

## OPTIONS BACKDATING, REVISITED

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Options backdating problems continue to rear their ugly heads, and the cost to shareholders has been substantial. Companies that have been, or are being investigated by the SEC and Department of Justice have dropped in price. In many cases the "equity" in the abusive companies has been (or will be) substantially diminished through required restatements as they address the costs associated with backdating. According to a recent Bloomberg article, investors have already lost *over \$7.9 billion* in value. In many cases the "real value" of the firm will prove far smaller than current market valuations support, affecting value over the long term.

Our original backdating study published 7/24/06 attempted to identify companies that may be subject to SEC or DOJ investigation based on their behavior during the 1996-2002 time period. The methodology rested on four criteria:

- ✓ Persistently aggressive accounting (Very Aggressive or Aggressive AGR<sup>®</sup> rating)
- ✓ Frequent unusually high levels of insider selling
- ✓ Unusually high levels of options exercised
- ✓ Unusually high short-term compensation

These metrics were derived from analysis of the original Wall Street Journal list of 50 companies that acted as our training set (see the Audit Integrity backdating options study posted on <http://www.auditintegrity.com/newsroom.html>). Using these metrics, we identified 510 companies that we believed were at risk for backdating.

Over the last two months an additional 31 companies have been identified with backdating problems:

Options Backdating Update					
Additional Companies Revealed between 7/24/06 and 9/24/06					
ADSK	Autodesk	CCI	Crown Castle International	<b>KOSP</b>	<b>KOS Pharmaceuticals*</b>
ALKS	Alkermes	<b>CEC</b>	<b>CEC Etnertainment*</b>	MRVL	Marvell Technology Group
<b>ARTC</b>	<b>ArthroCare*</b>	CHRD	Chordiant Software	QUIK	QuickLogic
ATML	Atmel	<b>COCO</b>	<b>Corinthian Colleges*</b>	RBAK	Redback Networks
<b>ATVI</b>	<b>Activision*</b>	CSC	Computer Sciences	SIGM	Sigma Designs
BCGI	Boston Communications Group	CVC	Cablevision	SYVT.OB	Sysview Technology
BCSI	Blue Coat Systems	DOIG.OB	Delta Petroleum	<b>THQI</b>	<b>THQ*</b>
BKS	Barnes and Noble	ENDO	Encodare	<b>TTWO</b>	<b>Take-Two Interactive Software*</b>
<b>BRCD</b>	<b>Brocade Communicationis Sys.*</b>	<b>FDRY</b>	<b>Foundry Networks*</b>	<b>VRSN</b>	<b>VeriSign*</b>
CAKE	The Cheesecake Factory	KBH	IKB Home	<b>XLNX</b>	<b>Xilinx*</b>
				<b>ZRAN</b>	<b>Zoran*</b>

*\*Identified by Audit Integrity prior to exposure*

Twelve of those 31 companies, or 39% of the companies named, were targeted by our model. Not perfect, but keep in mind that our methodology utilizes indirect forensic evidence, a very desirable approach since the perpetrator is concealing direct evidence of the misdeed....

We believe our four-factor model performed well in the two months since its original publication. Furthermore, we believe that it will continue to perform as additional perpetrators are uncovered. It is important to recognize that the AGR<sup>®</sup> rating, in and of itself, is a strong indicator of those companies that are less transparent and more frequently surprise their shareholders with disappointing news and the subsequent adjustment to the company's valuation.

The AGR<sup>®</sup> rating and the associated quantitative risk models for measuring potential underperformance, litigation, and restatement risk continue to be useful tools in identifying potential problems before they are recognized by the market at large.

Audit Integrity provides unique insight into managing risk. For more information please contact us at:

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