

**UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934  
Release No. 57890 / May 30, 2008**

**ACCOUNTING AND AUDITING ENFORCEMENT  
Release No. 2833 / May 30, 2008**

**ADMINISTRATIVE PROCEEDING  
File No. 3-13048**

**In the Matter of  
  
CHRISTOPHER W. KELFORD,  
  
Respondent.**

**ORDER INSTITUTING CEASE-AND-  
DESIST PROCEEDINGS PURSUANT  
TO SECTION 21C OF THE  
SECURITIES EXCHANGE ACT OF  
1934, MAKING FINDINGS, AND  
IMPOSING 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 21C of the Securities Exchange Act of 1934 (“Exchange Act”) against Christopher W. Kelford (“Kelford” or “Respondent”).

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (“Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this “Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order” (“Order”), as set forth below.

### III.

On the basis of this Order and Respondent's Offer, the Commission finds that:<sup>1</sup>

#### A. RESPONDENT

1. From June 2002 to April 2004, Kelford, age 57, served as the Vice President of Finance for the Dental Division of Centerpulse Ltd. ("Centerpulse" or the "Company"), a Swiss medical devices manufacturer. In this position, Kelford was responsible for, among other things, maintaining accurate books and records at the Division, and for devising and maintaining an adequate system of internal accounting controls at the Division.

#### B. SUMMARY

2. This matter arises out of a reserve release that Kelford directed during Centerpulse's fiscal third quarter 2002.<sup>2</sup> In particular, pursuant to instructions he received from Urs Kamber (Centerpulse's then-Chief Financial Officer) and Stephan Husi (Centerpulse's then-Controller), Kelford improperly directed his staff to make an unsupported \$1 million release from an inventory revaluation reserve kept on the Dental Division's books and records, which then rolled up into the Company's consolidated financial statements, and which had the effect of improving Centerpulse's reported earnings for the third quarter. This release was not in conformity with Generally Accepted Accounting Principles in the United States ("U.S. GAAP"),<sup>3</sup> and it caused Centerpulse's consolidated pretax income that quarter to be overstated by approximately 4.6 percent, as it was reported in the financial statements the Company included in the Form 6-K it furnished to the Commission on November 12, 2002.

3. By virtue of his conduct, Kelford violated Exchange Act Section 13(b)(5) and Rule 13b2-1 thereunder by knowingly falsifying certain books and records and knowingly circumventing certain internal accounting controls. Kelford also caused Centerpulse to violate Exchange Act Sections 13(b)(2)(A) and 13(b)(2)(B) by failing to keep accurate books and records, and by failing to devise and maintain an adequate system of internal accounting controls at the Dental Division.

#### C. BACKGROUND

4. Originally named Sulzer Medica AG, Centerpulse was a publicly traded corporation headquartered in Switzerland that manufactured a variety of medical devices, including hip and knee implants. From at least January 2001 through October 2003, Centerpulse's American Depository Shares were registered with the Commission pursuant to Exchange Act Section 12(b) and were traded on the New York Stock Exchange under the symbol "CEP." As a foreign private issuer, Centerpulse filed annual reports with the

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<sup>1</sup> 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.

<sup>2</sup> Centerpulse's fiscal year ended on December 31 of each calendar year, and accordingly its fiscal third quarter 2002 ended on September 30, 2002.

<sup>3</sup> While Centerpulse disclosed that its financial statements were reported in accordance with International Financial Reporting Standards, Centerpulse's accounting controls, and Kelford's practice, were to maintain the Division's accounts in accordance with U.S. GAAP.

Commission on Form 20-F and furnished other periodic reports to the Commission on Form 6-K. In October 2003, the Company was acquired by and merged with Zimmer Holdings, Inc., a U.S. medical devices company.

5. In 2001, Centerpulse was named as a defendant in over 1,980 products liability and personal injury lawsuits filed in federal and state courts in the United States, as well as courts in other foreign jurisdictions, which alleged various defects in certain hip and knee implants that the Company had recalled (the “recall litigation”). By May 2002, Centerpulse had obtained court approval for a global settlement of the recall litigation. The final settlement agreement established a trust of approximately \$1.1 billion to fund payments to individual plaintiffs and claimants. Centerpulse contributed \$725 million in cash to the trust in 2002, \$635 million of which was funded through a credit facility arranged by a consortium of banks.

6. During Centerpulse’s fiscal third quarter 2002, as Centerpulse was attempting to secure the \$635 million credit facility, Centerpulse employees improperly released certain reserves, did not record certain expenses, and made other accounting entries that did not comply with U.S. GAAP, and that had the effect of improving the Company’s reported financial results. Pursuant to instructions he received from Kamber and Husi, Kelford directed the improper release described in this Order.

**D. DESCRIPTION OF THE IMPROPER RESERVE RELEASE**

7. In 2001, Centerpulse’s outside auditors observed that the Company was not recording variances on a monthly basis for the difference between standard and actual costs associated with purchase prices, labor and overhead at the Dental Division. Centerpulse management agreed that going forward they would record such variances each month in accordance with the correct accounting treatment. However, during the first half of 2002, certain members of the Dental Division’s finance department did not consistently record manufacturing and inventory variances in this manner. Kelford was not employed by Centerpulse during this time period.

8. After becoming Vice President of Finance for the Dental Division in June 2002, Kelford recognized that inventory variances had not been recorded regularly during the first six months of the year. He directed that inventory variances be recorded monthly going forward. Pursuant to Kelford’s instructions, the Dental Division’s accounting staff made journal entries for variances in June, July and August 2002, with accompanying support and analyses. These adjustments increased the Dental Division’s inventory revaluation reserve by approximately \$1.2 million, which had the effect of reducing the Division’s third quarter income (and, thus, Centerpulse’s earnings) by approximately \$1.2 million.

9. On October 17, 2002, one day after the Dental Division’s third quarter books had been closed, Kelford received an e-mail from Kamber, who complained that the inventory revaluation adjustments had eroded the Dental Division’s profitability. Specifically, Kamber stated:

“I have been going through the numbers for the third quarter this year with Stephan Husi. When analyzing the Dental numbers very strange things appear.

Sales rose as we expected at almost 20% where as the profitability has decreased y.o.y. [year over year]. Stephan [Husi] informed me that this is due to ‘special’ adjustments in inventory....

Chris this is not acceptable at this time. I cannot show a decreasing profitability while the revenue increased at 20%. In theory, your Gross Profit and bottom line should go through the roof. We will all be in deep problems if I present this to the banks which give [sic] me \$635 million to pay the [recall] settlement.

I ask you to immediately contact Stephan Husi and go through item by item of what was booked. I cannot accept any reserves building, revaluation of inventory, etc. at this point. This has to be postponed to December.”

10. In a telephone conversation later that day, Kelford and Husi agreed to release \$1 million from the inventory revaluation reserve. Kelford then directed his staff to make a \$1 million adjustment to the Dental Division’s inventory revaluation reserve. Kelford directed the adjustment over the objection of one of his subordinates who refused to book the entry, and Kelford provided no documentation or support for the entry. The individual who recorded the entry wrote “Per Chris Kelford” on the journal entry form.

11. The reserve release was not in conformance with U.S. GAAP or the Dental Division’s policy for accounting for inventory variances. The release also effectively reversed the prior variance entries for June, July and August that had been made at Kelford’s instruction and that contained accompanying support and analyses. Moreover, the release was made based on corporate direction and had the effect of improving Centerpulse’s reported income in the third quarter of 2002.

12. As a result of the improper accounting practices set forth above, Centerpulse falsely reported in an interim report for the third quarter of 2002 that it had earned approximately \$21.9 million in pretax income for the third quarter of 2002 instead of at most approximately \$20.9 million, an overstatement of approximately 4.6 percent. That interim report was subsequently furnished to the Commission on November 12, 2002 in a Form 6-K.

## **E. LEGAL DISCUSSION**

13. Exchange Act Section 13(b)(2)(A) requires issuers with securities registered under Exchange Act Section 12 to make and keep books, records and accounts that accurately and fairly reflect the transactions and dispositions of their assets. Exchange Act Section 13(b)(2)(B) requires such registrants to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that, among other things, transactions are recorded as necessary to permit preparation of financial statements in conformity with GAAP or any other criteria applicable to such statements, and to maintain the accountability of assets. Exchange Act Rule 13b2-1 prohibits any person from directly or indirectly falsifying or causing the falsification of any book, record, or account subject to Exchange Act Section 13(b)(2)(A). No showing of scienter is necessary to establish violations of these provisions. See, e.g., SEC v. McNulty, 137 F.3d 732, 740-41 (2d Cir.), cert. denied sub nom., Shanklin v. SEC, 525 U.S. 931

(1998). Exchange Act Section 13(b)(5) prohibits a person from knowingly falsifying any book, record, or account or knowingly circumventing internal controls.

14. Kelford violated Exchange Act Section 13(b)(5) and Exchange Act Rule 13b2-1, and caused Centerpulse to violate Exchange Act Section 13(b)(2)(A), when he directed his staff to make an unsupported and improper \$1 million release from the Dental Division's inventory revaluation reserve. As a result, Centerpulse's third quarter 2002 books and records were false because they reflected an overstatement of the Company's consolidated income. The improper release also constituted a failure to devise and maintain an adequate system of internal accounting controls at the Dental Division which in turn caused Centerpulse to violate Exchange Act Section 13(b)(2)(B).

#### 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:

Pursuant to Section 21C of the Exchange Act, Respondent Kelford cease and desist from committing or causing any violations and any future violations of Exchange Act Section 13(b)(5) or Rule 13b2-1 thereunder and from causing any violations and any future violations of Exchange Act Sections 13(b)(2)(A) and 13(b)(2)(B).

By the Commission.

Florence E. Harmon  
Acting Secretary