

an SWX Group company



**ZUL-RLE-XIII/05**

**Decision of the Executive Committee of the  
Admission Board  
concerning  
X.**

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The Committee of the SWX Admission Board

[...]

arrived at a decision based on the following considerations:

### **Facts**

1. X. (hereinafter, X. or the company) is a joint-stock company domiciled in [...].
2. The company applies US Generally Accepted Accounting Principles (US GAAP) as its accounting standard.
3. The SWX Office of the Admission Board (the Office) examined the [...] semi-annual financial report of X. [...]
4. The substance of the inquiry was as follows: In its [...] annual report, X. broke down its segment reporting into [...] geographic regions [...]. In the company's [...] semi-annual report, however, only the segment revenues were disclosed. Lacking in particular were differentiations between "External revenue" and "Intersegment revenue", as well as information on "Segment net earnings".
5. Moreover, the [...] semi-annual report lacked a condensed cash flow statement and a statement of changes in shareholders' equity.
6. [...] X. responded to Office's request for information. The company merely made reference to the updated segment reporting enclosed with its response. No justification was provided as to why only the consolidated sales of the individual geographic segments were disclosed.
7. X. provided equally as little justification for the absence of a condensed cash flow statement. Instead, it merely made reference to the enclosed updated semi-annual report, which contained a detailed cash flow statement for the current and prior-year periods. In addition, the company's response simply made reference to the enclosed statement of changes in shareholders' equity for current and prior-year period. It provided no information whatsoever with regard to the missing statement of changes in shareholders' equity in the company's [...] semi-annual report.
8. The Office petitioned the Committee of the Admission Board as follows: that a reprimand be pronounced against X.; that such reprimand be published by SWX Swiss Exchange (SWX); and that procedural costs [...] be charged to X.
9. In order to preserve the legal right to a fair hearing, the Office afforded the company an opportunity to state its position on the motion for sanction that was submitted [...] to the Committee of the Admission Board. X. stated its position [...] within the granted period.
10. In essence, X. put forward the following arguments: X. was not aware at the time of the Directive on Requirements for Financial Reporting, which entered into force on 1 January 2005 and placed additional requirements on the interim financial reporting of companies that apply US GAAP. By mischance, the Directive was enacted at a time when X. was in the process of changing its auditors.
11. In addition it was asserted that X., being a foreign issuer, is not as closely in touch with regulatory developments as are Swiss-domestic issuers. Moreover, the company once again noted that there was no malintent involved.

12. In conclusion, X. petitioned that, if in fact a reprimand were to be pronounced, such reprimand not be published or that the publication be made without the mention of a name.

## **Considerations**

### **I. Competence**

13. Based on Art 81 §1 Points 1 and 3 LR in conjunction with Art. 82 §3 LR, and dependent upon the specific sanction to be imposed, either the Admission Board or the Disciplinary Commission of SWX is charged with ruling on potentially sanctionable acts associated with a violation of the issuer's duty to provide information or its failure to publish prescribed disclosures or notifications. As to sanctions under Art. 82 §1 Points 1-3 and 9 LR, the Committee of the Admission Board bears decision-making responsibility (see Admission Board Rules of Procedure, Point 3.5.3).

### **II. Basis**

14. Based on Art. 64 et seq. LR, the Directive on Enforcement of Financial Reporting Regulations and the Registration of Auditing Bodies entered into force on 1 June 2000. Margin reference number 10 of this Directive provides that SWX shall verify the proper application of accounting standards it recognizes.
15. US GAAP is deemed to be an SWX-recognized accounting standard as per Art. 70 LR and Admission Board Communiqué No. 20/2000.
16. According to Admission Board Communiqué No. 12/2002, an integral element of semi-annual reports published for the fiscal year starting on or after 1 January 2003 is that they be prepared (also in terms of presentation and disclosure) in accordance with the same accounting standard as applied in the annual financial statements. Because the [...] annual report of X. was prepared on the basis of US GAAP, this means that the company had to apply the Accounting Principles Board Opinion No. 28 "Interim Financial Reporting" (APB 28) in its semi-annual report.
17. SWX places more extensive requirements on semi-annual reporting for fiscal years that started on or after 1 January 2005. The relevant requirements for issuers applying US GAAP are laid down in mrn. 21 of the Directive on Requirements for Financial Reporting (DFR) and, in addition to compliance with APB 28, they call for the disclosure of certain minimum elements together with comparable prior-year figures (condensed balance sheet, condensed income statement, condensed cash flow statement, statement of changes in shareholders' equity, segment reporting, earnings per share and the notes).
18. In Admission Board Message No. 5/2004 of 22 March 2004, it was indicated that DFR would enter into force on 1 January 2005 and, among other things, regulate the requirements for semi-annual reporting. As a Directive, DFR has its basis in Art. 3 para 1 LR and is an integral part of the SWX rules and regulations with which issuers must comply.

### **III. Material aspects**

19. Both APB 28 and DFR require segment reporting from issuers that apply US GAAP. APB 28p30 lays down in detail the required information for segment reporting. Among that information as per APB 28p30i is "Revenues from external customers", "Intersegment revenues", "A measure of segment profit or loss", as well as "The total of the segments' measures of profit or loss to consolidated income".
20. Segment reporting constitutes a central element of overall financial reporting, in that the segmental results are a significant factor in assessing the current condition and future development of a company's individual segments. The mere disclosure of segment revenues, without providing the corresponding segmental results, offers investors only a cursory basis on which to form an opinion on the profitability of a company.
21. In terms of the condensed cash flow statement, mrn. 21 DFR requires that the semi-annual reports of those issuers that have chosen US GAAP as their accounting standard must include information about the relevant cash flows. In its [...] semi-annual report, X. provided no information whatsoever with regard to the required condensed cash flow statement.
22. The cash flow statement is essential for the assessment of a company's financial situation. The lack of a cash flow statement made it impossible for investors to gain a picture of X.' corresponding cash flows.
23. DFR also requires in mrn. 21 that the semi-annual report include a statement of changes in shareholders' equity for the current and prior-year reporting period. In its [...] semi-annual report, X. omitted this disclosure.

### **IV. Decision-making**

24. Art. 82 para. 1 LR stipulates that the degree of fault and gravity of the breach are to be taken into account in the event a of sanction.

#### **Gravity of the breach**

25. The incomplete segment reporting resulted in the inability of investors to gain a correct picture of the influence the company's individual segments have on its overall earnings situation.
26. The objective of segment reporting is to provide the users of the financial report with information on the relative quantities, profit contribution and growth tendencies of each business field or geographic region in which a company operates, this in order to a well-founded assessment of the opportunities and risks associated with the company. Solely on the basis of the balance sheet and income statement, which represent an aggregate of the various results from the individual business segments, no precise conclusions can be drawn in terms of to the value drivers and specific developments within the overall company.
27. The aforementioned deficiency constitutes a clear violation of applicable accounting principles. SWX has already sanctioned other issuers whose segment reporting in the interim or annual financial reports was deficient (Disciplinary Commission decision of 29 June 2005, DK/RLE/II/05; Committee of the Admission Board decision of 7 January 2005, ZUL/RLE/IV/04; Committee of the Admission Board decision of 29 January 2004, ZUL/RLE/III/04). In each of these three instances, the deficiencies were less serious than in the case at hand. Nevertheless, they were all deemed to be grave breaches of LR.

28. Hence this deficiency constitutes a **severe violation** of the rules laid down in LR (Art. 65 ff.) as well as in DFR (mrn. 21).
29. The condensed cash flow statement is also an essential part of semi-annual reporting, and it is of great significance to investors. Thus the lack of a condensed cash flow statement is also clear contravention of LR as well as the provision of DFR. The latter expressly stipulates that a condensed cash flow statement, including comparable prior-year figures, is to be published. The Committee of the Admission Board and Disciplinary Commission have already imposed sanctions on issuers whose annual or semi-annual reports contained incorrect cash flow statements (Committee of the Admission Board decision of 12 April 2005, ZUL/RLE/III/05; Disciplinary Commission decision of 28 May 2004, DK/RLE/II/04). In both instances, these violations were deemed to be severe. Hence the complete lack of a cash flow statement can by no means be viewed as a less grave breach.
30. Hence this deficiency also constitutes a **severe violation** of the rules laid down in Art. 65 ff. LR as well as in mrn. 21 DFR.
31. The statement of changes in shareholders' equity is also of great importance to investors because it reflects all the changes in the company's equity since the close of the previous accounting period. From this statement, it can be ascertained in particular which changes had a direct impact on shareholders' equity.
32. For issuers that apply US GAAP as their accounting standard, inclusion of the statement of changes in shareholders' equity in their semi-annual report became mandatory for the first time. The failure to publish a statement of changes in shareholders' equity can therefore be considered a **moderately severe violation** of Art. 65 ff. LR and mrn. 21 DFR.

#### **Degree of fault**

33. The prerequisite for the pronouncement of a sanction under Art. 81 para 1 Points 1 and 3 LR in conjunction with Art. 82 para 3 LR is, according to the consistently applied practice of the Committee of the Admission Board and the Disciplinary Commission, that the issuer can be accused of having committed at least one negligent violation of the LR.
34. Negligence in this regard pertains to the individual who did not consider or take into account the consequences of his or her actions that resulted from nonfeasant carelessness. The basic prerequisite for the existence of a breach of the duty to exercise due care, and hence for the determination of culpability, is the predictability of the ultimate result or, as it were, realization of the offense. Thus the material consequences of the business processes that lead to either the ultimate result or realization of the offence must be foreseeable. In the case of an omission, negligence to exercise due care is at hand if, on the basis of the given concrete circumstances, the requisite care was not exercised, i.e. when no action was taken despite the fact that, at the time, the breach of Art. 65 ff. LR and the applicable accounting standards as discussed herein was foreseeable and avoidable given the normal course of things and life experience in general.
35. In addressing its degree of fault, X. asserted that there was no willful intent on its part. Furthermore, the company was not aware of the 1 January 2005 entry into force of the DFR, given the fact that the Directive was adopted at a time when X. was in the process of replacing its auditors and that foreign companies are not as closely in touch with regulatory developments as are Swiss-domestic issuers.
36. These arguments by X. do not appear to make its actions excusable. Because a number of the key components of the company's [...] semi-annual report were deficient, this essentially had to have come to light during a pre-publication review of the financial statements. Hence the contention regarding a change in auditors is irrelevant. On one hand, the semi-annual report does not even require an

examination by auditors and, on the other, compliance with the rules governing financial reporting is the responsibility of the company. Hence it proves to be that X. exercised its financial reporting responsibilities carelessly by lack of thoroughness.

37. In summary, as a result of the obviousness of the relevant deficiencies and the qualitative significance of the identified deviations from the norm, the company must be accused of **negligence** in its breach of LR and DFR.

#### **Sanction to be imposed**

38. Considering the degree of fault and gravity of the breach, a **reprimand of X. with related publication** is to be issued as reasonable sanction (Art. 82 para 1 Points 1 and 9 LR).

### **V. Costs of the proceedings**

39. In sanction proceedings related to Art. 81 ff. LR, the costs are determined according to the time and expense involved as per Point 7.8 of the List of Charges. Considering the time and expense required for addressing the case at hand, procedural costs in the amount of [...] are justified. These costs are to be charged to X.

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## Decision

On the basis of the foregoing considerations, the Committee of the Admission Board has arrived at the following decision:

1. X. shall be **reprimanded** (Art. 82 para 1 Point 1 LR).
2. The SWX Swiss Exchange will **publish** said sanction against X. (Art. 82 para 1 Point 9 LR in conjunction with Art. 82 para 2 LR; publication to be made upon lapse of the appeal period as per Art. 82 para 4 LR).
3. The costs of the proceedings in the amount of [...] for the investigation and the decision in the first instance shall be charged to X. (Point 7.8 of the List of Charges associated with LR).

[...]