

# Long Island BusinessNEWS

## Welcome To Corporate America's New Black Eye

By Claude Solnik

### *Growing 'backdating' scandal brings fraud charges, reviews and lots of worry.*

The Securities and Exchange Commission made headlines last month when it charged top Comverse Technology executives with fraud, citing alleged "backdating" of stock options.

The SEC said Chief Executive Jacob "Kobi" Alexander and other executives, from 1991 to at least 2002, fraudulently backdated their stocks options to make it appear they were issued when the stock was lower than it actually was. The practice - deemed illegal, because it was done secretly - fraudulently shielded the executives from tax implications and incorrectly boosted company earnings, according to the SEC.

The charges attracted widespread attention to backdating, but the fact that the alleged practice appeared to stop in 2002 may be important by itself. Although the practice is only now coming to light - and not only at Comverse, but at several other companies in Long Island and across the country - the government by 2002 had already put measures into place making backdating unlikely, if not impossible.

When the SEC implemented the Sarbanes-Oxley Act on Aug. 29, 2002, companies were immediately required to file paperwork on the issuance of stock options within two business days - rather than the previous 45-day window. The SEC indicated this change was "necessary to satisfy the act's purpose to require immediate disclosure of insider transactions."

"If you look at the history of [backdating], it's all pre-2002," said Dennis O'Rourke, of counsel to Moritt Hock Hamroff & Horowitz in Garden City. "Sarbanes has, in a lot of ways, remedied the problem. You can only back-date a

maximum of two days. The backdating issue isn't necessarily over, but by virtue of the rules, it's very difficult."

Difficult now, but not as difficult before Sarbox. Companies large and small are now facing charges, or doing their best to avoid them, in what is a growing series of backdating scandals. For instance, Bethpage-based Cablevision Systems Corp. is conducting an internal investigation into possible backdating, stretching as far back as 1997. Executives from California-based Brocade Communications Inc., meanwhile, are fac-

### **Companies large and small are now facing charges, or doing their best to avoid them.**

ing federal fraud charges. All told, the SEC is investigating nearly 100 companies for potential backdating frauds.

Not that it's easy to catch an executive who backdated stock options. "If someone backdates, it's very difficult [to detect], not just in stock options, but in all transactions," said Larry Waldman, a partner at Holtz Rubenstein Reminick in Melville. "This is not an accounting firm issue. This is about management doing something."

Auditors may have been given misleading documents, making it more difficult to catch. "Oftentimes, the auditor [may have been] looking at legal documents that were doctored," said George Victor, another partner at Holtz Rubenstein Reminick. "That was part of the problem."

The backdating scandal isn't simply about issuing "in the money" options, either. Companies can issue options to buy at any price they choose. But by making it

appear that options were issued when the stock was at a lower price, firms can conceal the fact they were giving executives the right to buy stock at a price lower than its trading value.

Those options should have been reported as income (to the extent they were discounted from the trading price) and should have been written off on balance sheets as expenses.

"The alleged criminal activity is not the backdating," O'Rourke said. "It's how the company reported it on its financial statements. Filing misleading financial statements is the illegal part."

Thanks to Sarbox, all options are now required to be written off as expenses, which means they always show up on the balance sheet.

Another reason backdating scandals may prove more common in the 1990s and early 2000s is the increased use of options at the time. "The popularity of compensating people with stock options exploded in the 90s," said O'Rourke. "Tech companies used their stock as currency."

The government's efforts to convict people of criminal charges in backdating may hinge on intent - whether executives knew they were breaking the law or thought they were using a clever accounting technique.

"It's a key issue," said O'Rourke. "Concealing is a part of fraud. It's only logical that if someone is open about what they're doing and not concealing it, it's difficult to say they're committing fraud in that context."