SIX SWISS EXCHANGE

**SANKTIONSKOMMISSION COMMISSION DES SANCTIONS**

**Decision**

in the procedure SaKo 2013 – SA-RLE-IX/12

**X.**
[…]

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The Sanction Commission - […] – has rendered a decision as follows:

1. X. violated Art. 51 LR in accordance with the applicable financial reporting standard US GAAP (Accounting Standards Codification ASC 740-10) by issuing the […] annual financial statements on 15 March […] which reported income tax expenses that were understated by USD […] million leading to overstate the net income for the period by 20%.
2. A fine of CHF […] is imposed to X.
3. X. shall pay the costs of the sanctions procedure of CHF […].
4. This decision having acquired legal force shall be published by SIX Exchange Regulation.
5. X. may file an appeal with the Court of Arbitration within 20 trading days […].

Reasons for the decision

A. The applicable rules

1. X. (X.) released its US GAAP annual financial statements for the year ended 31 December […]on 15 March […]. In note 2 of these […] US GAAP financial statements, the Company stated that it has been unable to remediate the material weakness in the internal controls over financial reporting for income taxes in […]. The Company therefore performed additional procedures including reconciliations and analysis to ensure that the consolidated financial statements were compliant with US GAAP. As a result of these procedures, the Company identified errors that led to restatements of the previously released […], […], […] and prior years' income tax expense figures.
2. On 17 December […], X. published an amended US GAAP annual report for the year ended 31 December […]. Note 2 of this amended […] annual financial statements included further restatements of the previously reported […], […], […], […] and prior years' income tax expense figures.
3. On 28 December […], SER opened a formal investigation regarding possible breaches of rules in connection with the reporting obligations under the applicable accounting standards in the […] annual financial statements released on 15 March […]. After investigation, SER petitioned the Sanction Commission to issue a fine against X. X. is a Swiss Company and listed on SIX Swiss Exchange. Its registered shares are also listed on […]. Regardless of possible investigations of […] authorities, the Commission is competent for this procedure according to Swiss Law.
4. X. did not dispute the facts but petitioned to mitigate the sanction.
5. In February […] and according to X., its management identified a material weakness in the internal controls over financial reporting for income taxes. As a result, the annual financial statements for the year ended 31 December […] and published 8 March […] included restated financial information for […], […] and prior years, primarily related to errors in the accounting for income taxes. The errors resulted in an understatement of the income tax expense of USD […]million for

[…], USD […]million for […] and USD […]million for […]and prior periods (recorded in opening retained earnings).

6. In April […], X. hired an external accounting and consulting firm to perform an assessment of its tax accounting processes, to determine required changes to the existing processes, to design a remediation program and to assist it with the implementation of the remediation program. The external consultants also assisted X. with the analysis of the consolidated effective tax rate for the quarterly and annual […] financial statements. In May […], X. concluded the initial assessment of the required changes and started a remediation program during […] and […]. As part of this, the Company hired several senior tax professionals and engaged a second external accounting and consulting firm to assist with the preparation and review of tax reconciliations, accounts, balances as well as the schedules of adjustments.

7. On 15 March […], X. published the […] US GAAP annual financial statements, which included further restatements due to errors identified. In the aggregate, these errors resulted in an understatement of the income tax expense by USD […]million for […] and USD […]million for […] compared to previously restated results. Errors attributable to […] and prior years amounted to USD […]million (recorded in opening retained earnings).

8. Throughout July […], the on-going remediation efforts identified further errors in tax expenses. As a result, X. reported in a press release of 24 July […] the preliminary second quarter pre-tax results and confirmed the intention to file restated financial statements for the years […], […] and […]. X. stated that the timing for the filing of the restatements is depending on the results of the additional procedures and therefore still uncertain.

9. On 17 December […], X. released on the one hand the US GAAP interim financial statements for the six month period ended 30 June […]. On the other hand, it released amended US GAAP annual financial statements for the year ended 31 December […]. In the aggregate, the errors resulted in an understatement of income tax expenses of USD […]million for […], and additional restatements of USD […]million for […], USD […]million for […] and USD […]million for […] and earlier years (recorded in opening retained earnings).

10. The following tables summarize the restatements of income taxes by years and by categories (break down by years and by nature of adjustment):

| Date of the restatement / Attributable to the year ended | 17 December […] (in mn USD) | 15 March […] (in mn USD) | 8 March […] (in mn USD) | TOTAL (in mn USD) |
|---|---|---|---|---|
| 31 December […] | […] | - | - | […] |
| 31 December […] | […] | […] | - | […] |
| 31 December […] | […] | […] | […] | […] |
| 31 December […] and prior | […] | […] | […] | […] |
| **Total** | […] | […] | […] | […] |

Tab. 1: Restatement of income taxes – break down by years

| Date of the restatement / Nature of the adjustment | 17 December […] (in mn USD) | 15 March […] (in mn USD) | 8 March […] (in mn USD) | TOTAL (in mn USD) |
|---|---|---|---|---|
| Intercompany transaction adjustments | - | - | […] | […] |
| Fixed & intangible assets book/tax value differences | - | - | ([…]) | ([…]) |
| Return-to-accrual adjustments | - | - | […] | […] |
| Withholding tax adjustments | […] | […] | - | […] |
| Uncertain tax positions (UTPs) | […] | […] | - | […] |
| Valuation allowance for deferred tax assets | - | […] | - | […] |
| Other adjustments to current and deferred tax accounts | ([…]) | […] | - | […] |
| **Total** | […] | […] | […] | […] |

Tab. 2: Restatement of income taxes – break down by nature of adjustments

11. Compared to the annual report released on 15 March […], the restatement released on 17 December […] included a correction of an error related to income tax expense of USD […]million attributable to financial year […] (Tab. 1). The income tax expense was corrected from the previously reported USD […]million by 11.5% to USD […]million. In relation to the previously reported net income of USD […]million for the financial year […], the correction of USD […]million amounts to 20%. Therefore, the correction was material to the […] financial statements.

12. According to Art. 51 of the Listing Rules (LR), issuers are required to draw up annual financial statements in accordance with a financial reporting standard that is recognised by the Regulatory Board of SIX Swiss Exchange, in the present case the US GAAP.

13. Accounting Standards Codification (ASC) 740-10 governs the accounting for income taxes. According to ASC 740-10, an entity has to recognize the amount of taxes payable or refundable for the current period as well as the deferred tax liability or asset resulting from temporary differences and carry forwards at the end of the accounting period.

14. When recognizing tax positions, an entity needs to assess whether it is more likely than not that the tax positions will be sustained upon examination by the relevant tax authority (ASC 740-10-25-6). In assessing these uncertain tax positions (UTPs), the entity has to assume that it will be examined and that the tax authority has full knowledge of all the relevant information.

15. X. did not correctly account for income taxes and recognize tax positions at least throughout […] to […] (see tables above). In its […] annual financial statements released on 8 March […], it had to include restatements related to income taxes of USD […]million for […], USD […]million for […] and USD […]million for 2007 and prior periods. Of these amounts, a total of USD […]million was related to intercompany dividends, that were not properly tax-affected, USD […]million were related to differences between original estimates and reported income tax returns (return-to-accruals) and an offsetting amount of USD […]million was related to differences between the accounting value and the tax basis of fixed assets previously unaccounted for.

16. In the annual financial statements for the year ended 31 December […] released on 15 March […], X. included again restated income tax expenses due to errors. In the aggregate, these errors resulted in an understatement of the income tax expense by USD […]million for […] and USD […]million for […] compared to previously restated results. Additional errors attributable to […] and prior years totaled USD […]million. Of these amounts, a total of USD […]million was related to withholding taxes payable, USD […]million to UTPs, USD […]million to valuation allowances for deferred tax assets and USD […]million to other current and deferred tax effects.

17. On 17 December […], X. published once more another amended set of annual financial statements for the year […], including restatements of income tax expenses of USD […]million for […],

and additional amounts of USD […]million for […], USD […]million for […] and USD […]million for […] and earlier years. Of these amounts, USD […]million were related to UTPs, USD […]million to withholding tax adjustments and an offsetting amount of USD […]million to other current and deferred tax adjustments.

18. In summary it is established (and not disputed) that on 15 March […] by reporting materially incorrect tax expenses in its […] annual financial statements, X. breached the requirements of ASC 740-10 and thus Art. 51 LR.

B. The sanction

19. Art. 60 LR states that one or more of the sanctions listed in Art. 61 LR are imposed if an issuer commits a breach of a rule of the LR. In determining the sanction to be imposed, the Sanction Commission will take into consideration, in particular, the severity of the breach and the degree of fault. In cases of negligence, a fine of up to CHF 1 million may be imposed, in cases of wrongful intent up to CHF 10 million (Art. 61 para 1 LR). When setting the level of fines, the Commission will also take into account the impact of the sanction on the issuer concerned (Art. 60 para 2 LR). In arriving at its decision, the Commission is not bound by the sanction proposals submitted by the investigative bodies (Art. 40.4 Rules of Procedures - RP).

20. The listed company as such is subject to sanctions and not the persons or any institutional body acting for it.

Severity of the breach

21. The error in the […] annual financial statements published on 15 March […] was material. The income tax expense of X. was understated by USD […]million or 11.5%. Furthermore, the correction of the error decreased by 20 % the net income for the period initially reported of USD […]. Net income is one of the most important performance measures for users of financial statements. The overstatement of net income by 20% for the year ended 31 December […] is a breach that is serious in nature and thus severe.

Degree of fault

22. In the present case, there is no evidence to suppose that X. respectively its responsible persons breached the rules by acting with intent or conditional intent as defined under the applicable Swiss law (especially in view of the large amounts of costs incurred to remedy the weakness of internal control - see below). The breach was committed through negligence.

23. The material weakness in the internal controls over financial reporting for income taxes was identified in early […]. X. reported in its notes to the financial statements for […] that this material weakness was identified (and thus made restatements for the previous years). Nevertheless, X. failed to remediate these deficiencies to be able to release on time a correct […] annual report free from errors in financial reporting for income taxes. Throughout the year […] and within the additional four months reporting deadline after 31 December […] (as prescribed in Art. 10 of the Directive Financial Reporting), there was time for remedial efforts to improve the internal controls. As X. did not accomplish this on time and despite the large amount of investments for remedying deficiencies (see below), there remained a material weakness related to the Company's financial reporting that has to be considered. The fact that the necessary improvements have been finalized only in late […] shows the large scale of internal controls weaknesses within the organization that had to be improved.

Impact of the sanction

24. When determining a sanction and as mentioned before, consideration must be given inter alia to the listed company's financial resources. The same fine is likely to impact more heavily companies with more limited economic resources than those with greater financial capacity. Among other criteria, financial ratios may be used to determine financial capacity, earnings before interest and taxes (EBIT), net earnings, cash flow generated from operations, cash and cash equivalents, or shareholders' equity.

25. X. reported after the restatements:

- Net cash provided by operating activities of USD […]million for the […] financial year and USD […]million for the […] financial year,
- Operating income of USD […]million for […] and USD […]million for […],

- Income before income taxes of USD […]million in […] and USD […]million in […],
- A net loss of USD […]million for […] and a net income of USD […]million for […],
- Shareholders' equity (31 December) of USD […]million for […] and USD […]million for […].

For the year ending 31 December […], X. reported an operating income of USD […]million, a loss before income taxes of USD […]million and shareholders' equity of USD […]million.

Although X. recorded a net loss in […] and […], this does not constitute evidence that the impact of a fine up to CHF 1 million would be very great. The impact of any fine on X. must therefore be described as low. Even the maximum fine of CHF 1 million (as applicable in the present case) would not unduly burden the Company in view of its profits total assets and equity. This must apply, a fortiori, if the fine imposed is a fraction of the maximum amount.

26. On the one hand, considering the low impact of any on X.'s financial situation in accordance with Art. 61 LR, both the severity of the breach and the degree of fault are reasons to set the fine at the upper limit of the scale. On the other hand, it has to be taken into consideration that X. on 17 December […] published restated financial statements. During […] and […] it had identified and corrected the errors.

    Furthermore and in its favor it is necessary to take into account that X. spent a considerably large amount of around USD […]million in consultant work during […] and […] (before and after the release of the […] annual report on 15 March) for remedying the deficiencies in internal controls over financial reporting for income taxes. In addition and in favor of X., it has to be mentioned that at the time X. committed the error in its financial reporting no sanction had been imposed on the Company by the SER and this should be taken into account in determining the amount of any sanction (Art. 2.6 para 4 RP).

27. Considering all the circumstances for determining the sanction, a fine of CHF […]is appropriate.

28. According to the Rules of procedure, the costs of the procedure of CHF […] (CHF […]for SER, CHF […]for the Commission) are imposed on X.

29. The opening of the investigation has been published by SER. Consequently and in accordance with the provision of Art. 6.3 para 1 RP, the decision of the Sanction Commission has to be published.

(Decision of 16 September 2013)