UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64498 / May 13, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3283 / May 13, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14386

In the Matter of **GSI GROUP, INC.,** **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 GSI Group, Inc. ("GSI" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "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 it 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:[1]

Summary

1. From at least 2004 through at least June 2008 (the "Relevant Period"), GSI improperly recognized revenue on certain transactions even though revenue recognition was prohibited pursuant to generally accepted accounting principles ("GAAP"). The improper revenue recognition resulted in part from a deficient system of internal controls that included no clear procedures to determine what deliverables the company owed its customers and whether it had met those deliverables, along with a lack of understanding of the relevant accounting principles among key employees. In addition, for at least two material transactions that occurred in 2007 and 2008, certain GSI employees engaged in misconduct by causing GSI to recognize revenue when they knew or should have known that the revenue should not have been recognized. As a result, GSI overstated revenues by a total of approximately $1.9 million or 0.7% in 2004, $3.5 million, or 1.4%, in 2005; $43.1 million, or 16.6%, in 2006; $15.0 million, or 5.0%, in 2007 (including by $16.1 million, or 23.9%, for the fourth quarter of 2007); and by approximately $7.8 million (12.7%) and $3.3 million (5.6%) during the first and second quarter of 2008.[2]

Respondent

2. **GSI**, a New Brunswick, Canada corporation with its principal place of business in Bedford, Massachusetts, manufactures and sells laser systems and other technology products. GSI's stock was registered with the Commission pursuant to Section 12(g) of the Exchange Act and traded on the NASDAQ National Market System until July 31, 2006. From July 31, 2006 until April 15, 2010, GSI's stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and traded on the NASDAQ Global Market. On April 15, 2010, GSI's stock was delisted from the NASDAQ Global Market because it was delinquent in its Commission filings, deregistered from Section 12(b) of the Exchange Act, and reverted back to its designation under Section 12(g) of the Exchange Act. On November 20, 2009, GSI filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code in the U.S. Bankruptcy Court for the District of Delaware. On May 27, 2010, the U.S. Bankruptcy Court for the District of Delaware confirmed GSI's plan for reorganization. On July 23, 2010, GSI completed a rights offering and emerged from the Chapter 11 proceeding. On December 4, 2008, GSI announced that past financial statements filed with the Commission could no longer be relied upon due to errors discovered with GSI's recognition of revenue for those periods. On April 13, 2010, GSI filed restated annual and quarterly financial statements for the periods contained within the fiscal years 2004, 2005, 2006, 2007, and 2008. Effective February 14, 2011, GSI re-registered its common stock pursuant to Section 12(b) of the Exchange Act and is currently listed on the Nasdaq Global Select Market.

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

[2] Percentages are calculated based on restated revenues less discontinued operations.

Facts

Background

3. During the Relevant Period, GSI's Systems Division manufactured production systems that it sold to both domestic and international customers. GSI's production systems generally had both hardware (including lasers) and software components (including, in certain instances, customized, vendor specific, factory automation software) and required on-site installation by GSI personnel.

4. From at least 2004 to mid-2007, the division controller for the Systems Division made the determination when to recognize revenue from Systems Division sales. In mid-2007, pursuant to a reorganization of GSI's finance department (the "Finance Department"), GSI's corporate controller, assisted by an assistant corporate controller, took over the revenue recognition determination for the Systems Division.

5. During the Relevant Period, Systems Division sales staff documented the basic terms of a transaction in a Sales Order Approval Form ("Sales Order Form") which, along with other documents associated with the transaction, were to be collected by the Systems Division's sales order administration personnel. Before booking an order, the documents were to be reviewed and, depending on the size of the order, approved by varying levels of sales, finance and management staff. Transactions generally were automatically recognized as revenue upon shipment. Prior to the close of the quarter, the Finance Department reviewed the documents related to each transaction and determined whether to recognize or defer any revenue.

Internal Control Deficiencies

6. During the Relevant Period, GSI had numerous deficiencies throughout its system of internal controls that were attributable, in part, to its failure to understand and assess the risks in the control environment and to design and execute monitoring procedures that evaluated the controls over those risks. Among other things, Systems Division personnel did not communicate well with Finance Department employees, a problem that worsened after the mid-2007 reorganization. Accordingly, Finance Department employees often had difficulty getting information from Systems Division employees.

7. The structure of the revenue recognition process did not ensure proper communication of transaction terms to the Finance Department. For example, sales representatives agreed to provide additional items to customers after the company received a purchase order, or offered customers other incentives, but frequently failed to properly document or communicate those agreements to the Finance Department. Because the Systems Division did not have any clear process to ensure that any concessions, upgrades, or other terms agreed to in the period between booking and recognizing revenue from a transaction were included with the transaction documents, the Finance Department was often unaware of the actual transaction terms. Both the additional items and the incentives frequently impacted the timing of revenue

recognition because the Finance Department often relied on incomplete information when making the revenue recognition decisions.

8. In addition, key sales and Finance Department employees did not sufficiently understand the relevant accounting rules applicable to the multi-element arrangements. The corporate controller did not apply those accounting rules correctly, and he failed to apply proper oversight over other employees involved in revenue recognition decisions.

The Korean Transaction

9. During November 2007, a Korean customer agreed to purchase from GSI ten systems for nearly $1 million per system. Each system was equipped with a laser previously sold by GSI. GSI agreed to upgrade these systems by replacing the original lasers with a laser that had not yet been developed (the "Undeveloped Laser") when it became available.[3] As a final condition, the customer demanded that GSI upgrade five systems that the customer had previously purchased with Undeveloped Lasers once they became available.

10. In November 2007, one of GSI's product line managers (the "PLM") sent a letter to the Korean customer confirming GSI's obligation to upgrade the five systems with Undeveloped Lasers. The PLM did not copy anyone on the letter, and neither the letter nor the terms therein were provided to the Finance Department. The PLM completed the sales order approval form for the transaction representing, among other things, that GSI had not made any "promises or guarantees for future deliverables (systems improvements, software upgrades, etc)." The PLM also signed a quarterly certification for the Finance Department stating that he was unaware of any side transactions or contingencies. The PLM knew or should have known that this certification (and the representations therein) would be used by GSI in preparing its financial statements and would be provided to GSI's independent auditor in connection with the quarterly reviews of GSI's financial statements.

11. In December 2007, the PLM, members of the Finance Department staff, and the the general manager of the Systems Division (the "Systems GM") met to discuss whether they could establish vendor specific objective evidence of value or fair value for the Undeveloped Lasers and thus recognize revenue from the transaction. During these discussions, they concluded that GSI could establish fair value for the Undeveloped Laser if they could find a substantially similar laser that GSI had previously sold. Shortly thereafter, the PLM and others identified a laser (the "Identified Laser") as being substantially similar to the Undeveloped Laser.

12. In fact, the Identified Laser was not substantially similar to the Undeveloped Laser for the purposes of recognizing revenue. Among other things, the Undeveloped Laser was a unique, undeveloped product that had significantly different future application potential. In addition, on several occasions the PLM had communicated to the Finance Department and others that the Undeveloped Lasers were worth substantially more than the Identified Laser.

[3] During this period, GSI had two undeveloped lasers – a Multiple Pulse Infrared Laser and a Multiple Pulse Green Laser – that were to be upgraded in the production systems ordered by the Korean customer during 2007 and 2008. Neither of the lasers were substantially similar to the original lasers in the production system and, for the purposes of this Order, will be referred to collectively as the Undeveloped Laser(s).

13. On December 20, 2007, the corporate controller emailed the PLM a draft of a memo (the "Fair Value Memo") concluding that the Undeveloped Laser and the Identified Laser were substantially similar, which he asked the PLM to finalize and sign. The PLM, however, initially declined to sign the memo on the grounds that the lasers were different. The corporate controller then called the Systems GM and told him that if the PLM did not sign the memo, the company would not recognize revenue from the sale. The Systems GM indicated that he would talk to the PLM and, that same evening, the PLM emailed the corporate controller the signed Fair Value Memo. The PLM knew or should have known that this Fair Value Memo (and the representations therein) would be used by GSI in preparing its financial statements and would be provided to GSI's independent auditor in connection with the quarterly reviews of GSI's financial statements.

14. In the first and second quarters of 2008, the Korean customer ordered eight additional systems and corresponding upgrades for Undeveloped Lasers. The PLM signed another memo (to which the Fair Value Memo was attached) representing that the Undeveloped Laser to be used in these systems was substantially similar to the Identified Laser when in fact the lasers were not substantially similar. As a result, the Finance Department again used the Fair Value Memo to improperly recognize revenue for the systems.

15. During the first and second quarter of 2008, GSI recorded in its books and records and reported in its financial statements filed with the Commission over $8.9 million and $7.1 million in revenue, respectively, from the transactions with the Korean customer. However, GSI should not have recognized any revenue from these transactions during these periods because GSI had not delivered the Undeveloped Lasers, nor had it properly established fair value for the Undeveloped Laser in accordance with GAAP.

<u>The Taiwanese Transaction</u>

16. In or around January 2007, the PLM began negotiating a sale of six systems to a Taiwanese customer. The initial quotation specifically referenced a Tool Automation Specifications ("TAS") Agreement that related to the customer specifications or factory automation software that GSI would be obligated to provide.

17. During this same time, the primary engineer responsible for creating the factory automation software informed the PLM that implementing all the TAS specifications would be "a huge task," requiring over an additional 2000 hours of labor, would cost between $450,000 to $600,000, and could "not possibly be accomplished in the required time frame."

18. In March 2007, the Taiwanese customer ordered the six systems and specifically referenced compliance with the TAS as part of the arrangement. The PLM never informed the Finance Department that, as part of the transaction, the customer required customized software that would not be completed until several months after the systems had been installed and were operational. GSI booked the order and, between May and October 2007, shipped the six systems.

19. In late September 2007, the GSI's Finance Department told the PLM and other Systems Division personnel that GSI could not agree to any upgrades, contingencies, or future deliverables if it wished to recognize the revenue from the transaction. The PLM responded with an email specifically stating that "there are NO upgrades or contingencies," even though he knew that GSI had agreed to provide the customer with unique, customized software. The PLM also signed a quarterly certification stating that he was unaware of any contingencies or side agreements. When the customer accepted the first system during the fourth quarter of 2007, GSI recognized nearly $5 million in revenue from the six systems that had shipped, even though GSI still owed the customer the customized software. Because GSI had not delivered the customized software, and because it did not have fair value for the software, this revenue should not have been recognized at that time. The PLM knew or should have known that this certification (and the representations therein) would be used by GSI in preparing its financial statements and would be provided to GSI's independent auditor in connection with the quarterly reviews of GSI's financial statements.

20. On March 20, 2008 GSI's corporate controller emailed the PLM and others asking whether there existed a factory automation issue with respect to the Taiwanese customer. In response, the PLM told the corporate controller that GSI owed the customer "Phase II" factory automation, which GSI hoped to complete by the second quarter of 2008. The PLM provided the corporate controller with a copy of the TAS, which he stated contained the Phase II factory automation specifications.

21. In or around March 2008, the assistant corporate controller informed the corporate controller that the failure to provide factory automation may impact the revenue that GSI had previously recognized, which could result in a restatement. On April 3, 2008, the corporate controller emailed the assistant corporate controller, stating: "Please don't dig into these unless it blows up down the road. Let's work on getting things right going forward." On April 6, 2008, the corporate controller again emailed the assistant corporate controller: "When we go to the acceptance method this issue goes away. Let's dig into that once we get the quarter close behind us." The corporate controller did not properly investigate the matter and did not disclose the potential existence of undelivered factory automation software to the external auditors.

22. During the fourth quarter of 2007, GSI recorded in its books and records and reported in its financial statements filed with the Commission nearly $5 million in revenue from sales to the Taiwanese customer. However, GSI should not have recognized any revenue from this transaction during this period because GSI had not delivered the customized, factory automation software required under the customer agreement.

Impact on Financial Statements

23. As a result of the conduct described above, GSI overstated revenues by approximately $1.9 million (or 0.7%) in 2004, $3.5 million (1.4%) in 2005; $43.1 million (16.6%) in 2006; $15.0 million (5.0%) in 2007 (including by $16.1 million (23.9%) for the fourth quarter of 2007); and by approximately $7.8 million (12.7%) and $3.3 million (5.6%) during the first and second quarter of 2008, respectively.[4]

[4] Percentages are calculated based on restated revenues less discontinued operations.

24. The misleading financial information that resulted from the improper recognition of revenue from the Korean and Taiwanese transactions alone was material because it (1) overstated revenues by 7.1% in the fourth quarter of 2007, by 1.6% for fiscal year 2007, by 14.7% in the first quarter of 2008 and by 12.1% in the second quarter of 2008; and (2) overstated revenues for GSI's Systems Division by 21.5% in the fourth quarter of 2007, by 4.3% during fiscal year 2007, by 39.3% in the first quarter of 2008, and by 48.0% in the second quarter of 2008.[5]

25. As a result of the conduct described above, GSI's Form 10-K for the company's fiscal years 2004 through 2007, the Forms 10-Q for every quarter therein, as well as the Forms 10-Q for the quarters ended March 31, 2008 and June 30, 2008, contained false statements concerning GSI's financial results. For many of the quarterly periods described above, GSI issued press releases, subsequently filed with the Commission on Forms 8-K, containing the false and misleading financial information.

Violations

26. As a result of the conduct described above, GSI violated Section 13(a) of the Exchange Act and Rules 13a-1, 13a-11, 13a-13 and 12b-20 thereunder, which require every issuer of a security registered pursuant to Section 12 of the Exchange Act file with the Commission information, documents, and annual and quarterly reports as the Commission may require, and mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading.

27. As a result of the conduct described above, GSI violated Section 13(b)(2)(A) of the Exchange Act, which requires reporting companies to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect their transactions and disposition of their assets.

28. As a result of the conduct described above, GSI violated Section 13(b)(2)(B) of the Exchange Act, which requires all reporting companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles.

Remedial Efforts by GSI

29. In determining to accept GSI's Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff.

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[5] GSI also overstated pre-tax income by $1.4 million (6.4%) for fiscal year 2007, $3.6 million (5,206.0%) for the first quarter of 2008, and $2.9 million (1,443.1%) for the second quarter of 2008 as a result of the improper revenue recognition for the Korean and Taiwanese transactions.

IV.

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

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that Respondent GSI cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder.

By the Commission.

Elizabeth M. Murphy
Secretary

Service List

Rule 141 of the Commission's Rules of Practice provides that the Secretary, or another duly authorized officer of the Commission, shall serve a copy of the 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"), on the Respondent and its legal agent.

The attached Order has been sent to the following parties and other persons entitled to notice:

Honorable Brenda P. Murray
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