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Study Finds Backdating of Options Widespread

By STEPHANIE SAUL

More than 2,000 companies appear to have used backdated stock options to sweeten their top executives' pay packages, according to a new study that suggests the practice is far more widespread than previously disclosed.

The new statistical analysis, which comes amid a broadening federal inquiry of the practice of timing options to the stock market, estimates that 29.2 percent of companies have used backdated options and 13.6 percent of options granted to top executives from 1996 to 2005 were backdated or otherwise manipulated.

So far, more than 60 companies have disclosed that they are the targets of government investigations, are the subject of investor lawsuits or have conducted internal audits involving the practice, in which options are backdated to days when the company's shares trade at low prices. They include Apple Computer, CNet and Juniper Networks.

Last week, the United States attorney in San Francisco announced a task force to investigate the backdating of options, which appears to have been particularly popular in Silicon Valley during the 1990's dot-com boom. The study found that the abuse was more prevalent in high-technology firms, where an estimated 32 percent of unscheduled grants were backdated; at other firms, an estimated 20 percent were backdated.

An author of the study said the analysis suggested that the disclosures so far about backdated stock options may be just the tip of the iceberg.

"It is pretty scary, and it's quite surprising to see," said Erik Lie, an associate professor of finance at the Tippie College of Business at the University of Iowa.

Professor Lie said the findings were so surprising that he asked several colleagues to check his numbers. Together, they concluded that the numbers probably erred on the low side.

The study by Professor Lie and Randall A. Heron, of the Kelley School of Business at Indiana University, was posted Saturday to a University of Iowa Web site. Using information from the Thomson Financial Insider Filing database of insider transactions reported to the Securities and Exchange Commission, the two men examined 39,888 stock option grants to top executives at 7,774 companies dated from Jan. 1, 1996 to Dec. 1, 2005.

The findings were based on an analysis of whether share values increased or declined after option grant dates. “Half should be negative and half should be positive,” said Professor Lie. “That’s the underlying logic.”

But the analysis revealed that the distribution was shifted upward.

“This is not random chance. It’s something that’s manipulated, clearly,” said Professor Lie.

Of the companies examined, 29.2 percent, or 2,270, had at some point during the period manipulated stock option grants, the study estimated.

“Over all, our results suggest that backdated or otherwise manipulated grants are spread across a remarkable number of firms, although these firms did not manipulate all their grants,” the authors said.

The study concluded that before Aug. 29, 2002, 23 percent of unscheduled grants — as distinguished from grants that companies routinely schedule annually — were backdated. Unscheduled grants are easier to backdate.

On that day, the S.E.C. tightened reporting requirements to require that executives report stock option grants they receive within two business days. After that, the backdating figure declined to 10 percent of unscheduled grants, the paper said.

Professor Lie said that a number of companies simply ignored the new reporting rule. “You still see problems. The rule is not enforced,” he said.

Professor Lie, who first alerted S.E.C. investigators to problems with backdating after an analysis that he conducted in 2004, said there was some positive news in his new research.

“It has been suggested that some accounting firms have been pushing this practice more than others,” he said. “There’s actually very little evidence of that, which to me is very comforting.”

The study found that smaller auditors rather than larger ones were associated with a larger proportion of late filings and unscheduled grants, which most likely lead to more backdating and manipulative practices.

It also singled out two firms — PricewaterhouseCoopers and KPMG — as being associated with a lower percentage of manipulation.

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