

**ERICSSON'S COMMENTS ON THE PROSECUTION REGARDING  
EVASION OF TAX CONTROL**

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## Foreword by the President and Chief Executive Officer

It would not have been possible to create and develop a company like Ericsson, now in existence for more than one hundred years, without a corporate culture and fundamental values that permeate the business and the employees. Historically, the cornerstones are

- Respect
- Professionalism
- Perseverance

These terms are concise but should be widely interpreted. Governing policies and directives, complimented by a code of business ethics and conduct have since long provided the terms with substance.

From our policies, directives and code of business ethics and conduct it is unambiguously clear that the primary catchword includes **Respect for applicable laws, rules and regulations and sound business ethics**. Anything else is unacceptable.

Thus, we take a serious view on the fact that certain employees, former and present, are suspected of the criminal offence evasion of tax control.

It is neither appropriate nor feasible for Ericsson to describe in detail the situation or to enter into a polemical dialogue. Nevertheless, we believe that we have an obligation, particularly to our employees and business partners, to clarify certain facts and to disclose our view with respect to some of these facts.

Connected to this matter we have filed a criminal complaint against a former employee relating to something quite different than evasion of tax control, namely suspicion of economic irregularities against Ericsson. Unfortunately, we can never be entirely safeguarded from disloyal behavior. However, we can learn from what has occurred and strive to minimize the risk of repetition.

We cannot disclaim the entire responsibility for the misunderstandings that have occurred. However, I would like to emphasize that we are of the opinion that none of our present or former employees are guilty of evasion of tax control. Thus, the fact that prosecution has been initiated is not in itself a reason to reassess the confidence we have for the accused individuals who remain employees of Ericsson.

In the present situation we look forward to the matter being tried in court. It is important to us to put this matter behind us and focus on the future.

Stockholm April 2005

Carl-Henric Svanberg  
President and Chief Executive Officer

## **1. Background, purpose and limitations**

Ericsson's business activities are probably that well known that a description of the same is unnecessary in this context. For information on Ericsson's business activities, please see [www.ericsson.com](http://www.ericsson.com).

### *Factual background*

The events leading up to the prosecution occurred in the years 1998-2000. In 1999, Ericsson had, following a growth unprecedented in the company's history, an annual turnover of SEK 215 billion and more than 103,000 employees. Sales to countries outside of Sweden represented 96 per cent of the total sales through 300 local companies.

### *Commercial agents and their compensation*

The routines and the measures that are now subject to criticism are connected to Ericsson's economical relations to its commercial agents.

Collaboration with commercial agents requires neither justification nor detailed explanations. Commercial agents represent an important part of international business with a history of many centuries. Practically all major international companies, including competitors to Ericsson, engage agents. The activity of commercial agents is supported by law - in Sweden the Commercial Agency Act.

In a number of countries it is indispensable to engage local representatives having a local awareness and knowledge of the language as well as a familiarity with local rules, customs and culture.

Commercial agents engaged by Ericsson should be well established and respected in their respective societies. Ericsson has engaged some of its commercial agents for decades.

As the general rule, commercial agents are paid by commission, which normally also covers expenses. Considering the fact that sale of complicated systems is time consuming, and that no commissions will be paid in case the specific transaction covered by the agency agreement is not finalized, LME's agency agreements have sometimes stipulated that the agent shall be entitled to some compensation for expenses irrespective of the transaction being finalized or not.

This is true not only for the period in question, 1998-2000, but also before as well as after said period. However, in 1998 Ericsson's payment system was modified. This modified system, which was abandoned already in 2000, is the reason for the Swedish National Economics Crimes Bureau suspicion of evasion of tax control.

### *Why was the payment system modified?*

In conjunction with international cooperation in the field of taxes, certain countries - including Sweden - have adopted legislation on mutual administrative assistance in tax matters. On January 26, 1998, the Swedish Tax Authorities resolved to perform an audit at Ericsson with respect to an investigation of a third party. The Tax Authorities requested

information on the identity of some of Ericsson's commercial agents. Before this request, a major competitor had contacted Ericsson reporting they had received a telephone call from an individual who offered to sell a binder containing documents from a previous tax audit of Ericsson. The binder, which contained confidential Ericsson information, had disappeared from the Tax Authorities' office. The matter was reported to the police. The binder was never recovered.

At the same time some Ericsson agents expressed concern regarding Ericsson's ability to comply with agreed anonymity and confidentiality clauses in the agency agreements.

From a commercial standpoint, the situation was considered unsustainable. Thus, in mid 1998, a few employees of the parent company LME's departments "Corporate Markets" and "Financial Accounting and Control" initiated a modification of Ericsson's system of paying its commercial agents, while the compensation as such remained unaffected. The purpose was to meet agents' demands to protect their anonymity. The employees involved considered the modified payment system to comply with applicable rules and sound business practices.

#### *The modified payment system*

Simplified, the modification resulted in the payments to agents being made through payment intermediaries - not unusual in the banking world - in the present case referred to as service companies.

However, the modified payment system in practice came to be managed in a way not originally intended, which rendered control more difficult. Except for one person, Ericsson has no reason to suspect that any employee has made use of the system for personal profit or deliberately reduced transparency with respect to the legitimate interests the Bookkeeping Act provides for. The exception, which involves a former Ericsson employee (referred to as X), has been the subject of a criminal complaint filed in Switzerland by Ericsson.

X held in the period 1998-2000 a position with LME's Corporate Markets, but did also provide certain services to Financial Accounting and Control related to the modified payment system. He had been employed with Ericsson for decades and was entrusted with an important function in i.a. the administration of payments within the modified payment system. X contacted a Swiss attorney who was entrusted with organizing the payment system and for ensuring that no laws were violated.

A specific agreement regarding the organization of the payment system was entered into between LME and the Swiss attorney. Specific agreements were then entered into with foreign companies/service companies, subsequent to an assessment performed by the Swiss attorney.

When an agent had performed a service and a commission was to fall due, LME's Corporate Markets notified X and the Swiss attorney that they should instruct an appropriate service company to request sufficient funds from LME for payment to the agent. LME handled the commissions within the Ericsson group on a centralized basis. The request for funds was made by the issuance by a service company of a more or less standardized invoice. A common bank advice from LME would have been a simpler and more preferable way to respond to a request for payment sent by fax or equivalent. The Swiss attorney transferred from the service company to the agent the amount the latter was entitled to. Naturally, LME

received reimbursement from the Ericsson company that had made the deal triggering payment of commission to the agent.

Thus, the service companies received funds from LME. Over the period of approximately 18 months that is relevant to the prosecution for evasion of tax control, LME had paid approximately 3.3 billion SEK to the service companies. This amount may be compared to the net sales of Ericsson, amounting to SEK 215 billion for the year 1999 alone.

#### *Practices that have caused errors and misunderstandings*

The modified payment system was managed in an unintended way, which resulted in inadequate internal controls of the payments to agents via service companies. The circumstances that primarily lead to errors and misunderstandings are the following:

- Payments to and from the service companies were supposed to match, but the payment system was managed in a way that caused excess funds to accumulate in certain service companies. This was not immediately noticed since the excess funds were accounted for as liquid assets or as claims on the services companies.
- Other payment intermediaries than those engaged by the Swiss attorney were engaged directly by X. In total, 33 payment intermediaries were used, which can be categorized into four groups.
  - 1) A group of service companies that was engaged by the Swiss attorney.
  - 2) A service company that was based in the United Arab Emirates and was controlled by Italian businessmen.
  - 3) A service company that was based in Lebanon and was controlled by a Lebanese businessman.
  - 4) A group of service companies that were directly or indirectly controlled by a Swiss businessman.
- From our own as well as from the Swedish National Economics Crimes Bureau's investigations, we have gained an ever-greater understanding of how the modified payment system was handled. It became clear that large sums had for no obvious reason been transferred between service companies, and further that transfers had been made to beneficiaries unknown to Ericsson, or known to Ericsson but not entitled to compensation. Our own investigation made a breakthrough in April 2004 when we were allowed to review investigation work performed by a Swiss prosecutor concerning the flow of funds. We have every reason to be grateful for this assistance since we would not have been able to get access to the material on our own. The material is still being analysed by us. The analysis performed so far has resulted in a criminal complaint filed by Ericsson against X for suspicions of misappropriation of Ericsson funds, alternatively embezzlement.
- It has further been established that the service companies that were controlled by the Swiss businessman had received from LME an approximate amount of MCHF 95 in excess of the amount that was paid to our commercial agents. We have asked for these funds to be repaid and in response received a counterclaim but maintain nonetheless our claim for repayment.

- The arrangement with invoices from service companies (which actually represented requests for payment) has led to misunderstandings by the Tax Authorities. The Tax Authorities appear to claim that the payments have had an effect on the profits of LME. Between monthly closures, LME booked agent related payments from operating group companies and to service companies into a profit and loss account, but in each financial statement these sums were transferred to a balance account and thus the sums did not affect the profits of LME.
- Irrespective of the opinion of the Tax Authorities regarding any deduction right, Ericsson has prepared its accounts in accordance with generally accepted accounting principles. Payments to service companies have not been reported as an expense until fulfillment of the agent's services, and all disputed or doubtful debts as well as reconciliation differences have been treated in accordance with the concept of conservative accounting.

## **2. Tax audit and measures taken by the Swedish Tax Authorities**

In 2001 the Tax Authorities performed a tax audit concerning LME, and its subsidiaries ETX and ERA, limited to costs booked as compensation to market consultants for the income year 1999 (tax audit memorandum dated November 15, 2001). Costs for market consultants relate mainly to payments to the commercial agents. According to the memorandum, the tax audit was performed as a direct result of articles in the Swedish newspaper "Expressen". An Italian businessman named Marcellusi had provided the information. The assessment of the Tax Authorities pursuant to the performed audit resulted in reassessments as well as in a criminal complaint being filed - which subsequently led to the present prosecution. In its criminal complaint the Tax Authorities reported e.g.

In the fiscal year 1999 payments have been made in respect of invoices from the so-called payment intermediaries (in the number of 33) in a total amount of SEK 2,581,492,786. These invoices form the basis for the accounting entries of the company in the cost accounts previously referred to. The invoices and the agreements do not indicate that the payments are intended for other legal entities/individuals performing the consultancy services. If the audit had been performed without additional information – in the present case the revelation by Expressen regarding Federico Marcellusi's work on behalf of Ericsson – it would not have been possible to discover that the invoices were used to make hidden payments on behalf of the company. Also, it does not appear from the accounts that the company itself fixed the invoice amounts that appear in the accounts.

It is the opinion of the Tax Authorities that the company's intention with the modified payment system – using payment intermediaries to pay market consultants (also referred to as commercial agents; Ericsson's note) - has been to hide payment of compensation to the final beneficiaries. Thus, it has not been possible to control or assess the costs booked as compensation to market consultants, i.e. whether such costs are deductible and, if so, when such deduction right was earned.

It appears from what has been stated above that the company has ignored regulations incorporated in the Bookkeeping Act. As a result the bookkeeping for market consultants' costs could not be used as a basis for taxation of LME (including ETX) and ERA. Thus, the basis for the deduction has in parts had to be estimated to reasonable amounts. Bookkeeping measures undertaken by LME regarding invoices

from payment intermediaries, along with the fact that compensations to market consultants have not been booked in the accounts, have rendered the audit more difficult and time consuming. The deficiencies are such that they have resulted in the tax control being severely obstructed.

In addition to this criminal complaint, the Tax Authorities did not accept some tax deductions made by Ericsson for payments to its agents in certain countries through service companies. The increased company tax for all affected companies has been considered in the accounting. The reassessment for 1999 has been appealed and is now subject for re-examination by the Administrative Court.

### **3. Investigation by the Swedish National Economics Crimes Bureau and subsequent prosecution**

The Swedish National Economics Crimes Bureau's investigation initially resulted in notification of 16 individuals, present or former employees of Ericsson, of suspicion of evasion of tax control. The number of individuals under suspicion has since been much reduced and prosecution has now been initiated against less than half.

### **4. Ericsson's position and measures taken**

Ericsson has not been passive. Internal analyses and investigations were initiated as soon as there were indications that the modified payment system was handled – intentionally or unintentionally – in a way not originally intended. Such analysis and investigations are not yet completed. Already in the year 2000, i.e. prior to the tax audit, work to replace the payment system began and after 2001 it has no longer been in use.

Ericsson has also engaged external expertise, primarily concerning tax law and accounting.

In the Administrative Court Ericsson refers to an opinion rendered by Ulf Gometz - Professor in accountancy at the School of Economics of the University of Gothenburg and authorized public accountant 1959-1998 - in support of our judgment that the reassessments are unfounded. The opinion was prepared pursuant to an assignment from our external tax counsel in said tax litigation. Professor Gometz was requested by our external counsel to perform an independent review and render an opinion of payments and costs for a certain period in 1999 - to be determined by himself - with respect to the commercial agents engaged by LME, ETX and ERA. In his opinion, which came to encompass three binders including exhibits, professor Gometz criticizes the payment system as well as weaknesses in internal control. However, he also makes the point that:

It is most likely not difficult, even for non-experts, to realize that accounting requirements applicable to a group having the size and activity scope of Ericsson, are extremely strict. Perfection is unattainable.

He concludes in brief:

Some verifications, that did not comply with Article 76 of the Bookkeeping Act, have been accepted by LME and certain reconciliation differences have to this date not been entirely clarified. However, the criticism by the Tax Authorities with respect to LME/ETX and ERA's accounts is - based on what I have seen – greatly exaggerated.

To the extent the net differences have had any negative impact on the tax return, the companies have refrained from asking for tax deductions. Further, the Tax Authorities have not considered the fact that the companies have undergone an unprecedented turmoil during the period subject to criticism.

Professor Gometz further states that in his opinion the Tax Authorities have - most likely due to misunderstanding - made another major misjudgment. The reassessments are unfounded since the items (costs) invoked by the Tax Authorities of companies concerned have not been entered in a profit and loss account and thus have not affected the calculations of tax payable.

In retrospect, it can be stated that the modified payment system introduced in 1998 was far from perfect. However, to anyone who has monitored the investigations over the years it should, in Ericsson's opinion, be clear that there was never any intent of tax evasion or evasion of tax control when the modified payment system was introduced.

Ericsson has offered each of our employees or former employees suspected of evasion of tax control to assume the costs for a private defense attorney. After an initial period, X informed Ericsson that, because his interests conflicted with those of Ericsson, he had engaged a public counsel to defend his case.

## **5. Remarkable circumstances**

During the investigations a number of remarkable circumstances have come to light. Some of these have been referred to in earlier sections. They have been directed against Ericsson and probably caused economical damage. In addition, they might negatively have impacted the overall image of Ericsson.

### *X, the UBS bank and frequency in money transfers*

UBS is a Swiss bank. X opened an account with UBS.

It has become obvious that significant sums relating to numerous unexplainable transactions to and from the service companies, as well as payments to beneficiaries unknown to Ericsson, were transiting this account. The frequency in these payments took such proportions that the UBS bank deemed it appropriate to report a suspicion of money laundering to the Swiss prosecutor. From the investigation subsequently conducted by a Swiss prosecutor, Ericsson has gained useful information that we would otherwise not have obtained.

Despite our requests, X has not presented a full report on payments transiting this UBS bank account.

Suspicion of disloyalty was apparent early on in Ericsson's own investigation and was also forwarded in professor Gometz' report. In the report he states on the subject:

With more than 100,000 employees all over the world, and additional individuals contractually tied to the group, it cannot be ruled out that a few individuals did not comply with the group's instructions.

It is my impression that the group has been subjected to disloyal actions and that that is the main reason for the incapability of presenting a final balance of the accounts of the agents/service companies. It would be surprising if it turned out that X cannot play a key role in clarifying these circumstances.

As mentioned earlier, the Swiss prosecutor is investigating possible money laundering, with the UBS account as a starting point. This investigation has not resulted in any final conclusion.

### *Falsified documents*

The Swedish National Economics Crimes Bureau's investigation has revealed a number of documents that have turned out to be falsified. These are e.g. falsified minutes from alleged meetings at LME - meetings that never took place. Clearly, in falsifying documents, someone has attempted to rewrite history and to hide facts. This has affected innocent employees who were never involved in the matter being investigated. For the time being, it is not possible to state what measures will be taken in this matter.

## **6. Relation to prosecuted Ericsson employees**

Individuals being under suspicion or prosecution are deemed innocent until the opposite has been firmly established. It is our opinion that the prosecuted individuals neither deliberately nor on account of any gross negligence, are guilty of evasion of tax control. Thus, the fact that prosecution has been initiated does not give us any reason to terminate any of these individual's employment.

Another issue is whether the fact that prosecution has been initiated against an employee that still holds a position of trust in the group makes it inappropriate for him to continue to perform the same duties when the question of guilt is being tried. In answering this question consideration must be given to the individuals' possibility to fulfill their duties when the question of guilt is being tried. Another factor to consider is if the individual holds the same position in which the public prosecutor considers him to have acted at least grossly negligent. We will carefully consider the situation with said employees individually and make a decision as to their future services to the group.

## **7. Further investigation**

The Swedish National Economic Crimes Bureau is investigating yet another set of events, primarily qualified by the Bureau as gross tax fraud. Two Ericsson employees are notified of suspicion. The suspicion is related to a multimillion-dollar payment in 1999 from LME to a foreign bank. The payment was made on behalf of one of our subsidiaries under an agreement.

The contents of this investigation are, as always, secret by law until a final decision has been made on the issue of prosecution.

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