

Incentive Compensation and Share Repurchases

High incentive compensation can create perverse incentives to manipulate either the numerator or denominator of earnings per share. With the majority of incentive compensation plans weighted primarily on earnings per share targets, it is no surprise that companies with significant incentive compensation plans also employ significant share repurchase programs. With its positive effect on earnings per share and share price, share repurchase programs can be a typical method to enhance the remunerative potential of the company executives.

Audit Integrity has found that the riskiest companies (with a Very Aggressive Accounting and Governance (AGR) rating and EQM 1) are more likely to have this combination of high incentive compensation and share repurchases. In its most recent study, almost 50% of Very Aggressive rated companies with share repurchases (37% of the total Very Aggressive/EQM 1 category) also had high incentive compensation. In contrast, the least risky companies (with a Conservative AGR rating and EQM 5) had very low incidence of high incentive compensation and share repurchases. Just 6% of Conservative rated companies with share repurchases (only 18% of the total Conservative/EQM 5 category) also had high incentive compensation.

	with Share Repurchases, TTM	with Share Repurchases, TTM AND:				Average Equity Return, TTM
		CEO/CFO Incentive Compensation Industry Comparison	CEO/CFO Incentive Compensation Volatility	Other Officer Incentive Compensation Industry Comparison	Other Officer Incentive Compensation Volatility	
Very Aggressive	36.6%	48.4%	29.7%	48.4%	37.5%	-46.1%
Conservative	18.0%	6.3%	0.0%	12.5%	6.3%	-26.4%
<i>See tables I & II attached</i>						
Very Aggressive companies underperformed Conservative companies by 20 percentage points in the TTM						

**Industry Comparison measures the number of inter-quartile ranges (or standard deviations in case of counting numbers) between the company metric value and the industry median metric value (or average in case of counting numbers).*

**Volatility measures 2 year volatility; the coefficient of variance (standard deviation over the mean) of the metric over the prior eight quarters.*

**Both analytic dimensions are flagged when the company value is greater than or equal to the 80% percentile.*

Although touted as a tax efficient tool to return cash to shareholders, share repurchases can involve numerous hazards for shareholders. The golden rule of repurchasing only when the stock is trading below its intrinsic value and when no better investment opportunities are available is often violated by management. Debt-financed repurchases typically are also not prudent capital allocation decisions, unless management has identified that a recapitalization is needed and that its cost of debt is substantially less than its cost of equity. In addition, repurchases may be a more expensive tool if using accelerated share repurchases (ASR) programs, or may even be detrimental to shareholders if used just to counteract stock option dilution. Examples of high risk companies with both high executive compensation and share repurchase programs follow:

Accelerated Share Repurchase (ASR) Programs: EPS Manipulation in Disguise

ASRs shave off the shareholder base fully at execution and thus provide an immediate and larger boost to earnings per share than a traditional share repurchase. Its financial impact may potentially be misleading to shareholders though, with the ultimate price to be determined at the settlement of the forward contract. If the share price has risen subsequent to the share repurchase, then the company will be obligated to deliver cash or shares to the counterparty – thus paying more for the share repurchase than originally intended.

Parker-Hannifin Corporation (PH) - Very Aggressive (23); 4th Percentile

- Average Ratio of Incentive Comp to Annual Comp of the CEO & CFO
- Average Ratio of Incentive Comp to Annual Comp of Officers (excluding CEO & CFO)

Last year Parker Hannifin announced a \$500 million ASR with Morgan Stanley, which will purchase an equivalent number of shares of Parker stock in the open market over a period of up to four months.

The authorization is in addition to its previously announced share-repurchase program, under which approximately 9.5 million shares remain available for repurchase.

KLA-Tencor Corporation (KLAC) - Very Aggressive (28); 6th Percentile

- Average Ratio of Incentive Comp to Annual Comp of the CEO & CFO
- Average Ratio of Incentive Comp to Annual Comp of Officers (excluding CEO & CFO)

In 2007 KLA-Tencor completed a 14 million share ASR program. Since the company's inception in 1997, it has made significant shareholder repurchases, which in aggregate have totaled approximately 35 million shares (out of an aggregate total 47.8 million in repurchase authorizations). An additional 15 million share repurchases over the next 15 months were authorized in June 2008

CA, Inc. (CA) - Very Aggressive (37); 10th Percentile

- Average Ratio of Incentive Comp to Annual Comp of Officers (excluding CEO & CFO)

In 2007 CA's ASR program repurchased approximately 16.9 million common shares, or 3 percent of its outstanding common shares, at a cost of about \$435 million. The ASR is part of the Company's previously announced \$2 billion share repurchase plan.

Alliance Data Systems Corporation (ADS) - Very Aggressive (20); 3rd Percentile

- Average Ratio of Incentive Comp to Annual Comp of the CEO & CFO

Alliance Data Systems has repurchased \$150 million in shares in an ASR program, as part of an aggregate totaled of \$849 million repurchases in the last several years. In July 2008, a new repurchase program was approved for an aggregate \$1.3 billion in shares through December 2009.

Mirant Corporation (MIR) - Very Aggressive (29); 6th Percentile

- Average Ratio of Incentive Comp to Annual Comp of the CEO & CFO

Earlier this year Mirant completed a \$1.0 billion ASR program with JP Morgan for 26.6 million shares. The ASR program is in addition to open market purchases of \$3.6 billion. To date, it has bought back 110 million, or 43 percent, of its shares for about \$3.9 billion. In September it suspended the plan due to current market conditions.

Stock Option Overhang: When Share Repurchases Merely Negate Dilution

When utilized only to absorb stock option dilution, share repurchase programs benefit solely the executives of the company. Wealth is simply redirected from the shareholders to the executives, at the cost of free cash flow. While shareholder expectations are for a resulting decrease in total shares outstanding post-repurchase, this is not always the case when the repurchases are just used as dilution control.

Marchex, Inc. (MCHX) - Very Aggressive (41); 12th Percentile

- Average Ratio of Incentive Comp to Annual Comp of the CEO & CFO

Marchex bought back \$22 million in shares in 2007, and almost \$26 million through 3Q 2008 YTD. Despite the repurchases, Marchex has presented shareholders with dilution of a massive 6 million shares (a 16% increase) over the past two years.

Cisco Systems, Inc. (NASD:CSCO) - Very Aggressive (23); 3rd Percentile

- Average Ratio of Incentive Comp to Annual Comp of the CEO & CFO
- Average Ratio of Incentive Comp to Annual Comp of Officers (excluding CEO & CFO)

Last year Cisco announced a \$10 billion additional authorization for repurchases of its common stock, increasing the total authorized amount under its program to \$62 billion. Despite an aggregate total of over \$26 million in share repurchases over the past 3 years, its number of shares outstanding remain constant at roughly 6 billion.

Amgen, Inc. (NASD:AMGN) - Very Aggressive (17); 3rd Percentile

- Average Ratio of Incentive Comp to Annual Comp of the CEO & CFO

Last year Amgen authorized a new stock repurchase program of \$5.0 billion, which left \$6.5 billion remaining under this and the previously authorized stock repurchase program. Amgen has purchased \$11.5 billion in shares over the past three years, and its number of shares still remain at 1.1 billion.

When utilized properly by conservative companies, share repurchases can be an efficient means of using free cash flow to benefit shareholders. When combined with high incentive compensation in Very Aggressive companies, it can create a conflict of interest for management. Management may be motivated to undertake repurchases for the purposes of temporary manipulation of earnings per share or control of stock option dilution, both of which can be at the expense of the shareholder.

Very Aggressive Companies with Share Repurchases, TTM

Table I

Company Name	Ticker	Industry	Market Cap (\$m)	Period Ending	AGR Rating		AGR Score	AGR %ile	Percentiles				TTM Equity Return
					Current Qtr	1Q Prior			CEO/CFO Incentive Comp. Industry Comparison	CEO/CFO Incentive Comp. Volatility	Officer Incentive Comp. Industry Comp	Officer Incentive Comp. Volatility	
American Int'l Group, Inc.	AIG	Insurance (Prop. & Casualty)	5,135.7	6/30/2008	VA	VA	22	4			82		-96.8%
MBIA Inc.	MBI	Insurance (Prop. & Casualty)	2,686.5	6/30/2008	VA	VA	12	2	92		91		-86.7%
Genco Shipping & Trading Limited	GNK	Water Transportation	663.0	6/30/2008	VA	VA	21	4					-84.9%
Sigma Designs, Inc.	SIGM	Computer Peripherals	292.3	8/2/2008	VA	VA	18	2					-83.9%
Harman Int'l Industries Inc./DE/	HAR	Audio & Video Equipment	1,075.2	6/30/2008	VA	VA	38	9	93		98	92	-83.5%
United Rentals, Inc.	URI	Rental & Leasing	613.9	6/30/2008	VA	AGG	24	4	81	86		84	-78.8%
DundeeWealth Inc.	DW	Investment Services	693.6	6/30/2008	VA	AVG	41	12					-78.5%
Freeport-McMoRan Copper & Gold Inc.	FCX	Metal Mining	11,157.8	6/30/2008	VA	AGG	40	12	99		98		-78.0%
The Blackstone Group L.P.	BX	Investment Services	2,426.7	6/30/2008	VA	AGG	13	2					-76.4%
Iconix Brand Group, Inc.	ICON	Apparel/ Accessories	629.4	6/30/2008	VA	VA	22	4				83	-73.5%
Sonic Corporation	SONC	Restaurants	641.1	8/31/2008	VA	AGG	12	1				95	-71.8%
CME Group Inc.	CME	Investment Services	15,391.8	6/30/2008	VA	VA	19	3					-71.6%
Bank of America Corp.	BAC	Money Center Banks	121,274.9	6/30/2008	VA	AGG	15	2	94		93		-70.8%
MetLife, Inc.	MET	Insurance (Miscellaneous)	26,363.1	6/30/2008	VA	AGG	26	5	94		94		-69.1%
Eastman Kodak Co.	EK	Photography	2,459.1	6/30/2008	VA	AGG	14	2	85				-68.2%
TeleTech Holdings, Inc.	TTEC	Computer Services	590.4	6/30/2008	VA	AGG	24	4	83				-65.9%
Peabody Energy Corp.	BTU	Coal	9,201.5	6/30/2008	VA	VA	21	4					-63.2%
eBay Inc.	EBAY	Retail (Specialty)	19,498.9	6/30/2008	VA	VA	8	1	90	80	94	81	-62.0%
Ship Finance Int'l Ltd.	SFL	Water Transportation	993.0	6/30/2008	VA	AGG	20	3					-61.4%
Ness Technologies, Inc.	NSTC	Software & Programming	292.9	6/30/2008	VA	AGG	34	7				88	-58.3%
Tiffany & Co.	TIF	Retail (Specialty)	3,458.0	7/31/2008	VA	VA	29	5		86	90		-57.3%
Merck & Co., Inc.	MRK	Major Drugs	66,309.6	6/30/2008	VA	AGG	27	5			81		-55.2%
Zebra Technologies Corp.	ZBRA	Misc. Capital Goods	1,283.0	6/28/2008	VA	AGG	37	10					-52.6%

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Very Aggressive Companies with Share Repurchases, TTM – Table I cont'd

Company Name	Ticker	Industry	Market Cap (\$m)	Period Ending	AGR Rating		AGR Score	AGR %ile	Percentiles				TTM Equity Return
					Current Quarter	1Q Prior			CEO/CFO Incentive Comp. Industry Comparison	CEO/CFO Incentive Comp. Volatility	Officer Incentive Comp. Industry Comparison	Officer Incentive Comp. Volatility	
IDEXX Laboratories, Inc.	IDXX	Medical Equipment & Supplies	2,095.9	6/30/2008	VA	AVG	33	6					-52.4%
American Tower Corp.	AMT	Communications Services	12,728.3	6/30/2008	VA	VA	26	5	87	81	85		-52.0%
Ingram Micro Inc.	IM	Computer Hardware	2,187.9	6/28/2008	VA	AGG	36	9	94		84	86	-51.4%
Alkermes, Inc.	ALKS	Biotechnology & Drugs	934.1	6/30/2008	VA	VA	39	11		94		94	-51.3%
Alliance Data Systems Corp.	ADS	Computer Services	3,374.7	6/30/2008	VA	VA	20	3	87		89		-50.0%
Teradata Corp.	TDC	Computer Services	2,765.6	6/30/2008	VA	AGG	33	8					-49.8%
First American Corp.	FAF	Insurance (Prop. & Casualty)	1,895.4	6/30/2008	VA	VA	17	3	80	97		97	-49.6%
Juniper Networks, Inc.	JNPR	Communications Equipment	10,185.9	6/30/2008	VA	VA	15	2	93	84	94		-48.7%
Cognizant Technology Solutions Corp.	CTSH	Software & Programming	5,599.2	6/30/2008	VA	VA	33	8	82	80		88	-48.3%
Brady Corporation	BRC	Electronic Instr. & Controls	1,545.5	7/31/2008	VA	AGG	41	11		94	85	95	-47.6%
Cisco Systems, Inc.	CSCO	Computer Peripherals	104,541.4	7/26/2008	VA	VA	23	3	97	95	99	96	-46.3%
Biovail Corp. (USA)	BVF	Biotechnology & Drugs	1,365.0	6/30/2008	VA	VA	14	2				85	-44.7%
Biogen Idec Inc.	BIIB	Biotechnology & Drugs	12,414.1	6/30/2008	VA	VA	27	5	94		98		-42.2%
FactSet Research Systems Inc.	FDS	Computer Services	1,837.4	8/31/2008	VA	AGG	11	1		94		94	-41.7%
Fiserv, Inc.	FISV	Computer Services	5,472.3	6/30/2008	VA	VA	18	3	84				-41.1%
Novell, Inc.	NOVL	Software & Programming	1,649.0	7/31/2008	VA	AGG	20	2	90	92	83	80	-40.6%
W. P. Carey & Co. LLC	WPC	Real Estate Operations	912.6	6/30/2008	VA	AGG	26	5					-39.2%
Analogic Corp.	ALOG	Scientific & Technical Instr.	591.8	7/31/2008	VA	AVG	37	2		85		92	-36.8%
Hewlett-Packard Company	HPQ	Computer Peripherals	94,371.6	7/31/2008	VA	VA	19	2	98	92	99	93	-28.7%
SkillSoft Public Limited Company	SKIL	Computer Services	804.6	7/31/2008	VA	VA	41	10	87		81		-27.1%

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Very Aggressive Companies with Share Repurchases, TTM – Table I cont'd

Company Name	Ticker	Industry	Market Cap (\$m)	Period Ending	AGR Rating		AGR Score	AGR %ile	Percentiles				TTM Equity Return
					Current Qtr	1Q Prior			CEO/CFO Incentive Comp. Industry Comparison	CEO/CFO Incentive Comp. Volatility	Officer Incentive Comp. Industry Comparison	Officer Incentive Comp. Volatility	
Altria Group, Inc.	MO	Tobacco	39,539.0	6/30/2008	VA	VA	13	2	91		91		-27.1%
MSC Industrial Direct Co., Inc.	MSM	Misc. Capital Goods	2,232.1	8/30/2008	VA	AVG	11	1		88		83	-26.4%
QUALCOMM, Inc.	QCOM	Communications Equipment	62,783.2	6/29/2008	VA	VA	18	3	99	97	99	98	-24.5%
Wells Fargo & Co.	WFC	Money Center Banks	113,224.6	6/30/2008	VA	VA	23	4	94		89		-24.3%
Oracle Corporation	ORCL	Software & Programming	94,275.0	8/31/2008	VA	VA	20	3		94		94	-19.0%
InfoSpace, Inc.	INSP	Computer Services	296.1	6/30/2008	VA	VA	25	5	99	95	99	97	-17.4%
HealthSpring, Inc	HS	Insurance (Accident & Health)	966.9	6/30/2008	VA	AGG	32	7				88	-17.2%
Aon Corporation	AOC	Insurance (Miscellaneous)	11,745.5	6/30/2008	VA	VA	22	4	84		84		-9.4%
Check Point Software Technologies Ltd.	CHKP	Software & Programming	4,419.1	6/30/2008	VA	VA	0	1					-8.0%
Life Partners Holdings, Inc.	LPHI	Insurance (Miscellaneous)	482.9	8/31/2008	VA	VA	39	9					-5.9%
Haemonetics Corp.	HAE	Medical Equipment & Supplies	1,519.0	6/28/2008	VA	AGG	38	10					-5.3%
Gilead Sciences, Inc.	GILD	Biotechnology & Drugs	41,746.9	6/30/2008	VA	VA	21	4	94	83	98	80	-3.7%
McDonald's Corp.	MCD	Restaurants	65,152.6	6/30/2008	VA	VA	27	5	96		92		-1.9%
Genentech, Inc.	DNA	Biotechnology & Drugs	87,255.7	6/30/2008	VA	VA	22	4	86		91		-1.9%
Apollo Group, Inc.	APOL	Schools	11,018.1	8/31/2008	VA	VA	17	2			99	93	-1.3%
People's United Financial, Inc.	PBCT	S&Ls/Savings Banks	6,086.1	6/30/2008	VA	AGG	33	5	96		96		11.8%
Electronic Data Systems Corporation	EDS	Computer Services	12,601.0	6/30/2008	VA	VA	22	4					NULL
Comcast Corporation	CMCSA	Broadcasting & Cable TV	32,447.8	6/30/2008	VA	VA	36	9			97		NULL
Intercontinental Exchange, Inc.	ICE	Investment Services	6,181.2	6/30/2008	VA	VA	20	3	84		87		NULL
MDS Inc.	MDS	Biotechnology & Drugs	1,469.0	7/31/2008	VA	AGG	28	4					NULL
First National Bank Alaska	FBAK	Regional Banks	710.0	6/30/2008	VA	VA	34	7					NULL

Average Return, TTM = -46.09%

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Conservative Companies with Share Repurchases, TTM

Table II

Company Name	Ticker	Industry	Market Cap(\$m)	Period Ending	AGR Rating		AGR Score	AGR %ile	Percentiles				TTM Equity Return
					Current Qtr	1Q Prior			CEO/CFO Incentive Comp. Industry Comparison	CEO/CFO Incentive Comp. Volatility	Officer Incentive Comp. Industry Comparison	Officer Incentive Comp. Volatility	
InnVest Real Estate Investment Trust	INN.UN	Real Estate Operations	391.0	6/30/2008	CONS.	CONS.	80	85					-68.7%
International Minerals Corporation	IMZ	Gold & Silver	264.4	6/30/2008	CONS.	CONS.	81	87					-65.6%
3PAR Inc.	PAR	Computer Storage Devices	386.0	6/30/2008	CONS.	CONS.	81	88					-56.7%
Methode Electronics Inc.	MEI	Electronic Instr. & Controls	292.1	8/2/2008	CONS.	CONS.	84	92					-39.9%
RPC, Inc.	RES	Oil Well Services & Equipment	1,039.0	6/30/2008	CONS.	CONS.	81	88					-32.3%
Raven Industries, Inc.	RAVN	Electronic Instr. & Controls	582.8	7/31/2008	CONS.	CONS.	81	85					-27.5%
Fort Chicago Energy Partners L.P.	FCE.UN	Natural Gas Utilities	1,094.9	6/30/2008	CONS.	CONS.	85	94					-24.3%
PS Business Parks, Inc.	PSB	Real Estate Operations	925.4	6/30/2008	CONS.	CONS.	80	85			83		-22.5%
Employers Holdings, Inc.	EIG	Insurance (Prop. & Casualty)	625.3	6/30/2008	CONS.	CONS.	83	91					-19.4%
USA Mobility, Inc.	USMO	Communications Services	262.5	6/30/2008	CONS.	CONS.	82	89					-19.2%
Northbridge Financial Corporation	NB	Insurance (Prop. & Casualty)	1,411.7	6/30/2008	CONS.	CONS.	85	94					-14.6%
CARBO Ceramics Inc.	CRR	Oil & Gas Operations	1,064.1	6/30/2008	CONS.	CONS.	85	94					-6.9%
Harleysville Group Inc.	HGIC	Insurance (Prop. & Casualty)	906.0	6/30/2008	CONS.	CONS.	83	91				87	8.7%
Tompkins Financial Corporation	TMP	Regional Banks	473.5	6/30/2008	CONS.	CONS.	82	89					19.1%
Magellan Health Services, Inc.	MGLN	Healthcare Facilities	1,500.9	6/30/2008	CONS.	CONS.	83	91	93		92		NULL
Superior Essex Inc.	SPSX	Misc. Fabricated Products	895.6	6/30/2008	CONS.	CONS.	82	89					NULL

Average Return, TTM = -26.42%

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The Audit Integrity Accounting & Governance Risk (AGR®) Model

Audit Integrity is the leading provider of accounting and governance risk analysis on public companies. Through the forensic study of the factors behind fraud, Audit Integrity proprietary modeling effectively detects and measures fraud and transparency-related risks in more than 7,000 publicly traded corporations.

The proprietary Accounting & Governance Risk (AGR) rating is a measure of corporate integrity based on forensic accounting and corporate governance metrics, and is an indicator of aggressive corporate behavior which can put stakeholders at risk. The AGR Score is based on a quantitative model which weights specific accounting and governance metrics derived from corporate reporting. The score ranges from 0 to 100, with lower scores indicating higher risk.

The Audit Integrity AGR Equity Model

The AGR Equity Factor (EQF) is based solely on the AGR score, plus additional variables related to AGR persistence and volatility, to provide a better measure of equity risk than the AGR on a stand-alone basis. Extensive research has shown a clear relationship between Audit Integrity's primary risk measure, the AGR rating, and equity returns. Consistently, the lowest-rated companies underperform the market and highest-rated companies outperform. The results are consistent with prior research showing that corporate integrity, as measured by the AGR rating, is a significant factor in equity returns, with low correlation to other factors.

To validate the AGR Equity Factor, the model was back-tested over the time period of 1998-2007. Key findings include large and persistent equity returns spread between the highest and lowest-rated companies, with a 17.5% spread between the best and worst decile over the prior 10 years. From a quantitative modeling standpoint, the Equity Factor provides risk-adjusted, well behaved returns, as validated through key statistical measures.



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