

Comverse's backdating scandal

[Business](#), [Company](#)



Introduction

The stock market has always been riddled with scandals and controversies. While it has made many millionaires it has also made many overnight paupers and lured many into ruin. Scandals from stock frauds to backdating scandals rule in stock markets and the lure of the lucre really tells in the stock market. One of the types of scandals to hit the stock markets and which did not receive much attention until lately is that of backdating stock options.

Options backdating is simply granting an employee stock options that is dated prior to the date that the company actually granted the option. This generally means that the value of the stock option is set to less than the fair market value thus deceiving shareholders and potential shareholders and dealing out an unfair advantage and profit to certain favored individuals. While backdating may not necessarily be illegal it is virtually impossible to backdate options and achieve its ultimate aim of making money without falsifying records and documents hence misleading shareholders and other interested parties, which comes under the clear heading of accounting fraud.

Backdating itself was rife in the Silicon Valley and went unnoticed until a student doing statistical studies figured out that backdating with illegal accounting was occurring in many of the technology firms earning many an illegal profit stealthily. When he got in touch with the Wall Street Journal they followed up the story and the backdating scandal storm started brewing and one of its first casualties was Comverse Technology Inc. The Securities and Exchange Commission is currently investigating more than 80 public companies and the Internal revenue service is auditing 40 businesses for <https://assignbuster.com/comverses-backdating-scandal/>

improper reporting of backdated options.(Securities Litigation & Regulation, Mateja, W. B. &, Willis, L. B.(2006))

Comverse Technology Inc is the world's leading provider of software and systems enabling network-based multimedia enhanced communication and billing services. This scandal hit the headlines in 2005 and involved some of the top executives of the company and even today continues to bring forth many more shocking details of the fraud. Whether backdating options by some of its top executives is ethical still remains debatable and there are many gray areas that still need to be dealt with. However this scandal has had a long term effect on the company and it is still recovering from the blow that it suffered during the investigations and subsequent convictions of its executives.

The Comverse Background story

The Comverse Backdating scheme by three of the company's top executives started coming apart in March of 2005 when a reporter called the CEO Jacob " Kobi" Alexander asking how it was that all options grants were made at a time when there was a sharp dip in stock prices of Comverse Technology Inc. Very soon an internal investigation was initiated by forming a special committee and hiring the outside law firm Dickstein Shapiro in New York as against the usual firm that they used Weil, Gotshal & Manges raising some more pertinent questions regarding the involvement of senior General counsel William Sorin. The outside counsel here is William Sorin. Soon federal investigating agencies started following up on the story and in early August of 2006 3 top executives of Comverse Inc were charged with backdating stock options fraud in the company.

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According to federal prosecutors, Kreinberg and Alexander used fictitious names to generate stock options and then created a "secret slush fund" to evade the company's written plan on issuing them. Alexander then personally doled out the options, with Kreinberg's advice and consent, to the employees he favored. Compounding the scheme were the misleading statements made about the options in the company's public filings, including its proxy statements and annual reports. The general counsel, who was also in on the scheme, drafted and signed off on the reports. (Options run out at Comverse, Richard Duprey (2006))

While they arrested 2 of the executives CFO David Kreinberg and former General Counsel William Sorin the kingpin of the racket CEO Jacob "Kobi" Alexander fled the police and was later tracked down to Sri Lanka leading to high drama. He is currently in Namibia in prison facing extradition charges. The three executives allegedly made more than \$8.4 million by backdating options, this was in addition to the \$156 million that was made on these backdated options.

Ethics of backdating options

While backdating of stock options is considered as illegal by many there are still others who claim that it is perfectly legal. The main ethical aspect surrounding backdating seems to be related to the disclosure of backdating details and whether the accounts are clear and transparent. As long as the intent is not to deceive or commit fraud and earn a fast buck backdating is perfectly legal. There are in fact no legal statutes that make backdating illegal. However it is virtually impossible to achieve backdating and its main aim of putting grants "in the money" without falsifying documents and

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attempting to cover up the sham which comes under the heading of accounting fraud against which there are legal statutes. If backdating is done with proper documents and intimation of other stock holders the very purpose of backdating is defeated. Backdating is generally done to grant employees and favoured individuals within the organisation an extra compensation without providing any necessary accounting or details in financial statements. The stock options are provided at a lesser price and it is dated earlier to show compatibility between the price and the date without having to account for it to investors and other stock holders thus misleading them and giving others an unfair advantage

Former CEO of Comverse Inc Jacob Alexander of Comverse maintains that backdating of stock options is not illegal. He also explains that he relied on the advice of experts such as lawyers and accountants regarding his former company's options awards, according to his lawyers. According to his lawyers " Backdating options is not illegal. Alexander relied on lawyers and accountants to draft Comverse's disclosures and to prepare its financial statements," Alexander's lawyers noted that " The charges relate to the disclosure and accounting treatment of the options,". (Comverse's Alexander: Backdating Not a Crime , Stephen Taub(2007))

While whether backdating is illegal or not is debatable and involves deliberation on the circumstances surrounding it the Comverse backdating scandal is clearly illegal and unethical. 2 of the top executives apart from the CEO pleaded guilty to securities fraud , mail fraud , wire fraud and conspiracy and it has come to light that stock options were backdated and granted to fictional employees. Later these were transferred to a fictional

internal account of I. M. Fanton which supposedly stood for 'Phantom Of the Opera'. This allowed CEO and founder of Comverse Inc Alexander to transfer the stock options to himself and some other employees within the conspiracy thus earning huge profits and deceiving shareholders and potential shareholders clearly showing that the intent was to commit a fraud and that intention was satisfied. Some others argue that it may be a crime but it is a victimless crime owing to the fact that nobody was tangibly affected adversely. However these just seem to be blind arguments as these executives were aiming to deceive shareholders and board members regarding the stock options that were actually provided at a lesser price without disclosing it thus increasing the company's expense towards compensation. Thus the parties affected were clearly the company its employees, shareholders and board members whose money was clearly being swindled. Hence backdating is unethical and clearly illegal at least in the Comverse backdating scandal.

Its effect on Comverse Business

While many wrote off Comverse after its involvement in major lawsuits it still continues to try to gain its lost ground. Comverse Inc tottered under the effect of its various scandals, with it being one of the top affected in backdating history, after having 3 of its top executives, including its CFO and CEO charged with various backdating offenses the future of Comverse seemed to be under a cloud.

The company lost more than 30% of its value after the scandal hit it and has been suffering heavy losses apart from having to layoff more than 500 of its 1000 employees. Its 2007 first quarter report shows that the organization

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suffered more \$60 million operational loss. This is in stark contrast to the first quarter of 2006 when it posted a profit of \$8.6 million. (Comverse up for sale, Efrat Neuman (2007)). Share prices of Comverse which dropped to an all time low picked up by mid June of 2006 although tremors did affect it now and then. Shlomo Goldberg over at Seeking Alpha writes " Why are people increasing their short positions on Comverse? Is it because of its failed business? Certainly not. They are doing it because of the developments they expect in the inquiry..".(One Cheer For Comverse (CMVT), Tiernan Ray(2006))

The backdating scandal brought the company under scrutiny from various groups from shareholders to vendors. Shareholders panicked and the share prices dropped to an all time low. It was delisted from NASDAQ on 1st February 2007 for failing to file its financials on time It was removed from the S&P 500 and Nasdaq-100 at the same time. (Options run out at Comverse, Richard Duprey (2006))One of the outfalls of its move to the pink sheets was the increasing number of investors who became wary of the company. Move to the pink sheets means that holders of the company's \$419,647,000 of Zero Yield Puttable Securities due May 15, 2023 and New Zero Yield Puttable Securities due May 15, 2023 - a former of convertible bond known as ZYPS - will have the right to require the company to repurchase them at 100% of the principal amount. Daniel Ives, an analyst at Friedman Billings Ramsey, says in a note this morning that the move is a "major negative jolt" for the stock, and notes that some investors are prohibited from owning stocks traded on the pink sheets. That said, he contends the break-up value of the company would be \$23-\$27 a share - and

that the delisting makes the sale of the company more likely.(Comverse: Nasdaq Lowers The Boom, Eric Savitz (2007)) Before the scandal came to light Comverse's share was traded at 29\$ with an estimated \$6 billion worth , however the shares are now trading at \$20 with a net worth of \$4. 5 billion.

Similarly the scandal gave rise a lot of scrutiny from companies that use Comverse as a vendor as the company was in the midst of several investigations and indictments relating to stock frauds whose outcome could have affected the companies longevity and management stability and hence the vendor viability. In addition to this more practical view many held the view that as a service provider their scandals indicated more about them personally as a company and continuing to do business with them may be a risk. If they are wrong at the top they are wrong right through is what they felt. Also Comverse came up with several governance changes after its top executives were charged for various backdating frauds by federal prosecutors. The governance changes related to shareholders and board governance policies that would help shareholders share more authority. This action was aimed at diffusing anger by shareholders over the scandal Comverse adopted access bylaws which included a proxy access bylaw meaning that shareholders could now decide who would appear for the directorial ballot. (Comverse to Allow "Proxy Access", Stephen Taub(2007))

At the same time Comverse contends that the scandal “ will not affect our ability to continue providing outstanding products, technology and service to our customers worldwide. We are committed to regaining compliance with all filing requirements and obtaining re-listing of our common stock in a timely

manner.”(Comverse to Allow "Proxy Access", Stephen Taub(2007))However just as it seemed to be recovering from this scandal and turning the corner rumours are rife that it is up for sale. The latest news to hit the headlines is that Comverse Inc is up for sale following heavy losses that it suffered due to the backdating scandal..

Inspite of it being written off Comverse Inc seemed to be determined to regain its previous reputation , business and lost glory. It is slowly turning the corner and many investors are now not bothered about the scandals that once ravaged it. However whether is it possible for it to recover from the havoc that was wreaked on it by its founder and his associate conspirators is yet to be seen . With it up for sale it seems like its fate is overtaking it.

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