BIOMET INC
Form 10-K/A
May 29, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K/A

(Amendment No. 1)

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended May 31, 2006.

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from ______ to ______.

Commission file No. 0-12515.

(Exact name of registrant as specified in its charter)

Indiana	**35-1418342**
(State of incorporation)	*(IRS Employer Identification No.)*
56 East Bell Drive, Warsaw, Indiana	**46582**
(Address of principal executive offices)	*(Zip Code)*

(574) 267-6639

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on which registered
Common Shares	The Nasdaq Stock Market

Securities registered pursuant to Section 12(g) of the Act: None

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ¨ No x

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K/A or any amendment to this Form 10-K/A. ¨

Indicate by a check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filers and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.): Yes ¨ No x

The aggregate market value of the Common Shares held by non-affiliates of the registrant, based on the closing price of the Common Shares on November 30, 2005, as reported by The Nasdaq Stock Market, was approximately $8,037,326,823. As of July 13, 2006, there were 244,831,097 Common Shares outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Identity of Document	Parts of Form 10-K Into Which Document Is Incorporated
Proxy Statement with respect to the 2006 Annual Meeting of Shareholders of the Registrant filed with the Securities and Exchange Commission on August 15, 2006	Part III

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EXPLANATORY NOTE

As described in further detail below, Biomet, Inc. (*Biomet* or the *Company*) is amending its annual report on Form 10-K for the fiscal year ended May 31, 2006 (the *Original Filing*). The Company also expects to separately amend its quarterly report on Form 10-Q for the period ended August 31, 2006 and separately file its reports on Form 10-Q for the periods ended November 30, 2006 and February 28, 2007. The Company has not amended and does not intend to amend any of its previously filed annual reports on Form 10-K or quarterly reports on Form 10-Q for the periods affected by the restatement other than this amended annual report on Form 10-K/A and the Company s quarterly report on Form 10-Q for the period ended August 31, 2006. Accordingly, the Company s previously issued financial statements, earnings press releases and similar communications affected by the restatement and any related reports of its independent registered public accounting firm should not be relied upon.

The Company s decision to restate its financial results was based on the results of an independent investigation of the Company s stock option grants for the period from March 1996 through May 2006 by a special committee (the *Special Committee*) formed by the Company s Board of Directors (the *Board*) following the publication of an analyst report suggesting that certain historical stock option grants took place on dates where the Company s stock price was trading at relatively low prices and the filing of two shareholder derivative lawsuits alleging improper backdating of stock options. The Special Committee retained independent counsel to advise it in connection with and to conduct its investigation. Counsel to the Special Committee also hired independent accountants to assist in the investigation.

On December 18, 2006 and March 30, 2007, the Company announced preliminary reports from the Special Committee presented by counsel to the Special Committee and the independent accountants retained by counsel to the Special Committee. Based upon an analysis of these reports and relevant accounting literature, including Staff Accounting Bulletin No. 99 Materiality, the Company s Audit Committee determined on March 30, 2007 that the Company should amend its annual report on Form 10-K for the fiscal year ended May 31, 2006 and quarterly report on Form 10-Q for the period ended August 31, 2006 to reflect the restatement of the Company s consolidated financial statements (fiscal years ended May 31, 2006, 2005 and 2004 and periods ended August 31, 2006 and 2005) and related disclosures reflected therein. On May 25, 2007, the Board received and discussed the following updated findings contained in the Special Committee s final report.

The Special Committee s Findings

The Special Committee s investigation was based upon the review of an extensive collection of physical and electronic documents, interviews of more than two dozen individuals, and analysis of approximately 17,000 grants to purchase approximately 17,000,000 Biomet common shares on over 500 different grant dates over the 11-year period from March 1996 through May 2006. The Special Committee made the following findings:

- The Company s written stock option plans were treated by Company management, and the stock option committee, as formalities concerning the manner in which individual stock option grants were to be approved, resulting in a failure to abide by the terms of the plans;

- The Company failed to receive appropriate legal or accounting advice from its former General Counsel and Chief Financial Officer related to its stock option program and, as a result, legal and accounting rules were not followed;

- The Company failed to put in place and implement internal controls to manage its stock option program, including by failing to devote sufficient resources to the administration of its stock option program;

- The Company failed to prepare and maintain appropriate books and records documenting the administration of its stock option program, specifically with regard to the approval of individual stock option grants;

- Most stock options issued by Biomet were dated on dates other than the date of grant of those options, as that date was defined by the stock option plans;

- The Company engaged in purposeful opportunistic dating (and, therefore, pricing) of stock options; and

- As a result of all of the above, certain of the Company s proxy statements related to the grant of stock options, particularly to executive officers and non-employee directors, including certain information incorporated by reference in Part III of this amended annual report on Form 10-K/A, were not accurate.

The Special Committee also reported that members of senior management were aware of the practice of dating options on a date other than the date on which final action regarding the option occurred, and that certain members of senior management, namely the Company s Chief Financial Officer and General Counsel during the period, were or should have been aware of certain accounting and legal ramifications, respectively, of issuing an option with an exercise price lower than the fair market value on the date of issuance. The Special Committee also concluded that, based upon the information gathered and reviewed by the Special Committee, the misdating and mispricing of stock option awards was driven by a desire to make the options more valuable to the employees who received the awards and not to enrich those who managed the stock option program, though the Company s practice also did inure to the benefit of those who managed the stock option program.

The Special Committee s Recommended Remedial Measures

In addition to its findings above, the Special Committee s report contains recommendations concerning the Company s processes relating to the granting, administration and accounting of stock options. On May 25, 2007, the Board received and discussed the remedial measures suggested by the Special Committee which included:

- The procedures for stock option approval should be formalized in a manner consistent with the terms of the Company s underlying stock option plans and records of individual stock option awards should be maintained using commercially available software by experienced and qualified personnel;

- The Board should commit to exercising additional oversight of Company management and conduct a thorough review of the Company s governance and internal control practices;

- Certain personnel should be removed from the administration of the Company s stock option program and financial reporting function or provided additional oversight and training;

- Certain individuals who were directors or executive officers of the Company at the time they received misdated or mispriced awards should disgorge any benefit derived from the exercise of such misdated or mispriced awards and increase the exercise price for those unexercised misdated or mispriced awards; and

- The Company should take steps to address the tax consequences to employees of the Company s historical stock option granting practices.

The Board of Directors continues to thoughtfully consider these recommendations and has either implemented or is in the process of implementing several of the Special Committee s recommendations. For example, in response to the Special Committee s preliminary report announced on March 30, 2007, all current members of the Board agreed that, with respect to misdated or mispriced stock option awards to the current directors on or after January 1, 1996 which had not yet been exercised, the exercise price of such unexercised stock option awards would be increased to the fair market value of the Company s common shares on the measurement date applicable to such award. Furthermore, the current members of the Board agreed that, with respect to misdated or mispriced stock option awards to the current directors on or after January 1, 1996 which had previously been exercised, such directors would at a future date remit to the Company an amount equal to the excess, if any, of the fair market value of the Company s common shares on the applicable measurement date, as described below for such award, over the exercise price of such award. Over the 11-year period of the investigation, the collective difference between the exercise price at which options awarded to non-employee directors should have been issued less the exercise price at which such options were improperly issued was less than $1 million in the aggregate and did not exceed $150,000 for any one director.

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Furthermore, in light of the Special Committee s findings, on March 30, 2007 Gregory D. Hartman retired as Senior Vice President Finance, Chief Financial Officer and Treasurer, and Daniel P. Hann retired as Executive Vice President of Administration and a Director of the Company. In order to ensure a smooth transition of business operations and financial matters, Messrs. Hartman and Hann will serve as consultants to the Company pursuant to severance and consulting agreements with the Company dated as of March 30, 2007 (the *Retirement and Consulting Agreements*). Pursuant to the terms of these agreements Messrs. Hartman and Hann have agreed that, with respect to misdated or mispriced stock option awards granted to Messrs. Hartman or Hann which have vested but had not yet been exercised, the exercise price of such unexercised stock option awards will be increased to the fair market value of the Company s common shares on the measurement date applicable to such award. Furthermore, Messrs. Hartman and Hann have agreed that, with respect to misdated or mispriced stock option awards which had previously been exercised, Messrs. Hartman and Hann would at a future date remit to the Company an amount equal to the excess, if any, of the fair market value of the Company s common shares on the measurement date for such award over the exercise price of such award. Over the 11-year period of the investigation, the collective difference between the exercise price at which options awarded to Section 16 officers should have been issued less the exercise price at which such options were improperly issued was less than $3 million in the aggregate and did not exceed $400,000 for any one Section 16 officer. Lastly, except for 75,000 options granted to Mr. Hann in March 2006, Messrs. Hartman and Hann have each agreed to immediately terminate and forfeit any unvested stock option awards and that no options will be accelerated as a result of their retirement. As a result Messrs. Hann and Hartman have agreed to immediately terminate and forfeit approximately 164,000 and 89,000 unvested stock option awards respectively. Additional details of Messrs. Hartman s and Hann s Retirement and Consulting agreements are provided in the Company s April 2, 2007 and April 23, 2007 current reports on Form 8-K. On February 26, 2007, the Company announced the appointment of Jeffrey R. Binder as President and Chief Executive Officer and a member of the Company s Board of Directors. On March 30, 2007, the Company announced the appointment of J. Pat Richardson as Vice President Finance and Interim Chief Financial Officer and Treasurer, and on May 14, 2007 the Company announced the appointment of Daniel P. Florin as Senior Vice President and Chief Financial Officer to become effective June 5, 2007.

In addition, the Company s current Chief Executive Officer and Interim Chief Financial Officer have met with the key personnel throughout the Company who have significant roles in the establishment and maintenance of internal controls over financial reporting and disclosure controls and procedures to emphasize the Company s commitment to enhancing the Company s internal controls over financial reporting and disclosure controls and procedures. The Company s Human Resources, Legal and Finance departments either have or will, prior to the Company s resumption of the issuance of stock option awards, be provided additional training and education designed to ensure that relevant individuals involved in the administration of stock option grants understand the terms of the Company s equity-based award plans and the relevant accounting guidance for stock options and other share-based payments. In addition, the Company s Human Resources, Legal and Finance departments will develop, prior to the Company s resumption of the issuance of stock option awards, formal, documented stock option grant procedures and practices to ensure systematic approval and execution of stock option grants and the proper recording of such grants in the Company s stock administration records and financial statements. Lastly, although the Company is not currently granting stock option awards and has not granted any stock option awards since December 2006, the Company has either implemented or is in the process of implementing additional changes to its internal controls over financial reporting noted in Item 9A. Controls and Procedures of this amended annual report on Form 10-K/A.

Finally, the Special Committee concluded that pursuit of the claims made in the Biomet derivative litigation related to stock option grants would not be in the best interests of the Company at this time. For a further description of the Special Committee s considerations in arriving at this conclusion see the Company s current report on Form 8-K filed with the Securities and Exchange Commission (the *SEC*) on May 25, 2007.

The Company has advised the Midwest Regional Office of the SEC of the Special Committee s findings.

Accounting for Stock Option Awards

APB No. 25 Awards. The accounting guidance for determining share-based compensation expense applicable to Salaried Employee Awards, Officer Awards, Director Awards, New Hire, Promotional and

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Employee Anniversary Awards, each as defined below (collectively *APB No. 25 Awards*) is Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, or *APB No. 25*. APB No. 25 defines the measurement date of a stock option award as the first date on which are known both (1) the number of shares that an individual employee is entitled to receive and (2) the option or purchase price. Under APB No. 25 a measurement date is required to be selected for each stock option award and compensation expense must be recognized ratably over the vesting period of the option award for the excess, if any, of the quoted market price of the stock on the measurement date over the stated exercise price of the award. In many instances the Company selected option grant dates and corresponding option exercise prices with respect to APB No. 25 Awards that were before the date that both the number of shares that an individual was entitled to receive and the exercise price for the award had been finalized. The Company also deemed the stated grant date to be the measurement date resulting in no compensation expense for those options in the financial statements as previously reported. For purposes of establishing the measurement date for accounting purposes, the practice of using the stated grant date rather than the date that the number of shares that an individual is entitled to receive and exercise price were finalized resulted in incorrect measurement dates and financial statement errors. In connection with the restatement reflected in this amended annual report on Form 10-K/A, the Company has selected alternative measurement dates for APB No. 25 Awards to correct for these errors.

Non-APB No. 25 Awards. The accounting guidance for determining share-based expense applicable to Distributor Awards (as defined below) is based on Emerging Issues Task Force 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquisition, or in Conjunction with Selling, Goods or Services, or *EITF 96-18*. Under EITF 96-18, additional share-based expense is evaluated based on the fair value of the Distributor Award at the date of grant and then remeasured at each subsequent reporting period over the vesting period of the award. Prior to fiscal 2003, the Company did not record expense for stock options granted to non-employee distributors. In fiscal 2003 and subsequently, the Company began recording expense based on EITF 96-18. The Company has calculated (or recalculated in the case of fiscal years subsequent to 2002) expense for awards to non-employee distributors in accordance with EITF 96-18 for the 11-year period of the investigation.

Categories of Stock Option Awards

The Company has categorized the approximately 17,000 stock option awards to purchase approximately 17,000,000 Biomet common shares during the 11-year period in question based upon the recipient of the award and the process by which the award was finalized. As result of the deficiencies described above under the heading The Special Committee s Findings, the Company used incorrect measurement dates for approximately eighty percent of these awards resulting in errors in the Company s financial statements. In connection with this amended annual report on Form 10-K/A, the Company has examined the best evidence available, including but not limited to, electronic and physical documents related to the awards and interviews with individuals involved in the administration of the Company s stock option program during the 11-year period, in order to determine the appropriate measurement dates and correct these errors.

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The following table summarizes the five categories of stock options awards during the 11-year period in question (Salaried Employee Awards, Officer Awards, Director Awards, and New Hire, Promotional and Employee Anniversary Awards, and Distributor Awards), the total number of shares granted during the 11-year period, and the additional compensation expense or additional distributor stock option expense related to those awards as the case may be (in thousands):

Type of Awards	*Number of Shares Underlying Awards*	*Percentage of Total Number of Shares Underlying Awards*	**Pre-Tax Additional Expense**
APB No. 25 Awards (1) (2):			
Salaried Employee Awards	12,707	75%	$ 43,179
Officer Awards	1,268	7	2,684
Director Awards	174	1	633
New Hire, Promotional and Employee Anniversary Awards	1,939	11	3,571
Total (prior to consideration of vesting and forfeitures)	16,088	94	50,067
Less forfeitures and amounts unamortized at May 31, 2006			(16,938)
Total (additional expense through May 31, 2006)			33,129
Non-APB No. 25 Awards (3):			
Distributor Awards (additional expense through May 31, 2006)	866	6	5,091
Total Pre-Tax Additional Expense for APB No. 25 Awards and Non-APB No. 25 Awards (after consideration of vesting and forfeitures through May 31, 2006) (4)	16,954	100%	$ 38,220

(1) Under APB No. 25, additional share-based compensation expense was calculated above as the excess of fair market value of the Company s common shares on the applicable measurement date less the exercise price of the stock option award multiplied by the number of shares subject to the option award in question. Share-based compensation expense is recognized ratably over the vesting period of each option award, a period which is typically between 3 and 8 years with respect to the stock option awards in question.

(2) In light of the judgment involved in selecting alternative measurement dates, a sensitivity analysis was completed which assessed the impact on pre-tax additional share-based compensation expense of using different alternative measurement dates. See Compensation Expense and Sensitivity Analysis.

(3) Measurement of distributor stock options expense for Distributor Awards is based on EITF 96-18 as described in more detail below. Under EITF 96-18, additional share-based expense is measured above based on the fair value of the Distributor Award at the date of grant and then remeasured at each subsequent reporting period over the vesting period of the award.

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(4) Total Pre-Tax Additional Expense for APB No. 25 Awards and Non-APB No. 25 Awards (after consideration of vesting and forfeitures) is the sum of the pre-tax additional share-based expense for APB No. 25 Awards ($33,129) and pre-tax additional distributor stock options expense under Non-APB No. 25 Awards ($5,091), in each case after consideration of vesting and forfeitures through May 31, 2006. This amount is the additional share-based expense reflected in the Company s restated consolidated financial statements included elsewhere in this amended annual report on Form 10-K/A.

Salaried Employee Awards. Salaried Employee Awards were typically made to a broad base of employees of the Company and its subsidiaries on an annual basis as part of an extensive process that required several months to complete. Pursuant to authority granted under the 1992 Employee and Non-Employee Director Stock Option Plan (the *1992 Plan*) and the 1998 Qualified and Non-Qualified Stock Option Plan, as amended June 24, 2005 (the *1998 Plan*), the Board s Compensation and Stock Option Committee was delegated authority to administer the Company s stock option program. On an annual basis the Compensation and Stock Option Committee typically approved a pool of stock option awards, without specification of exercise price terms, which were allocated to each business unit within the Company. The stock option awards appropriated to each business unit were further allocated to individual employees within the business unit using discretionary criteria by members of management within each business unit (the *business unit head*). On an annual basis the business unit head communicated his or her allocation to the chief financial officer or the stock option administrator and a notification was delivered to the stock option recipient advising the employee of their award. The exercise prices for Salaried Employee Awards during the 11-year period in question were apparently set in several ways, including, among others, using the lowest price of the month or quarter or the date the allocation was received by the chief financial officer or stock option administrator. The alternative measurement dates reflected in this amended annual report on Form 10-K/A with respect to Salaried Employee Awards was determined based on the earliest date when evidence existed demonstrating that the individual share allocations were approved and the exercise prices were known. This determination required the use of judgment by the Company, other than with respect to stock option awards granted to employee sales personnel that were based on the achievement of pre-determined sales goals. For awards to employee sales personnel, representing stock options to purchase approximately 293,000 Biomet common shares, the Company determined that the alternative measurement date should be based on the last trading day of the period when the sales goal was achieved.

Officer Awards. Officer Awards were made annually to the Company s officers during the 11-year period in question. No stock options were awarded to Niles L. Noblitt, the Chairman of the Board, or Dane A. Miller, the Company s former Chief Executive Officer, during the 11-year period in question. Of the stock options awarded to officers during the 11-year period, stock options to purchase 280,000 Biomet common shares had appropriate measurement dates while the remaining stock options to purchase 988,000 Biomet common shares had inappropriate measurement dates. For those awards with inappropriate measurement dates, the alternative measurement date reflected in this amended annual report on Form 10-K/A with respect to the Officer Awards was determined in a substantially similar manner as the Salaried Employee Awards.

Director Awards. From 1996 through February 1999, each non-employee director was granted an option to purchase 5,000 Biomet common shares every three years during his or her service on the Board under the 1992 Plan. From March 1999 through 2006, each non-employee director was granted an option to purchase 2,000 Biomet common shares annually under the 1998 Plan. For those awards with inappropriate measurement dates, the alternative measurement date reflected in this amended annual report on Form 10-K/A with respect to the Director Awards was determined in a substantially similar manner as the Salaried Employee Awards.

New Hire, Promotional and Employee Anniversary Awards. New hire, promotional and employee anniversary awards were awarded to employees upon their date of commencement of employment with the

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Company, achievement of a significant promotion within the Company or the employee s hire date anniversary. The exercise prices for these awards during the 11-year period were set in several different ways including the date of hire, promotion or anniversary; the lowest price of the month or quarter in which the hire, promotion or anniversary occurred; the end of month price; or other selected dates. Generally, the Company determined the alternative measurement date for these awards based on the actual dates of hire, promotion or anniversary. These alternative measurement dates were used due to the relatively small number of shares underlying New Hire, Promotional and Anniversary Awards in total and per grant, as well as the difficulty in establishing alternative measurement dates with respect to New Hire, Promotional and Anniversary Awards. For a discussion of the sensitivity analysis performed by the Company in connection with this amended annual report on Form 10-K/A see Compensation Expense and Sensitivity Analysis below. The Company s sensitivity analysis indicates that the use of different alternative measurement dates would not have a quantitatively material impact to the incremental additional share-based compensation expense recorded by the Company in any prior period financial statements reflected in this amended annual report on Form 10-K/A.

Distributor Awards. Distributor Awards were made periodically to the Company s non-employee distributors. There were options to purchase 866,000 Biomet common shares awarded to non-employee distributors during the 11-year period of the investigation. Prior to fiscal 2003, the Company did not record expense for stock options granted to non-employee distributors. In fiscal 2003 and subsequently, the Company began recording expense based on EITF 96-18, See Note A to the financial statements. The Company has calculated (or recalculated in the case of fiscal years subsequent to 2002) expense for awards to non-employee distributors in accordance with EITF 96-18 for the 11-year period of the investigation. EITF 96-18 requires the Company to measure the fair value of the Distributor Awards at the date of grant and then remeasure fair value at each subsequent reporting period over the vesting period of the award.

Payroll and Withholding Taxes, Penalties and Interest

The payroll and withholding tax treatment of a stock option granted to a U.S. employee or other service provider depends on whether the stock option qualifies as an Incentive Stock Option (*ISO*) or a Non-Qualified Stock Option (*NQO*). An ISO is a stock option that satisfies certain requirements set forth in Internal Revenue Code Section 422, including a requirement that the exercise price of the stock option may not be less than the fair market value of the underlying shares on the date of grant. An NQO is any stock option that does not satisfy the requirements to be treated as an ISO.

Upon exercise of an NQO, we are required, to the extent applicable, to (1) withhold the optionholder s share of social security, Medicare and other employment taxes (which we collectively refer to as payroll taxes) and any federal, state or local income tax and (2) pay Biomet s share of payroll taxes. However, upon exercise of an ISO, we are not required to withhold any income taxes nor are we required to withhold or pay any payroll taxes.

Our stock options granted during the 11-year period were generally intended to qualify as ISOs and accordingly, except for federal withholding in certain instances with respect to same day sales, we did not withhold federal income taxes, state income taxes or the employee s share of social security, Medicare and other employment taxes upon exercise of these options, nor did we pay the employer s share of social security, Medicare and other employment taxes. However, as described above, approximately eighty percent of our stock options granted during this period were subject to revised measurement dates. Any stock option that was granted with an exercise price less than the fair market value of the underlying shares on the revised measurement date would not have qualified as an ISO and should have been treated as an NQO for payroll and withholding tax purposes. In these cases, we have accrued payroll and withholding taxes, penalties and interest for stock options and included these amounts in the restated financial statements.

In preparing the restatement reflected in this amended annual report on Form 10-K/A we have assumed a normal statute of limitations on the assessment of payroll and withholding taxes. Thus, we have reversed expense recorded in prior periods and as a result recognized a benefit in the period in which the statute of limitations for the respective option exercise expires in an aggregate amount of $14.3 million. However, the statute of

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limitations may not apply in the case of a false or fraudulent return with the intent to evade tax or in the case of a willful attempt in any manner to defeat or evade any employment or withholding tax. If the statute of limitations were determined not to have expired the benefit which we have recognized could be deemed to be payable. The Company believes there was no intent to evade paying taxes. See Risk Factors Related to the Stock Option Investigation in Item 1A of Part I of this amended annual report on Form 10-K/A.

In most instances, ISOs which were exercised as a same-day sale were properly treated as a disqualifying disposition and the income was reported on the individuals Form W-2. In these situations, we accrued payroll taxes, penalties and interest but did not accrue federal or state income taxes as the income from the disqualifying disposition of stock options was included on the employee s Form W-2 and applicable state and federal income taxes were paid by the employee. For certain ISOs which subsequently converted to a NQO stock option, we accrued federal and state income taxes, payroll taxes, penalties and interest at the applicable rates, if the income was not reported on the individuals Form W-2.

The combination of taxes, penalties and interest resulted in a net compensation charge of $21.4 million for fiscal years 1996 through 2006.

We believe that the unpaid employee portion of taxes represents joint and several obligations of both us and our employees. However, the change of status of employee options from ISO to NQO was a result of flaws in our stock option granting practices as discussed above. We believe that the employees would likely have a valid claim against us in the event we attempted to recover a portion of the additional taxes, penalties and interest from them. Accordingly, we believe it is appropriate to accrue both the employee and the employer portions of all taxes. In addition, we believe such additional taxes, penalties and interest should be recorded in the respective years in which the underlying in-the-money options were exercised.

Additional Share-Based Compensation Expense, Distributor Stock Options Expense and Payroll and Withholdings Taxes

As a result of the findings of the Special Committee, management has concluded that incorrect measurement dates were used for financial accounting purposes for approximately eighty percent of the stock option awards during the 11-year period reflected below. The effect of recognizing additional share-based compensation expense, distributor stock options expense and payroll and withholding taxes during the 11-year period is as follows (in thousands):

	Additional Share-Based Compensation Expense (Pre-Tax)(1)	Additional Distributor Stock Options Expense (Pre-Tax)(2)	Additional Payroll and Withholding Taxes (Pre-Tax)	Total Additional Expense (Pre-Tax)	Tax Effect	After-Tax Expense
1996	$ 26	$ 132	$	$ 158	$ 58	$ 100
1997	516	305	7	828	269	559
1998	1,071	725	335	2,131	686	1,445
1999	2,068	1,121	1,020	4,209	1,415	2,794
2000	4,371	1,226	1,424	7,021	2,312	4,709
2001	5,517	1,079	6,023	12,619	4,030	8,589
2002	5,556	1,307	4,348	11,211	3,808	7,403
2003	4,887	124	4,921	9,932	3,320	6,612
Total 1996-2003 effect (3)	24,013	6,019	18,078	48,109	15,898	32,211
2004	3,875	(413)	4,617	8,079	2,776	5,303
2005	2,792	(51)	490	3,231	988	2,243
2006	2,449	(464)	(1,779)	206	(30)	236
Total 2004-2006 effect (3)	9,116	(928)	3,328	11,516	3,734	7,782
Total effect (3)	$ 33,129	$ 5,091	$ 21,406	$ 59,626	$ 19,632	$ 39,994

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(1) Under APB No. 25, additional share-based compensation expense was calculated above as the excess of the fair market value of the Company s common shares on the applicable measurement date less the exercise price of the stock option award multiplied by the number of shares subject to the stock option award in question. Share-based compensation expense is recognized ratably over the vesting period of each stock option award, a period which was typically between 3 and 8 years with respect to the stock option awards in question.

(2) Under EITF 96-18, additional distributor stock options expense is measured above based on the fair value of the Distributor Award at the date of grant and then remeasured at each subsequent reporting period over the vesting period of the award.

(3) Amounts in table may not foot or cross-foot due to rounding.

Compensation Expense and Sensitivity Analysis

The Company s selection of the alternative measurement dates for each of the stock option awards discussed under the heading Categories of Stock Option Awards was based upon the best evidence available to the Company. Due to a lack of documentation and process surrounding the Company s administration of its stock option plans, the Company s estimate of the appropriate measurement date was based on grant documentation such as e-mails, spreadsheets listing the employees and the number of shares to be granted to such employees, and other correspondence or documentation related to the award that provided the best evidence that the terms of the award had been fixed with finality. In some instances that documentation did not clearly identify with certainty the date that the terms of the award were fixed with finality but did identify a range of potential dates. In those cases the Company exercised judgment in selecting the most appropriate measurement date.

As described above, judgment was exercised by the Company in determining the appropriate alternative measurement date for each of the stock option awards in question. The use of a different alternative measurement date than that used by the Company could have resulted in different share-based compensation expense than those recorded in the Company s restated financial statements and included in this amended annual report on Form 10-K/A. The Company performed sensitivity analysis of the effect on share-based compensation expense of using different approaches for selecting alternative measurement dates than the approach used to record share-based compensation expense in the Company s restated financial statements and included in this amended annual report on Form 10-K/A.

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Presented below is a summary that illustrates the impact of different approaches of measuring additional share-based compensation expense from fiscal 1996 to 2006. The summary below excludes distributor stock options expense arising from Distributor Awards (as these awards are accounted for under EITF 96-18) and is presented after considering forfeitures and vesting (dollars in thousands).

			Sensitivity Analysis			
Year	Additional Share-Based Compensation Expense (Pre-Tax) (1)	Error as a % of Pre-Tax Income (1)	Additional Share-Based Compensation Using End Date Alternative (Pre-Tax) (2)	Error as a % of Pre-Tax Income (2)	Additional Share-Based Compensation Using High Price Alternative (Pre-Tax) (3)	Error as a % of Pre-Tax Income (3)
1996	$ 26	.0%	$ 45	.0%	$ 68	.0%
1997	516	.3%	842	.5%	1,266	.7%
1998	1,071	.5%	1,853	.9%	2,789	1.3%
1999	2,068	1.0%	3,550	1.8%	5,342	2.7%
2000	4,371	1.6%	7,543	2.7%	11,350	4.0%
2001	5,517	1.8%	9,531	3.0%	14,342	4.6%
2002	5,556	1.5%	9,603	2.6%	14,449	3.8%
2003	4,887	1.1%	8,457	1.9%	12,726	2.8%
1996 - 2003 (4)	24,013		41,424		62,332	
2004	3,875	.78%	6,736	1.3%	10,136	2.0%
2005	2,792	.51%	4,860	0.9%	7,313	1.3%
2006	2,449	.40%				