Exchange Regulation

SIX Exchange Regulation
Sanction notice in the matter of
X

SB-RLE-II/16

1. Overview of proceedings

1. X (hereinafter also referred to as “X”, “the Company” or “the Issuer”) is a company incorporated under Swiss law with its registered office in […], canton of […]. The Company’s shares are listed in the International Reporting Standard of SIX Swiss Exchange in Zurich.

2. These proceedings relate to the […] IFRS interim financial statements for the period […] and the […] IFRS annual financial statements for the period […] of X.

3. In a letter dated […], SIX Exchange Regulation launched a preliminary investigation in connection with the […] IFRS interim financial statements of X, to which the Company replied timely (after an extension of the deadline) in its letters dated […], providing relevant documentation. The lawyers’ letters, which had also been requested, were received by e-mail on […].

4. In its letter dated […], SIX Exchange Regulation raised additional questions to the preliminary investigation in connection with X’ […] IFRS interim financial statements and extended the preliminary investigation to X’ […] IFRS annual financial statements. In the same letter dated […], the ad hoc publicity team of SIX Exchange Regulation also initiated a preliminary investigation. As the Company did not collect the registered letter, SIX Exchange Regulation resent it by e-mail and the deadline for answering the questions was extended to […]. The Company responded with two letters dated […].

5. On […], representatives of the Company and its auditors met SIX Exchange Regulation in the offices of SIX Group Ltd. The original letter of […] was handed over in person. Following this meeting, a further brief telephone conference was held with the Company’s representative […] on […]. This telephone call was summarized in an e-mail and sent to X by SIX Exchange Regulation on the same day, together with additional questions. The questions were answered within the required deadline by the Company in two e-mails on […].

6. SIX Exchange Regulation opened an investigation on […].

7. In relation to the Company’s obligation to comply with the provisions of Art. 51 of the Listing Rules (LR) and the IFRS used to prepare its financial statements, the investigation did not refute the suspicion of a breach of the LR.

8. SIX Exchange Regulation has therefore issued this sanction notice pursuant to section 3.5 (2) of the Rules of Procedure (RP).

2. Applicable regulations and jurisdiction

9. The bearer shares of X are listed in the International Reporting Standard of SIX Swiss Exchange so that as a result, the Company is subject to the regulations of SIX Swiss Exchange Ltd, in particular the LR and its implementing provisions, as a condition of maintaining its listing.

10. The Company has signed a declaration of consent certifying that it agreed to be bound by the LR, the provisions implementing the LR, and the RP.

11. If an issuer breaches its obligations under the LR, the Additional Rules or their implementing provisions, a sanction as described in Art. 61 LR may be imposed (Art. 60 LR).

12. In the present case, the issuer breached the provisions on financial reporting standards (Art. 51 LR), and as a result, SIX Exchange Regulation may impose a reprimand or a fine pursuant to section 3.5 (2) RP. This sanction will be published (section 6.2 (5) RP). The sanction notice will be made available on the SIX Exchange Regulation website in anonymized form (section 6.2 (6) RP).

13. SIX Exchange Regulation has jurisdiction in this case pursuant to Art. 59 LR and section 3.5 (2) RP and has therefore issued this sanction notice.

3. Considerations

3.1 General

14. According to Art. 50 LR issuers of listed shares are required to publish interim financial statements in accordance with the applicable accounting standards. The interim financial statements must be drawn up in accordance with the provisions of Art. 51 LR.

15. According to Art. 49 LR issuers of listed shares are required to publish audited annual financial statements in accordance with the applicable accounting standards. The financial statements must be drawn up in accordance with the provisions of Art. 51 LR.

16. The Company uses IFRS as its accounting standard. IFRS is one of the accounting standards recognized by SIX Exchange Regulation under Art. 51 LR and of the Directive on Financial Reporting (DFR).

3.2 Error-free presentation of information in financial reports

17. In accordance with qualitative characteristics (QC) 12 of the Conceptual Framework for Financial Reporting issued by the International Accounting Standards Board (IASB) in September 2010, financial reports represent economic phenomena in words and numbers. To be useful, financial information must not only be relevant, but must also faithfully represent the phenomena it purports to represent. To be a perfectly faithful representation, the information presented should therefore be as complete, neutral and free from error as possible.

18. SIX Exchange Regulation has identified the following sanctionable breaches in the […] IFRS annual financial statements and the […] IFRS interim financial statements:

3.2.1 Errors in the […] IFRS annual financial statements

[…] case

19. According to IAS 37p86, unless the possibility of any outflow in settlement is remote, a company must disclose a brief description of the nature of a contingent liability for each class of contingent liability at the reporting date, together with an estimate of its financial effect and the uncertainties relating to the amount or timing of any outflow.

20. In IAS 10p3, events after the reporting period are described, among other things, as unfavourable events that occur between the end of the reporting period and the date when the financial statements are authorized for issue. The company must update the disclosures in its financial statements to reflect such events, even when the information does not affect the amounts recognized (IAS 10p19 or IAS 10p21).

21. The subsidiary Z is engaged in an ongoing legal case originating from […], with the authorities claiming the company owes […] of […] tax. The […] tax authorities regard the services […] performed for X between […] and […] as subject to […] tax, whereas Z believes that they constituted an export of services, and were thus exempt from […] tax. The Company lodged an appeal against this assessment.

22. At the beginning of […], the […] tax authorities demanded that Z pays the […] allegedly owed plus interest into two deposit accounts as security. Z complied with this demand in […] and paid the required amount to the […]. The legal case and the payment into the two deposit accounts was disclosed in the […] IFRS interim report for the first time. The amount was reclassified from cash to non-current assets and a brief description of the legal case was provided under contingent liabilities. X expressed the view in […] that there was only a remote possibility of the […] tax authorities winning this legal dispute.

23. The situation and the associated disclosures did not change in the subsequent […] and […] IFRS annual reports and in the […] and […] IFRS interim reports. The amount was simply adjusted to reflect movements in foreign exchange rates.

24. Before the publication of the […] IFRS annual financial statements on […], the following events occurred:

    a) On […] the court in […] ruled as first instance against Z and agreed entirely with the […] tax authorities that the […] tax was payable. Z was informed of the court ruling by its […] attorney on […] and the appeal was then prepared and submitted on […].

    b) On […] Z was informed by the […] tax authorities by registered letter that the amount owed was now due for payment. According to X, this letter was never received by Z.

    c) On […] the […] tax authorities informed Z by letter that the deposit would now be collected. According to X, it did not receive this letter until […], which was too late for it to be included in the analysis of the legal case at year-end. X was surprised by this notice, as until then it had believed that the […] tax authorities could only collect the deposit after a final ruling from the court of last instance. X' […] attorney confirmed to X' financial controller on […] that the […] tax authorities were entitled to unilaterally seize the deposit.

    d) On […], the […] law firm issued a lawyers' letter to Z with their assessment of the outstanding legal cases for the purposes of financial reporting for the financial year […]. The […] case is described as above in the letter and the attorneys assessed Z's chances of winning the tax dispute as reasonable ("chance raisonnable").

25. X published its […] IFRS annual financial statements on […] without changing the disclosures on the […] dispute with the […] tax authorities. According to the Company, it was only aware at this point of the defeat in the court of first instance and decided that this did not change anything in its overall assessment of the legal case. The chance of the […] tax authorities winning the case was still seen as "remote" and the defeat in the court of first instance was not mentioned.

26. In the view of SIX Exchange Regulation, the defeat in the court of first instance should at a minimum have been classified as a material, non-adjusting event after the reporting date and disclosed accordingly (IAS 10p21). Moreover, SIX Exchange Regulation believes that X' view that the chances of the […] tax authorities winning the case were "remote" is implausible given the defeat in the court of first instance and the assessment in the lawyers letter. In SIX Exchange Regulation's view, this matter qualifies at a minimum as a contingent liability.

27. X therefore breached the provisions of IAS 10p21 in conjunction with IAS 37p86. The failure to provide updated disclosures on the tax case meant that readers of the financial statements were denied material information to correctly evaluate the Company's net assets, financial position and profitability.

28. In the […] IFRS interim financial statements […], the deposit at […], previously recognized in other non-current assets, was finally derecognized and charged to operating expenses, leading to a significant loss of […]. The adverse ruling by the court in […] and the fact that X had lodged an appeal were also mentioned.

Other errors in the […] IFRS annual financial statements

29. In the consolidated statement of income, general and administration expenses were understated by […]. An equal and opposite amount of income from research grants was also omitted. This error had no impact on the loss reported for the year, but the total income and total operating expenses subtotals were both understated by this amount. The error was meanwhile corrected in the […] IFRS annual financial statements as a result of this investigation.

30. The reconciliation of the defined benefit obligation in note […] is incorrect. The "experience adjustments" item was incorrectly termed and should have been shown as "actuarial gains and losses". Moreover, the sign of this item was reversed, which meant that the individual items did not add up to the total for the table (the total itself was correct). Moreover, note […] did not contain disclosures on the actuarial gains and losses arising from changes in demographic and financial assumptions, as required by IAS 19p141(c). The error in sign was corrected in the […] IFRS annual financial statements, but the other missing information was still not included in the […] IFRS annual financial statements.

3.2.2 Errors in the […] IFRS interim financial statements

31. The consolidated interim statement of income as at […] showed an operating loss of […]. This amount is not the arithmetic sum of income […] minus operating expenses […] , which would be […]. The income was mistakenly not included in the calculation. As a result, the operating loss was overstated by […]%.

32. The segment reporting in note […] provides a geographical analysis of total operating expenses. The total operating expenses were shown as […] as

at […], which does not correspond to the total operating expenses of […] reported in the interim statement of income. According to X, the difference of […] corresponds to the market value of the options issued to […] as part of a capital increase on […]. A reconciliation or explanation of the difference was not provided. In the same table, the figures for the comparative period […] are all wrong. The figures for the full year […] were included instead.

33. In note […], which provides a breakdown of finance income and expenses, the net finance result is stated as […]. This should arithmetically be […] and is therefore not correct. However, the finance result is reported correctly in the interim statement of income itself.

34. In note […], the pension cost is understated by […]. Employees' contributions in the amount of […] were wrongly included as pension income, and secondly, the administrative expenses of […] were not included. Note […] also contains the tables "Changes in prepaid pension cost" and "Changes in other comprehensive income", which are not included in the corresponding note in the […] IFRS annual financial statements. No further information is provided on these tables. There is also no indication as to why these tables should be relevant for the interim financial statements, but not for the annual financial statements. In addition, the totals reported do not seem to provide useful information, either quantitatively or qualitatively.

35. According to the verbal explanation provided by X on […], the large number of errors and inconsistencies in the report was due to the fact that a preliminary version of the […] IFRS interim financial statements was mistakenly uploaded to the X website rather than the final version.

3.3 Minor errors

36. In the consolidated income statement as at […], the net finance result is shown with the wrong sign as an expense rather than income of […]. The consolidated net loss, on the other hand, is calculated correctly. In addition, the net finance result is broken down into the line items finance income […] and finance expense […]. But the finance expense should in fact be […] and the finance income […]. This error was corrected in the […] financial statements.

37. The convention used by X in the […] IFRS annual financial statements to represent income and expenses as positive and negative figures proved to be confusing and prone to errors. X changed this in the […] IFRS annual financial statements; all income items are now shown as positive figures and all expense items as negative figures.

38. Note […] of the […] IFRS annual financial statements provides a reconciliation of income taxes. However, the individual items do not add up to the total shown. The "expenses charged against equity" item should have been […] rather than […]. This error was corrected in the […] IFRS annual financial statements.

39. Note […] of the […] IFRS annual financial statements contains a breakdown of operating expenses by nature. Again, the individual items do not add up to the total shown. This error was corrected in the […] IFRS annual financial statements.

40. In note […] of the […] IFRS interim financial statements, loss per share, the weighted average number of shares in issue is stated as […] as at […]. This figure is incorrect; the correct figure is […].

41. The highlighting of minor errors is intended merely to assist the Company in eliminating these errors in future.

4. Severity of the breach and degree of fault

42. Art.61(2) LR provides that in determining the sanction to be imposed, due consideration must be given, in particular, to the severity of the breach and the degree of fault.

4.1 Severity of the breach

43. The annual and interim reports are one of the most important source of information for investors for assessing a company's net assets, financial position and profitability. If the information is not substantially error-free, this limits the faithfulness of the financial reporting and therefore its relevance for financial statements readers.

44. IAS 37 and IAS 10 contain provisions on the disclosure of contingent liabilities and events after the reporting date that are designed to highlight significant events and potential risks to the reader in a timely manner, in addition to the financial data recognized in the balance sheet and income statement.

45. Due to the absence of disclosures on the development and assessment of the […] dispute in the X […] IFRS annual financial statements, investors were unable to finally judge on the Company's net assets, financial position and profitability. The failure to provide the information that the court of first instance had ruled against X and in favour of the […] tax authorities led investors to believe that there had been no developments in the tax dispute. The unchanged re-assessment by the Company was not disclosed and its failure to provide any explanation was misleading.

46. The accumulation of errors in the […] IFRS annual financial statements and the […] IFRS interim financial statements makes it impossible for readers to form a complete and accurate judgement on the Company's net assets, financial position and profitability, as through the errors it is unclear which parts of the report are correct and which are incorrect. The inaccuracies and errors are also confusing to a reader and seem to suggest a lack of diligence in preparing the financial statements.

47. The errors in the […] IFRS annual financial statements and in the […] IFRS interim financial statements in combination with the non-disclosure of significant information on the contingent liabilities in the […] IFRS annual financial statements represent a clear breach of the applicable accounting rules. Most of the errors in the annual and interim financial statements are not material by themselves, but the large number of errors affect the overall picture significantly. In addition, the non-disclosure of the unfavourable court ruling and the reassessment of the situation in the […] dispute with […] also gave rise to a misleading picture. For these reasons this represents a **severe breach** of the Listing Rules (Art. 51 LR) in conjunction with the IFRS Conceptual Framework, IAS 37 and IAS 10.

4.2 Degree of fault

48. Issuers are obliged under the Listing Rules to ensure that they meet their obligations under the Listing Rules, the Additional Rules and the associated implementing provisions.

49. Anyone who knowingly and willfully commits a breach of the relevant rule is deemed to have acted with intent. An issuer is deemed to have acted with conditional intent if it did not directly intend to breach one of its regulatory

duties, but at the very least is alerted to the possibility of a breach occurring, and accepts the risk that such a breach may occur.

50. An issuer is generally deemed to have acted negligently if, through culpable carelessness, it has failed to consider or take account of the consequences of its actions. The essential condition for a breach of the duty of care is the foreseeability of the outcome. The main elements of the sequence of events leading to the outcome must be foreseeable.

51. It should be noted that this case concerns the sanctioning of a legal entity rather than an individual. The Company is to be sanctioned if it is held that it failed to take all necessary and reasonable organizational measures to prevent a breach of the obligations incumbent upon it under the LR. This applies equally to small companies such as X, which are required to organize themselves in such a way as to meet their listing obligations. The degree of fault must therefore be assessed according to largely objective criteria. Any acts performed by individuals or executive bodies on behalf of the Company must be imputed to the Company (Decision of the Sanction Commission dated November 30, 2007 [SaKo/MT/III/07], point 9).

52. SIX Exchange Regulation has no reason to believe that the errors in the […] IFRS annual financial statements and the […] IFRS interim financial statements were committed intentionally or with conditional intent. However, if the internal process and controls had been better organized and the accounts had been drawn up with the required care, these errors could have been avoided.

53. It is therefore to be assumed that the company **acted negligently** with regard to the errors in the […] IFRS annual financial statements and […] IFRS interim financial statements and the failure to provide information in the […] IFRS annual financial statements on the […] dispute, with the resultant breach of Art. 51 LR in conjunction with the IFRS Conceptual Framework, IAS 37 and IAS 10.

4.3 Conclusions

54. X breached the provisions of IFRS and therefore of Art. 51 LR by withholding material information for assessing the Company's net assets, financial position and profitability from investors in the […] IFRS annual financial statements and […] IFRS interim financial statements. In addition, through the inaccuracies in the […] IFRS annual financial statements and the […] IFRS interim financial statements, X made it impossible for investors to form an error-free and therefore faithful view of the Company's net assets, financial position and profitability. This breach was caused through **negligence** and is deemed to constitute a **serious violation**.

55. SIX Exchange Regulation took into account that X declared its willingness to correct the errors in the […] IFRS annual financial statements and […] interim report set out in section 3.2 and 3.3 during the ongoing investigation. Most of the errors have already been corrected in the […] IFRS annual report.

56. In determining the sanction, the fact that SIX Exchange Regulation has imposed no sanctions on X **in the last three years** was also taken into account. Any possible sanctions imposed at an earlier date are disregarded.

57. The appropriate sanction for the serious breach of Art. 51 LR in conjunction with the IFRS Conceptual Framework, IAS 37 and IAS 10 due to negligence is the issue of a **reprimand** pursuant to Art. 61 (1) no. 1 LR. This reprimand will be published (section 6.2 (5) RP). The sanction notice will

be made available on the SIX Exchange Regulation website in anonymized form (section 6.2 (6) RP).

5. Costs

58. Art. 59 LR in conjunction with section 2.9 RP and section 9.8 of the List of Charges provides that in sanction proceedings, the applicable charges shall be determined on the basis of the actual costs incurred.. These costs shall be charged to the Company. In the present case, the costs incurred by SIX Exchange Regulation for the current proceedings amount to […].

6. Sanction notice

SIX Exchange Regulation hereby issues the following sanction notice:

X breached the requirements of the applicable IFRS and, as a consequence, the provisions of Art. 51 LR in its […] IFRS annual financial statements and […] IFRS interim financial statements in the following ways:

In the […] IFRS annual financial statements, X failed to disclose its defeat in the court of first instance in the […] case as a material event after the reporting date and as a contingent liability as required by IAS 10p21 and IAS 37p86. As a result, readers of the financial statements found out about this ruling and the associated payment of […] only in the […] IFRS interim financial statements. Moreover, in the […] IFRS annual financial statements, the subtotals “Total income” and “Total operating expenses” were both understated by […] and the disclosures on the defined benefit pension obligation were incorrect. The net loss for the year was not affected by these errors.

In the […] IFRS interim financial statements, an arithmetic error in the income statement led to the operating loss line being overstated by […]. The disclosures on the segment reporting, the financial result and on the pension liability were also incorrect.

These represent serious breaches of the Listing Rules and were caused by negligence.

1. A **reprimand** will be issued to X (Art. 61 (1) no. 1 LR), with this sanction being published (section 6.2 (5) RP). The sanction notice will be made available on the SIX Exchange Regulation website in anonymized form (section 6.2 (6) RP).
2. X is ordered to pay costs of the proceedings of […].

(Sanction notice of 20 June 2016)