Anderson	Overbrook	PA	18320	1,256,325.00	48,320.19	222,369.53	125,632.50
183-66-7282	Dooley, D.	M	7/14/1970	6/7/1993	14 Anderson Ave	Overbrook	PA	19402	41,601.00	1,600.04	7,363.38	4,160.10
184-54-0080	Livinghouse, L.	M	9/23/1969	4/2/1990	198 Mayfield Dr	Philadelphia	PA	19104	138,927.00	5,343.35	24,590.08	13,892.70
168-42-5854	Knechtle, D.	F	3/19/1966	8/24/1998	234 Apple Stree	West Chester	PA	19402	566,065.00	21,771.73	100,193.51	56,606.50
210-56-0067	Knouse, L.	F	6/6/1965	9/22/1986	1005 Compton Drive	Overbrook	PA	19402	32,857.00	1,263.73	5,815.69	3,285.70
261-89-7094	Begone, C.	M	5/21/1965	2/3/1997	747 Prairie Street	Philadelphia	PA	19402	14,873.00	572.04	2,632.52	1,487.30
166-46-9328	Ostroski, J.	F	10/16/1964	9/19/1990	12 Harold Lane	West Chester	PA	19103	43,808.94	1,684.96	7,754.18	4,380.89
203-56-3178	Roth, B.	M	4/7/1964	7/31/1989	102 Willow Street	Mt. Laurel	NJ	19402	58,878.00	2,264.54	10,421.41	5,887.80
135-64-0109	Hafer, F.	M	2/20/1964	10/5/1987	1049 Andrea Place	Malvern	PA	18320	69,581.00	2,676.19	12,315.84	6,958.10
175-56-5365	Wolfe, K.	M	1/13/1963	5/2/1988	104 Broad Street	Overbrook	PA	19402	250,161.00	9,621.58	44,278.50	25,016.10
199-52-6686	Zillhardt, M.	F	10/14/1962	11/5/1981	19 Carpenter Blvd	West Chester	NJ	19103	212,804.00	8,184.77	37,666.31	21,280.40
182-58-2751	Hadley, R.	M	1/31/1962	5/13/1985	98 Randolph	Philadelphia	PA	19103	2,334,106.00	89,773.31	413,136.76	233,410.60
183-56-6884	Borneman, M.	M	10/26/1961	2/23/1998	934 Pharmore Drive	Moorsetown	NJ	19103	33,481.00	1,287.73	5,926.14	3,348.10
164-52-5332	Feick, S.	F	7/27/1960	11/2/1992	51 Drexel Road	Norristown	PA	19103	29,489.00	1,134.19	5,219.55	2,948.90
124-23-2342	Jones, M.	M	12/20/1959	5/27/1986	101 Waldorf Way	Philadelphia	Pa	19103	130,000.00	5,000.00	23,010.00	13,000.00
200-79-1113	Nellson, M.	M	10/3/1959	6/8/1997	P.O Box 197	West Chester	PA	19382	96,740.00	3,720.77	17,122.98	-
101-01-0101	Nelsen, M.	M	10/1/1959	6/6/1997	123 Main Street	West Chester	PA	19406	64,740.00	2,490.00	11,458.98	6,474.00
987-65-4321	Ostrrowski, J.	F	9/30/1959	6/5/1997	430 Orange	Malvern	PA	19406	88,920.00	3,420.00	15,738.84	8,892.00
323-45-6789	Nelse, M.	M	9/29/1959	6/4/1997	P.O Box 197	West Chester	PA	19382	42,640.00	1,640.00	7,547.28	-
204-56-4497	Marchione, T.	F	8/3/1959	9/26/1983	189 Plate Ave	Mt. Laurel	NJ	19155	231,110.00	8,888.85	40,906.47	23,111.00
299-58-4277	Bennett, J.	M	5/8/1958	1/6/1986	280 Belmont Ave	Philadelphia	PA	18320	89,070.00	3,425.77	15,765.39	8,907.00
166-46-9263	Haldeman, G.	M	10/15/1957	10/11/1988	1413 Appier Street	Norristown	PA	18320	38,796.00	1,492.15	6,866.89	3,879.60
190-46-6702	Nelson, M.	M	4/24/1957	4/18/1983	P.O Box 197	West Chester	PA	19382	341,032.00	13,116.62	60,362.66	-
182-50-6491	Rohrbach, C.	F	1/23/1957	11/4/1991	105 Mt. Mutumbo Circle	Malvern	PA	18320	36,393.00	1,399.73	6,441.56	3,639.30
246-02-4513	Aldridge, S.	M	12/2/1955	11/7/1994	100 Bonner Blvd	Philadelphia	PA	19103	33,843.00	1,301.65	5,990.21	3,384.30
219-64-3286	Szurgot, Z.	F	10/31/1952	4/11/1994	1049 Andrea Place	Malvern	PA	18320	69,581.00	2,676.19	12,315.84	6,958.10
200-38-2419	Osmond, E.	M	3/17/1948	2/2/1998	234 Ferret Street	Drexel Hill	PA	19155	43,770.00	1,683.46	7,747.29	4,377.00
027-38-8275	Clarkson, R. E.	M	2/8/1948	7/24/1991	5 Glen Loch	Wilmington	DE	19402	532,908.00	20,496.46	94,324.72	53,290.80
200-38-8317	Goodwin, V.	F	10/13/1947	11/4/1991	109 Happy Valley Ave	Overbrook	PA	19155	39,099.00	1,503.81	6,920.52	3,909.90
241-78-1207	Cagle, J.	F	7/31/1947	8/5/1985	133 Bergdoll Terrace	Norristown	PA	19104	36,708.00	1,411.85	6,497.32	3,670.80
200-38-2419	Weicicoskie, C.	M	10/22/1945	2/13/1989	180 Hope Street	Mt. Laurel	NJ	19104	42,692.00	1,642.00	7,556.48	4,269.20
187-34-9193	Franklin, B.	M	6/26/1945	9/25/1967	998 Golf Road	Malvern	PA	19155	41,277.00	1,587.58	7,306.03	4,127.70
279-40-0755	Yehl, R.	F	12/14/1944	1/13/1986	1943 Pearson Place	Norristown	PA	18320	35,360.00	1,360.00	6,258.72	3,536.00
171-36-7901	Stealing, I.M.	F	10/13/1944	11/11/1996	15 Birch Tree Lane	Moorsetown	NJ	19104	31,458.00	1,209.92	5,568.07	3,145.80
203-34-3852	Freeman, B.	F	4/30/1944	3/10/1969	109 Marchant Manor	Drexel Hill	PA	19103	48,249.00	1,855.73	8,540.07	4,824.90
173-34-8850	Rios, A.	F	8/17/1943	2/9/1983	225 Ruby St	Drexel Hill	PA	19155	41,862.00	1,610.08	7,409.57	4,186.20
173-34-9496	Morganti, A.	M	7/29/1942	2/2/1965	110 Columbus Ave	Overbrook	PA	19103	54,613.00	2,100.50	9,666.50	5,461.30
195-34-2650	Stamm, D.	M	6/25/1942	8/28/1961	92 Maple St	Norristown	PA	19104	50,061.00	1,925.42	8,860.80	5,006.10
203-30-0163	Raymond, L.	M	7/28/1939	10/17/1966	198 Cobbs Creek	Drexel Hill	PA	19155	2,333,909.00	89,765.73	413,101.89	233,390.90
<b>Total</b>									<b>9,706,167.94</b>	<b>373,314.15</b>	<b>1,717,991.73</b>	<b>922,575.59</b>

Appendix 4: Accounts Receivable Detailed Aging Report 12/31/06

Accounts Receivable Detailed Aging  
As of December 31, 2006

Customer #	Customer Name	Customer Address	0-30 Days	30-60 Days	60-90 Days	Over 90 Days	Customer Total
101	AAA Electronics	111 Atlantic Blvd. Philadelphia, PA 19107					
			Inv. # 350	10,850			
			Inv. # 370	82,700			
			Inv. # 410	6,800			
							<b>100,350</b>
102	Abba, Inc.	350 Pine Rd. Baltimore, MD 21201					
			Inv. # 220			170,370	
			Inv. # 360	26,395			
							<b>196,765</b>
103	Anderson, Inc.	400 West St. San Jose, CA 95112					
			Inv. # 100			11,200	
			Inv. # 540	6,023			
							<b>17,223</b>
104	Boomin Systems Co.	890 Broad St. Philadelphia, PA 19107					
			Inv. # 150			33,350	
			Inv. # 390	6,954			
			Inv. # 420	3,350			
							<b>43,654</b>
106	Better Quality Stereos	350 Market St. Philadelphia, PA 19106					
			Inv. # 380	3,030			
							<b>3,030</b>
105	Big Buy Video Center	100 Park Ave. New York, NY 10001					
			Inv. # 180			12,030	
			Inv. # 210	8,979			
							<b>21,009</b>
107	Circuit Audio and Video	240 Mall Blvd. King of Prussia, PA 19406					
			Inv. # 110			187,150	
			Inv. # 120			137,040	
							<b>324,190</b>
108	Cool Sounds, Inc.	620 Cool Ave. Philadelphia, PA 19107					
			Inv. # 130		41,600		
							<b>41,600</b>
109	Nelson's Stereo Supply	123 Main St. King of Prussia, PA 19406					
			Inv. # 230		5,076		
			Inv. # 250		379		
			Inv. # 340			28,675	
							<b>34,130</b>
110	Def Systems, Inc.	180 Front St. Philadelphia, PA 19106					
			Inv. # 140		9,203		
			Inv. # 240		7,700		
							<b>16,903</b>
111	Electronics-R-Us	230 Infringement St. Philadelphia, PA 19107					
			Inv. # 160			8,506	
							<b>8,506</b>
112	Fast Eddie's	870 Quick Blvd. Philadelphia, PA 19107					
			Inv. # 260			9,900	
			Inv. # 310			2,010	
			Inv. # 320			1,902	
							<b>13,812</b>
113	General Video Supply	100 GVS St. New York, NY 10001					
			Inv. # 170			12,660	
			Inv. # 330	10,950			
							<b>23,610</b>
114	Granny's Stereos	900 Old St. Philadelphia, PA 19107					
			Inv. # 460	30,501			
			Inv. # 670	314,339			
							<b>344,840</b>
115	Kenson Co.	430 Anderson Ave. New York, NY 10001					
			Inv. # 470	5,900			
			Inv. # 680			187,734	
							<b>193,634</b>
116	Nelsons # 1 Electronics	123 Main St. King of Prussia, PA 19406					
			Inv. # 115		16,050		
			Inv. # 175			32,700	
							<b>48,750</b>
117	Phat Stereo Systems, Inc.	320 Money St. Philadelphia, PA 19107					
			Inv. # 480		3,030		
			Inv. # 630	2,018			
			Inv. # 640			3,400	
							<b>8,448</b>



**Appendix 5: Accounts Payable Aging Report 12/31/06**

**Accounts Payable Aging Report**

**As of December 31, 2006**

Vendor #	Vendor Name	Address	0-30 Days	30-60 Days	60-90 Days	Over 90 Days	Total Due Per Vendor
201	Allison Wholesalers	112 Ridge Avenue, Phila, PA 19128					
				Inv # 33456A	134,567		
				Inv. # 45267A	83,412		
				Inv. # 45645A			
			347,654				565,633
202	Bolton Electronics	405 Hollywood Blvd., Los Angeles, CA 95178					
				Inv. # 220		23,456	
				Inv. # 360	34,532		
							57,988
203	Cam's Exotic Cars	123 Market St, Phila, PA 19134					
				Inv. # 345678		345,621	
				Inv. # 345870	45,634		
							391,255
208	Coffeehouse Systems	145 West Avenue, New York, NY 10023					
				Inv. # 180		23,452	
				Inv. # 210	45,345		
							68,797
209	DMX Wholesalers	432 Pine St., Phila, PA 19128					
				Inv. # 380	123,400		
							123,400
210	EXS Systems	340 Norristown Drive, Wilmington, DE 19324					
				Inv. # 2345		145,234	
				Inv. # 2476		23,432	
							168,666
211	EZ PASS Electronics	344 41st Street, Avalon, NJ 08234					
				Inv. # 130		54,321	
							54,321
212	Fellicity GrandStand	143 West Main Blvd, New York, NY 10023					
				Inv. # 465	134,543		
				Inv. # 487		124,564	
				Inv. # 521		34,543	
							293,650
213	GPX	234 Race Street, Philadelphia, PA 19106					
				Inv. # 34A		356,425	
				Inv. # 45A		45,345	
							401,770
214	Nelsen Temp Agency	PO Box 197, West Chester, PA 19382					
				Inv. # 160		285,060	
							285,060
215	IDX	245 South Street, Philadelphia, PA 19107					
				Inv. # 260		65,729	
				Inv. # 310	45,756		
				Inv. # 320	59,510		
				Inv. # 320			
			59,510				230,505
216	Industry Special Boutique	456 West 41st Street. New York , NY 10001					
				Inv. # 170		126,600	
				Inv. # 330	119,000		
							245,600
217	JR Nickel	900 Old St. Philadelphia, PA 19107					
				Inv. # 563	110,020		
				Inv. # 894	140,500		
							250,520
218	John's Electronic Surplus	430 Anderson Ave. New York, NY 10001					
				Inv. # 47023	47,133		
				Inv. # 47056	132,010		
							179,143
219	MN Consulting	234 Market Street, Philadelphia, PA 19107					
				Inv. # 115	123,450		
				Inv. # 175	34,532		
							157,982



**Accounts Payable Aging Report (Continued)**

**As of December 31, 2006**

Vendor #	Vendor Name	Address	0-30 Days	30-60 Days	60-90 Days	Over 90 Days	Total Due Per Vendor
205	Nelson's Consulting	PO Box 197, West Chester, PA 19382	Inv. # 25 Inv. # 26 Inv. # 27	56,432 14,234 45,345			116,011
220	Old School Limited	2001 Market Street, Phila, PA 19128	Inv. # 5672 Inv. # 5684 Inv. # 5573	30,300 820,180	134,000		984,480
223	Pilot Electronics	500 System Ave. San Jose, CA 95112	Inv. # 700 Inv. # 720	30,590 54,969			85,559
224	Stereos Inc.	100 Sony St. San Jose, CA 95112	Inv. # 49002 Inv. # 49008	145,000 134,890			279,890
229	Storage Incorporated	200 S. Broad St, Philadelphia, PA 19134	Inv. # 845	162,100			162,100
241	Timmy's Electronics Shop	430 Anderson Ave. New York, NY 10001	Inv. # 56445 Inv. # 56876	47,151 132,010			179,161
242	Tony's Wholesalers	5676 Market Street, Philadelphia, PA 19107	Inv. # 450 Inv. # 620	35,000 534,900			569,900
243	XYZ Decision Stereos	23 Main St, Wilmington, DE 19345	Inv. # 50034	69,994			69,994
244	Y Ask For Anything More	700 Main St, Phila, PA 19127	Inv. # 190420 Inv. # 190378			248,750 29,865	278,615
<b>Total Per Period</b>			<b>2,731,572</b>	<b>1,431,896</b>	<b>1,067,273</b>	<b>969,259</b>	<b>6,200,000</b>

**NOTES**