UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 10281 / January 18, 2017

SECURITIES EXCHANGE ACT OF 1934
Release No. 79815 / January 18, 2017

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3845 / January 18, 2017

ADMINISTRATIVE PROCEEDING
File No. 3-17791

In the Matter of **ORTHOFIX INTERNATIONAL N.V.** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Orthofix International N.V. ("Orthofix" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement ("Offer") that the Commission has determined to accept. Respondent admits the facts set forth in Paragraphs 1 through 93 below, acknowledges that its conduct violated the federal securities laws, admits the Commission's jurisdiction over it and the subject matter of these proceedings, and consents to the entry of this Order Instituting Cease-and-Desist Proceedings pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

SUMMARY

From at least 2011 to mid-2013 ("the relevant period"), Orthofix materially overstated its distributor revenue and operating income in various annual and quarterly reports and earnings releases filed with the Commission. The majority of this misconduct occurred at Orthofix's then-largest segment, its Spine segment ("Spine"). In particular, Orthofix improperly recognized revenue associated with several transactions with Spine's distributors, including its largest international distributor during the relevant period. Among other things, it entered into contingent sales with that distributor and also recognized revenue for product sales when the product could not be resold due to Orthofix's delay in providing a required associated product. Moreover, in the domestic section of Spine, Orthofix improperly accounted for certain transactions by treating certain price discounts as expenses instead of a reduction to revenue and recognizing revenue on transactions in which the purchaser had the ability to return or exchange products.

Orthofix's misconduct, however, was not limited to Spine as it also improperly recognized revenue in its Orthopedics Segment through extra-contractual agreements used at its Brazilian subsidiary. Moreover, throughout the relevant period, Orthofix had inadequate internal accounting controls over its distributor revenue recognition and had a culture of setting aggressive internal sales targets and imposing pressure to meet those sales targets.

As a result of its misconduct, Orthofix restated its financial results for the first quarter of fiscal year 2013, all reporting periods in fiscal years 2012 and 2011, and its annual reporting period in fiscal year 2010. For example, Orthofix announced that it had overstated its net sales for fiscal year 2011 by 6% and its operating income by over 430%. By engaging in the foregoing misconduct, Orthofix violated the antifraud, reporting, books and records, and internal accounting controls provisions of the federal securities laws, namely Sections 17(a)(2) and 17(a)(3) of the Securities Act and Sections 13(a), 13(b)(2)(A), 13(b)(2)(B) of the Exchange Act, and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder.

RESPONDENT

Orthofix International N.V. ("Orthofix") is a company organized under the laws of Curacao and is headquartered in Lewisville, Texas. It is a diversified medical device company that develops and sells products used by doctors and other medical specialists to treat and repair human spine and orthopedic conditions. Orthofix's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and trades on the NASDAQ.

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[1] The findings herein are made pursuant to Respondent's Offer and are not binding on any other person or entity in this or any other proceeding.

Orthofix's fiscal year ends on December 31. During the relevant period, Orthofix sold securities to its employees pursuant to Form S-8 registration statements filed with the Commission. A broad range of employees could purchase Orthofix stock in these offerings via payroll deductions. During the relevant period, the Form S-8 registration statements incorporated by reference the company's public filings with the Commission.

OTHER RELEVANT PERSONS

The **Spine CFO** served as the Chief Financial Officer of Orthofix's Spine Segment from July 2010 until he resigned in approximately February 2013.

The **Spine President** served as the President of Orthofix's Spine Segment from November 2011 through November 2012. The Spine President is no longer employed by Orthofix.

The **Spine Sales VP** served as the Vice President of Global Sales and Development for the international portion of Orthofix's Spine Segment from March 2011 until May 2013. The Spine Sales VP is no longer employed by Orthofix.

The **Corporate CFO** served as Orthofix's Chief Financial Officer from March 2011 through November 2012. In November 2012, the Corporate CFO became the President of Orthofix's Spine Segment until he left Orthofix in July 2013. In the Order, we use the term **New Spine President/Prior Corporate CFO** to describe this person's conduct from November 2012 and beyond.

FACTS

A. <u>Orthofix's Business and Structure</u>

1. Orthofix's business was primarily divided into two Global Business Segments during the relevant period – Spine and Orthopedics. During the relevant period, Spine was Orthofix's largest segment and contributed two-thirds of the company's overall revenues.

2. Spine had several operating divisions during the relevant period. For example, Orthofix Spinal Implants ("OSI") was responsible for international sales of spinal implants and related instruments.

3. During the relevant period, the Spine CFO was responsible for the accounting and financial functions of Spine, including preparing its operating results (which were included in Orthofix's public filings with the Commission).

4. The Spine CFO reported directly to Spine's President, a salesperson, during the relevant period. The Spine President was in charge of Spine's sales and overall management. The Spine President had several sales persons who worked under him, including an individual who served as Spine's Vice President of Global Sales and Development ("Spine Sales VP").

5. In essence, the Spine Sales VP was the relationship manager for a number of relationships that OSI had with certain international distributors. The Spine Sales VP had a sales team of approximately four employees who reported to him and had day-to-day responsibility for certain distributor relationships.

6. While the Spine CFO reported directly to the Spine President during the relevant period, the Spine CFO also had dotted line reporting responsibility to Orthofix's Corporate CFO (hereinafter "Corporate CFO"). The Corporate CFO was responsible for the preparation of Orthofix's public filings, including its consolidated financial results.

7. Spine sold various products including spinal and cervical implants and related instruments. The instruments and implants were interconnected as implants could not be used in patients without functioning instrument sets.

8. Spine sold the above products through two primary methods: (i) sales of its products to U.S. and international distributors who then sold the products to hospitals and physicians and (ii) sales of its products directly to hospitals and physicians in the U.S.

B. <u>Orthofix's Revenue Recognition Policies and Practices and Distributor Business Practices</u>

a. <u>Revenue Recognition Policies and Practices</u>

9. ASC 605-10-25-1 provides that revenue may be recognized only when it is both realized or realizable and earned. Consistent with the authoritative literature, Orthofix's financial statements disclosed four criteria as its revenue recognition policy.

10. The four criteria are: (i) persuasive evidence of an arrangement exists; (ii) delivery has occurred or services have been rendered; (iii) the seller's price to the buyer is fixed and determinable; and (iv) collectability is reasonably assured.

11. Other than the four criteria disclosed in its filings, Orthofix did not have any other revenue recognition policies during the relevant period and failed to adequately document how it satisfied the four criteria with respect to the sales transactions that were recognized as revenue. Moreover, Orthofix could not and did not reasonably estimate the revenue recognition impact of the amount of future returns when extra-contractual agreements included rights of return.

12. With limited exceptions, Orthofix recognized revenue during the relevant period based on the "sell-in" method, which provides for revenue recognition upon shipment of products to the distributor.

b. <u>Distributor Business Practices During the Relevant Period</u>

13. Orthofix entered into written agreements with distributors of its product. These distributor agreements provided, among other things, standard payment terms for purchase of products. These standard payment terms ranged typically from 90 to 180 days.

14. During the relevant period, Spine had an unwritten policy requiring that modifications to the terms in existing distributor agreements had to be approved by the Spine CFO. The Spine CFO's approval authority in this regard extended to all aspects of distributor agreement terms, including pricing, commissions, discounts, extensions of payment terms, payment plans, returns, and exchanges. The Spine CFO was the only person within OSI who had any type of revenue recognition training.

15. Moreover, Orthofix did not have any policies and procedures requiring the analysis and/or documentation of the impact, from a revenue recognition perspective, of modifications to the standard contractual terms contained in distributor agreements.

C. Orthofix Aggressively Set Internal Sales Targets and Imposed Pressure to Meet those Targets

16. During the relevant period, Orthofix had a culture of aggressively setting internal sales targets and imposing pressure upon its sales personnel to meet those targets.

17. Spine generally set sales targets in the following manner. Towards the end of a fiscal year, the Spine sales leaders prepared sales forecasts (by month, quarter, and for the year) for the upcoming fiscal year and sent those forecasts to the Spine President and Spine CFO. The Spine President and Spine CFO then reviewed and approved the forecasts before adding the costs components to prepare a budget which included the revenue targets.

18. The budget was then sent to the then-Company CEO who approved the budget or rejected it. If the budget was rejected, it was revised for review and resubmitted to the Company CEO for approval.

19. On August 28, 2012 – and reflecting the pressure imposed to meet revenue targets – the Spine Sales VP sent the following email to his sales team with the subject line "September Gut:"

> I need your gut feeling on the revenue we can generate in September. We need $2 million in addition to what is on the portal . . .based on the feedback I have received I have gotten so far, we are off about $1.5 million. I know what people say they need, but as you know this is important. We need to ask everyone to purchase just a bit more . . .if I have to walk into [the Spine President's] office and tell him we are short again, that is going to be a major problem.

20. After receiving the above email, one of the sales persons who reported to the Spine Sales VP emailed a colleague separately and wrote:

> I was just speaking with [the Spine Sales VP] and had finance listened to us last year we wouldn't be in this mess. We all predicted our markets could not sustain this growth but they got greedy. Found this budget brutal because here we are for another year just estimating the dollars.

D. Orthofix Improperly Recognized Revenue on Several Transactions with Brazilian Distributor

a. Orthofix Improperly Recognized $5 Million in Revenue in FY 2011 by Selling Implants without Instrument Sets

21. OSI had several international distributors during the relevant period, but its largest distributor of product was located in Brazil (hereinafter "the Brazilian Distributor"). In fact, for eight of the nine quarters from Q1 2011 to Q1 2013, the Brazilian Distributor was the Company's second largest customer on a revenue per quarter basis.

22. Entering 2011, Orthofix had a receivable of approximately $5 million from the Brazilian Distributor from prior sales. After discussions with the Spine President and Spine Sales VP, the Brazilian Distributor forecasted that it would purchase approximately $8.5 million of Orthofix implants and instruments in FY 2011.

23. Prior to this time, Orthofix had sold implants along with used instrument sets rather than new ones to the Brazilian Distributor. As discussed above, implants and instruments were interconnected because the implants could not be used in patients without related instrument sets.

24. At this time, however, the Brazilian Distributor could no longer purchase previously used instrument sets because ANVISA (the Brazilian equivalent of the U.S. Food and Drug Administration) imposed new regulations prohibiting the importation of used instrument sets.

25. Orthofix did not have the new instrument sets (105 in total) available to be shipped along with the implants it shipped to the Brazilian Distributor. Rather than waiting until the new instrument sets were available, Orthofix – in FY 2011 – shipped approximately $5 million in implants to the Brazilian Distributor despite the fact that these implants could not be used in patients without the new instrument sets.

26. Orthofix recognized the approximately $5 million revenue upon shipment of the above implants. Orthofix's recognition of revenue in this regard was improper as delivery of the interconnected product – the instruments – had not yet occurred. Orthofix knew that the implants could not be used in patients without the instruments. As such, payment timing and terms were contingent upon the instrument sets being made available and therefore, revenue recognition was inconsistent with Orthofix's accounting policy because it did not meet the fixed or determinable criteria or the collectability criteria.

27. This improper recognition of revenue caused Orthofix's financial statements to be materially misstated in its Forms 10-Q for the second and third quarters of FY 2011 and its year-end Form 10-K for FY 2011 and corresponding earnings releases.

28. By the beginning of FY 2012, virtually none of the 105 instrument sets had been shipped to the Brazilian Distributor. Thus, the Brazilian Distributor refused to pay for the implants because those implants that Orthofix had previously shipped to the Brazilian

Distributor could not be used without the instrument sets. As a result, the Brazilian Distributor's amounts payable to Orthofix increased from approximately $5 million at the beginning of FY 2011 to approximately $11 million at the beginning of FY 2012.

29. In March 2012, the Spine President and Spine Sales VP had discussions with the Brazilian Distributor concerning a payment plan to address the increasing amounts payable. The Brazilian Distributor agreed to pay approximately $4.2 million of the amounts payable by the end of FY 2012 but only if all the remaining 105 instrument sets were delivered by the end of April 2012.

30. The Spine President and Spine Sales VP agreed to this payment plan proposal without approval from the Spine CFO.

31. By April 30, 2012, Orthofix had only shipped 40 of the 105 instrument sets. Accordingly, in June 2012, the Brazilian Distributor informed the Spine Sales VP and Spine President that it would only pay $1.6 million of its amounts payable in December 2012 and $2.6 million in February 2013.

32. The Spine President and Spine Sales VP agreed to this payment plan proposal without approval from the Spine CFO. More broadly – throughout the relevant period – Orthofix did not establish and maintain procedures to reasonably ensure proper communication to the Company's finance and accounting departments of deviations from contractually established terms, which included written or unwritten agreements made with Company distributors.

b. <u>Orthofix Improperly Recognized Even More Revenue with the Brazilian Distributor in Summer 2012</u>

33. In late May 2012, the Spine President discussed a product launch plan with the Brazilian Distributor to purchase approximately $2.5 million of a new Orthofix implant product called Firebird. This product, however, had not yet been approved by ANVISA and, therefore, could not be shipped into Brazil until such approval was obtained.

34. The Brazilian Distributor agreed to place the order on the following conditions: (i) one year to pay for the implants contingent on ANVISA approval; (ii) 210 days to pay on all subsequent product orders; and (iii) all corresponding instrument sets needed to be available once ANVISA approved the implants. Neither Orthofix nor the Brazilian Distributor knew when ANVISA would grant approval.

35. Moreover – despite the fact that the Brazilian Distributor was provided 210 days to pay on any subsequent purchase orders – the new payment terms were not reflected in any revised or amended distributor agreement with the Brazilian Distributor.

36. The Spine CFO learned of this transaction a few weeks after the product had been shipped but before the company filed its third quarter FY 2012 financial results. In particular – on July 24, 2012 – the Spine Sales VP forwarded the Spine CFO an email

describing the transaction along with a series of emails containing prior discussions between him and the Brazilian Distributor's President.

37. The Spine CFO replied to the Spine Sales VP and the Spine President – "[Spine Sales VP], can you please address how we ended up with a full year to pay for the June order. I have a hard time managing that with a lot of pressure to reduce our ballooning [Days Sales Outstanding]." The Spine Sales VP replied, "we accepted this due to the need for that size of an order."

38. Despite the contingent nature of the sale and the Spine CFO's own concerns about how this transaction would impact the company's Days Sales Outstanding, the over $2 million in revenue from this transaction was recognized immediately upon shipping the implants to the Brazilian Distributor's U.S. based subsidiary located in Atlanta, Georgia.

39. Orthofix's recognition of revenue in this regard was improper because the Brazilian Distributor's obligation to pay, and the payment terms themselves, were contingent upon ANVISA approval and, therefore, revenue recognition was inconsistent with Orthofix's accounting policy because it did not meet the fixed or determinable criteria or the collectability criteria.

c. <u>Corporate CFO Became Aware of Issues with Implant Without Instruments Transactions</u>

40. The Corporate CFO – soon after beginning in that role in early 2011 – implemented a general unwritten bad debt policy applicable to both Spine and Orthopedics. The policy required that any accounts receivable that had been outstanding at least 360 days from the invoice date of a shipment had to be fully reserved as bad debt. The Corporate CFO, along with the Corporate Controller and Segment CFOs, were responsible for the calculation of the bad debt reserve.

41. On August 1, 2012 – two days after Orthofix had filed its Form 10-Q for the second quarter of FY 2012 and as part of the process for handling Orthofix's bad debt calculation – the Corporate Controller emailed the Spine CFO an aging schedule identifying that as of June 30, 2012 approximately $4 million of amounts owed to OSI was over one year old.[2]

42. The aging schedule contained in this email, however, demonstrated that the allowance for doubtful accounts as of the second quarter of FY 2012 was only $1.6 million (or 40% of accounts receivable over 360 days old). The Corporate Controller then wrote "what doesn't make sense is that our policy is to reserve all amounts in the [over one year old bucket]."

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2 Orthofix used the term "360+ day bucket" to denote amounts due over one year old.

43. The Corporate Controller then forwarded the email to the Corporate CFO and wrote the following:

> I spoke with [the Spine CFO] on this. The rationale for not reserving all of the 360+ bucket for [Spine] is that technically the receivable balance from [the Brazilian Distributor] is not >360 days old since they have extended terms in their contract. The aging schedule is based on days past the invoice date for all [accounts receivable]. To further exacerbate the situation, [the Brazilian Distributor] could not sell the Implants inventory that we sold to them in 2011 since we were delayed in sending them the instrument sets that they needed to sell the Implants). This one-year delay was caused by [ANVISA] who required us to send new instruments (as opposed to our original plan to move used instruments).

44. The Corporate Controller further noted in the email that – based on discussions he had with the Spine CFO – the Brazilian Distributor planned to make a $4 million payment in December 2012 that would significantly reduce the 360+ day bucket in the year-end aging presentation.

45. Unbeknownst to the Corporate Controller and the Spine CFO, however – and as another example of Orthofix's inadequate internal accounting controls surrounding distributor revenue recognition – the Brazilian Distributor had already informed the Spine President and Spine Sales VP that it would only pay $1.6 million in December 2012 and another $2.6 million in February 2013 because the 105 instrument sets had not been delivered in full in April 2012.

46. Through this email, the Corporate CFO was on notice that Orthofix had a significant outstanding receivable associated with implants for which there had been an at least one year delay in sending the corresponding instrument sets.

47. The Corporate CFO, however, did not take steps to investigate the circumstances of the original transaction and to determine whether the revenue associated with the original transaction had been properly recognized. As noted earlier, Orthofix improperly recognized $5 million of revenue because the implants could not be used in patients without the instruments. As such, payment timing and terms were contingent upon the instrument sets being made available and, therefore, revenue recognition was inconsistent with Orthofix's accounting because it did not meet the fixed or determinable criteria or the collectability criteria.

48. Orthofix had inadequate internal accounting controls to evaluate the impact of these facts on the revenue that was previously recognized on this transaction. In particular, Orthofix did not establish and maintain procedures to reasonably ensure an assessment by the Company's finance and accounting department of deviations from contractually established terms.

d. <u>Orthofix Improperly Recognized Even More Revenue with the Brazilian Distributor in Fall 2012</u>

49. In the fall of 2012, Orthofix improperly recognized even more revenue with the Brazilian Distributor. By the fall of 2012, the Spine President had left the company and was replaced in that role by the Corporate CFO (hereinafter "New Spine President/Prior Corporate CFO").[3]

50. Beginning in September 2012, the Spine Sales VP solicited the Brazilian Distributor to purchase approximately $1.5 million of Orthofix implants that had not yet been approved by ANVISA. Thus – as with the summer 2012 sales transaction with the Brazilian Distributor – this product could not be shipped into Brazil until that approval occurred.

51. The Brazilian Distributor indicated that it would agree to the purchase but only under the following two conditions: (i) the ability to renegotiate the payment terms if ANVISA approval did not occur by the end of 2012 (just three months away) and (ii) one year to pay for the product. Neither Orthofix nor the Brazilian Distributor knew when ANVISA would grant approval.

52. Despite the conditions noted above, Orthofix recognized the revenue from this transaction immediately upon shipping the implants to the Brazilian Distributor's warehouse located in the United States. In particular, Orthofix's recognition of revenue in this regard was improper because the Brazilian Distributor's obligation to pay, and the payment terms themselves, were contingent upon ANVISA approval and, therefore, revenue recognition was inconsistent with Orthofix's accounting policy because it did not meet the fixed or determinable criteria or the collectability criteria.

53. This improper recognition of revenue – in combination with the improper recognition of revenue for other transactions in FY 2012 described previously and later – caused Orthofix's financial results in its FY 2012 Form 10-K (and corresponding earnings release) to be materially misstated.

e. <u>The Brazilian Distributor's President Described Transactions to Spine CFO and Spine Sales VP</u>

54. As discussed previously, in March 2012, the Spine President and Spine Sales VP discussed a payment plan proposal such that the Brazilian Distributor would pay approximately $4.2 million of its amounts owed by the end of 2012. The Brazilian Distributor responded that it would only agree to this payment if all of the 105 instrument sets were delivered by the end of April 2012. When these instrument sets were not delivered by April 2012, the Brazilian Distributor informed the Spine President and Spine Sales VP in June 2012 that it would only pay $1.6 million in December 2012 and $2.6 million in February 2013.

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[3] The then-CFO of Orthofix's Orthopedics Segment replaced the New Spine President/Prior Corporate CFO as the Corporate CFO.

55. On December 1, 2012, the Spine Sales VP emailed the Brazilian Distributor's President and wrote "I believe you have been speaking with [the Spine CFO] about the end of the year payment of $4 million. They are all extremely anxious about this. This has to happen as agreed."

56. The Brazilian Distributor's President replied "No [the Spine CFO] did not communicate with me, certainly because it is quite clear this was agreed with [the Spine President]. We will pay $1.6 million in December."

57. The Spine Sales VP forwarded this email to the Spine CFO, writing "this is a disaster," despite the fact that the Spine Sales VP had been informed in June 2012 that the Brazilian Distributor would only pay $1.6 million in December 2012. The Spine CFO then forwarded the above email to the New Spine President/Prior Corporate CFO and wrote:

> [The Brazilian Distributor's President] says below they made a payment agreement with [the Spine President] . . .I have no idea what may have been promised. I do know that I fought pricing and terms concessions, but those were ultimately given at some point despite my denials. This was commonplace. I was told that I was the decision maker on pricing and terms and then secretly overridden. [The Spine Sales VP] did it all of the time – don't know how much [the Spine President] was involved.

58. On December 7, 2012, the Brazilian Distributor's President travelled to the U.S. to meet with the Spine CFO and Spine Sales VP. At that meeting, the Brazilian Distributor's President provided a Power Point presentation to the Spine CFO and Spine Sales VP with a detailed chronology of events on each of the sales transactions described previously, including the implant-without-instruments transactions, the June and September 2012 transactions, and the payment plan related issues.

59. The Spine CFO subsequently forwarded the Power Point presentation to the New Spine President/Prior Corporate CFO. The Spine CFO did not forward this Power Point presentation to the company's then Corporate CFO and did not reassess the revenue that the company had previously recognized and disclosed in its financial statements.

60. The New Spine President/Prior Corporate CFO failed to confirm that this Power Point presentation had been brought to the attention of the then Corporate CFO and did not separately confirm that the transactions outlined in the Power Point presentation had been separately discussed with the Corporate CFO. Moreover, the New Spine President/Prior Corporate CFO failed to evaluate the impact that the information contained in the Power Point had on the revenue that the company had previously recognized and disclosed in its financial statements when he served as the company's Corporate CFO.

61. Ultimately, Orthofix filed its FY 2012 Form 10-K in March 2013 and took no steps to correct the revenue that it had previously improperly recognized on the implants-without instruments, Firebird, and September 2012 transactions with the Brazilian Distributor. Moreover, Orthofix did not adequately assess the collectability of the significant receivables it had with the Brazilian Distributor.

62. As a result of this and other errors described below, Orthofix materially misstated its financial results in its FY 2012 Form 10-K and corresponding earnings release.

E. Orthofix Improperly Recognized Revenue with Other Spine International Distributors

a. Introduction

63. In addition to the Brazilian Distributor, OSI had relationships with other international distributors including in Italy, Spain, and Mexico. In total, these four international distributors accounted for over 70% of OSI's revenue and almost 4% of Orthofix's consolidated revenue in FY 2011 and 2012.

64. Orthofix improperly recognized revenue with each of these distributors and did not have adequate internal accounting controls to provide reasonable assurance that transactions with these distributors were recorded as necessary to permit the preparation of financial statements in conformity with GAAP.

b. Italy

65. On October 22, 2011, the Spine President emailed the Company CEO, Corporate CFO, Spine CFO, and Spine Sales VP concerning the need for OSI to meet its fourth quarter fiscal year 2011 forecast of $6 million in revenue. The Spine President wrote "if we fail at this endeavor then the company will be at risk and next year will be Hell on Earth for all of us."

66. In early December 2011 – in an attempt to meet Spine's internal sales targets for the fourth quarter of FY 2011 – the Spine Sales VP emailed the Italian Distributor and solicited it to make a $400,000 order. The Italian Distributor's President responded that it could make the order if they had extended payment terms of 180 days and the ability "in case of cash difficulties" to extend those payment terms. Moreover, the Italian Distributor's President noted that "it is a very bad moment for Italy."

67. The Spine CFO was copied on these email exchanges and, despite the specifically identified financial difficulties in Italy, Orthofix recorded the revenue upon shipment of the products. This revenue recognition upon shipment was improper because payment terms were contingent upon timing of the Italian Distributor's sell-through and payment receipt of the products and, therefore, revenue recognition was inconsistent with Orthofix's accounting policy because it did not meet the fixed or determinable criteria or the collectability criteria.

c. Spain

68. In early December 2011, the Spine Sales VP, by email, solicited the Spanish Distributor to make a $300,000 order. The Spanish Distributor noted the difficult conditions in the Spanish economy at the time. The Spine Sales VP responded that "based on the expected challenges in Europe due to the instability of the financial institutions," he could offer extended payment terms of 180 days for instruments and 150 days for implants.

69. In late December 2011, the Spine Sales VP forwarded this email exchange to the Spine CFO for his approval of the extended payment terms. The Spine CFO provided his approval. Orthofix recognized the revenue from this transaction upon shipment of the products and this was improper because it did not meet the fixed or determinable criteria.

70. In July 2012, the Spine Sales VP, without getting the approval of the Spine CFO, solicited the Spanish Distributor to place an $810,000 order in which he offered the Distributor certain concessions, which he characterized as the "deal of the century." The concessions included extended payment terms on the order and the right to return $250,000 of excess distributor inventory that resulted from the order. Orthofix's recognition of revenue from this transaction upon shipment of the products was improper because payment terms and timing were contingent upon certain extra-contractual concessions and, therefore, revenue recognition was inconsistent with Orthofix's accounting policy because it did not meet the fixed or determinable criteria or the collectability criteria.

d. Mexico

71. In September 2012, the Spine Sales VP, without getting the approval of the Spine CFO, solicited the Mexican Distributor to place a $300,000 order in which he offered the Distributor a number of concessions. The concessions included extended payment terms on the order, and expansion of sales territory and reduction in sales quotas for the next year. Orthofix's recognition of revenue from this transaction upon shipment of the products was improper because payment terms and timing were contingent upon certain extra contractual concessions and, therefore, revenue recognition was inconsistent with Orthofix's accounting policy because it did not meet the fixed or determinable criteria or the collectability criteria.

F. Orthofix Improperly Accounted for Spinal Stimulation Product Transactions

72. Orthofix's revenue recognition issues were not just limited to transactions with certain of its international distributors for spinal products. Orthofix also improperly accounted for certain domestic distributor transactions in Spine involving spine stimulation products.

73. Beginning in the first quarter of FY 2012, the Spine President began exploring opportunities to generate more revenue in the domestic spine market by selling spine stimulation products to wholesale distributors. Prior to this time, Orthofix sold these products directly to patients, doctors and hospitals. The Spine President began exploring selling these products directly to wholesale distributors who would then resell them to doctors and hospitals.

74. At this time, the wholesale market for these products was dominated by an Orthofix competitor. To draw market share away from this competitor, the Spine President and Spine CFO determined that they would need to sell Orthofix spinal stimulation products at deeply discounted prices.

75. Accordingly, the Spine President and Spine CFO decided they would offer the wholesalers products at deeply discounted prices-per-unit. Moreover, Orthofix paid a referral fee to the wholesaler that was termed as a "commission."

76. For example, if Orthofix agreed to sell 100 units for $1,500 per unit, or $150,000, Orthofix also agreed to pay the wholesaler a commission of 25%, or $37,500, which essentially reduced the amount being paid for the product to $112,500 ($150,000 less $37,500).

77. Orthofix improperly treated these commissions as expenses rather than as reductions to revenue. Orthofix's accounting treatment was improper because where the vendor does not receive an identifiable benefit for the commissions, sales discounts such as these are presumed to be a reduction in the seller's price pursuant to ASC 605-50-45-2. Thus, these commissions should have been treated as further price discounts and as a reduction in revenue.

78. Due to this improper accounting, Orthofix overstated its revenue by approximately $1.7 million in FY 2012, with the overwhelming majority of this amount (approximately $1.4 million) being overstated in the third quarter of FY 2012.

79. Moreover, Orthofix improperly recognized revenue upon shipment on two of the spinal stimulation transactions in which the purchaser was granted a right to exchange the products for cervical stimulation products.

80. In particular – because Orthofix could not and did not reasonably estimate the revenue recognition impact of the amount of future returns – Orthofix was precluded from recognizing revenue upon shipment in the above transactions pursuant to ASC 605-15-25-1(f).

81. As a result, Orthofix overstated its revenue by over $650,000 in FY 2012, with all of this revenue being improperly recognized in the third quarter of FY 2012.

G. <u>Orthofix Engaged in Improper Accounting at its Orthopedics Brazilian Subsidiary</u>

82. As noted earlier, Orthofix had two primary business segments during the relevant period – Spine and Orthopedics. Within Orthopedics, Orthofix had a Brazilian subsidiary known as Orthofix do Brazil. During the relevant period, the Orthofix do Brazil subsidiary had inadequate internal accounting controls surrounding revenue recognition and, as a result, improperly recognized revenue associated with certain distributor transactions upon shipment.

83. In particular, Orthofix do Brazil used side agreements that included extended payment terms and other concessions, and therefore, did not meet the revenue recognition requirements upon shipment of the product.

84. Moreover, Orthofix do Brazil improperly recognized revenue upon shipment in at least FY 2011 and FY 2012 as a result of providing distributors with rights to both exchange and return products.

H. Orthofix Improperly Calculated its Excess and Obsolete Reserve for Certain of Its Inventory

85. During the relevant period, Orthofix calculated an excess and obsolete (E&O) reserve for its inventory. In essence, the E&O calculation serves as an estimated reserve against inventory based on – among other things – assumptions related to the marketability or saleability of inventory on hand.

86. During the relevant period, Orthofix improperly calculated or accounted for its E&O reserve in two respects. First – in the third quarter of FY 2011 – Orthofix launched a new product called FORZA. Orthofix experienced issues with FORZA's launch and therefore took an E&O reserve totaling approximately $1.2 million in the second quarter of fiscal year 2012.

87. In the fourth quarter of fiscal year 2012, a new E&O calculation policy was implemented at Spine to conform the E&O calculation performed at another Orthofix segment since at least 2007.

88. The updated E&O policy, among other things, provided that an E&O reserve would not be taken in the first four years of a product's launch. Applying that policy, in the fourth quarter of FY 2012 the Spine CFO reversed the reserve originally booked in the second quarter of FY 2012 (which resulted in a $1.2 million gross margin increase in the fourth quarter of FY 2012).

89. On restatement, however, Orthofix concluded that the FORZA E&O reserve should not have been reversed due to the fact that issues with FORZA's launch had indeed impacted demand.

90. Second, in connection with the company's restatement process and based on a previously known design deficiency in the company's controls over the computation and recording of its E&O reserve, Orthofix reviewed the broader methodology it used to compute and record its inventory reserve. Based on this review, Orthofix determined that it had improperly made reductions to previously recorded reserves based on changes in forecasted demand in contravention of ASC 330.[4]

91. As a result of its improper reserve accounting for this broader issue and the FORZA issue noted above, Orthofix understated its E&O reserve by $3.4 million and $5.6 million in FY 2011 and 2012, respectively.

I. Orthofix's Restatement

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[4] ASC Topic 330, Inventory (specifically ASC 330-10-35-14) states that a write-down below cost at the close of a fiscal year creates a new cost basis.

92. In late March 2014, Orthofix restated its financial statements for the first quarter of fiscal year 2013, all quarterly and annual periods in fiscal years 2012 and 2011, and the annual period for fiscal year 2010.

93. As a result of certain improper distributor revenue recognition practices, Orthofix announced that it had overstated – for example – fiscal year 2011 net sales by approximately 6% and operating income by over 430%. Moreover, in the restatement, Orthofix acknowledged certain material weaknesses in its internal control over financial reporting.

VIOLATIONS

94. Securities Act Section 17(a)(2) prohibits any person from obtaining money or property in the offer or sale of securities by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

95. Securities Act Section 17(a)(3) prohibits any person from engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser in the offer or sale of securities.

96. Section 13(a) of the Exchange Act requires issuers to file such periodic and other reports as the Commission may prescribe and in conformity with such rules as the Commission may promulgate. Exchange Act Rules 13a-1, 13a-11, and 13a-13 require the filing of annual, current, and quarterly reports, respectively. In addition to the information expressly required to be included in such reports, Rule 12b-20 of the Exchange Act requires issuers to add such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading. "The reporting provisions of the Exchange Act are clear and unequivocal, and they are satisfied only by the filing of complete, accurate, and timely reports." *SEC v. Savoy Industries*, 587 F.2d 1149, 1165 (D.C. Cir. 1978) (citing *SEC v. IMC Int'1, Inc.*, 384 F. Supp. 889, 893 (N.D. Tex. 1974)). A violation of the reporting provisions is established if a report is shown to contain materially false or misleading information. *SEC v. Kalvex, Inc.*, 425 F. Supp. 310, 316 (S.D.N.Y. 1975).

97. Section 13(b)(2)(A) of the Exchange Act requires issuers to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." Section 13(b)(2)(B) of the Exchange Act requires issuers to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit the preparation of financial statements in conformity with generally accepted accounting principles.

98. As a result of the conduct described above, Orthofix violated Securities Act Sections 17(a)(2) and 17(a)(3) and Exchange Act Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) and Rules 12b-20, 13a-1, 13a-11, and 13a-13.

COOPERATION AND REMEDIAL ACTION

In determining to accept Respondent's Offer, the Commission considered remedial acts undertaken by Orthofix, including its enhancement of internal controls, the restructuring and strengthening of the Company's accounting and finance group (which includes retention of additional accounting personnel), and Orthofix's cooperation with the staff's investigation.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Respondent cease and desist from committing or causing any violations and any future violations of Securities Act Section 17(a)(2) and 17(a)(3), and Exchange Act Sections 13(a), 13(b)(2)(A), 13(b)(2)(B) and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder.

B. Respondent shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of $8,250,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following three ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request[5];

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofin.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Orthofix as a Respondent in these proceedings, and the file number of these proceedings; a copy

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[5] The minimum threshold for transmission of payment electronically is $1,000,000. For amounts below the threshold, respondents must make payments pursuant to option (2) or (3) above.

of the cover letter and check or money order must be sent to Antonia Chion, Division of Enforcement, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5720.

C. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the penalties referenced in paragraph IV.B above. This Fair Fund may receive the funds from and/or be combined with fair funds established for civil penalties paid by other respondents for conduct arising in relation to the violative conduct at issue in this Orthofix proceeding, in order for the combined fair funds to be distributed to harmed investors affected by the violative conduct. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields
Secretary