WorldCom, Another one tries to deceive by fraudulent accounting

Submitted To : Sir. Syed Haroon Rasheed

Submitted By: Umar Rauf

Mohammad Saad Tariq

Class (section) : BBA 2K8 (**C**)

Table Of Contents: Page no.

1. ABSTRACT 1
2. INTRODUCTION 1
3. LITERATURE REVIEW 2
4. METHADOLOGY 7
5. CONCLUSION 7
6. REFRENCES 8

ABSTRACT:

A small telecommunication company by the name of long distance discount service, was started in 1983 by Bernard Ebber. By acquisition of many other small companies it grew large such that it became second largest telecommunication company in early 90's.It acquired almost 60 companies including large companies which were main competitor like MCI. After this much number of acquisition, company changed its name to WorldCom. Company was quite popular in media as it had significant control over the internet and other telecommunication services. In late 90's telecommunication industry suffered from a downturn but Ebber was determined to maintain WorldCom's position in the market. So in order to not let the share price of WorldCom go down, WorldCom manipulated its accounts and instead of showing losses, which was the actual picture, Company showed profits. Company was able to practice this fraudulent accounting till mid of 2002 till the fraud was discovered by internal auditors of WorldCom. This was the biggest fraud ever done in the history.

INTRODUCTION:

In the history of telecommunication industry there were many companies which had a good start but could not survive in the slump of telecommunication industry in late 90's.One of these Companies was WorldCom. WorldCom which was initially known as Long-Distance Discount service (LDDS) came into being in 1983 by the investment of Bernard Ebbers. There was a lot of demand for internet and telecom services in those

days, only one company in the market by the name of AT&T, which was regulated by government. So LDDS bought services from AT&T and sold it at lower prices to its customers. By acquisition of many small firms LDDS became the fourth-largest long-distance telecom network in U.S by 1993.This growth had a sufficient effect on LDDS share price that it enabled it to generate enough revenues from shares to finance expensive acquisition. In 1995 LDDS changed its name to WorldCom. After this Company started acquiring even large companies, among them was UUNET, a company in U.S privatized by National Science Foundation, which was one of the oldest carriers of internet traffic. In 1998 WorldCom merged with MCI which was the highest-priced acquisition in those days. In 2000 Company was not allowed a merger with SPRINT because regulators feared of the company to turn in a monopoly. During this period telecommunication industry was going through a down turn so in order to survive WorldCom started using fraudulent Accounting Practices. They continued to do so till 2002 when fraud was discovered by internal audit committee of WorldCom. In March 2002 Company itself also acclaimed that it manipulated its accounts for the past few years. In July 2002 Company was filed for Bankruptcy.

LITERATURE REVIEW:

As the telecommunication industry grew opportunities for telecom firms to expand globally also increased. The rapid growth of the internet in early and mid 90s gave boost to the telecom industries. Firms tried to construct new networks which exaggerated the business plans of the firms. In 1996, problems started when competition became intense and firms borrowed funds heavily to finance their growth. Many of the competitors

could not survive and filed bankruptcy.

Prof. Fotios C. Harmantzis, PhD, MBA,Telecommuniactions management school of technology managemnt. Stevens institute of technology.

THE CAUSES OF DOWNFALL:

WorldCom board of directors did not paid attention, how the company was running. WorldCom had been in a debt of billions thus reducing its cash flow. WorldCom had already opened up new markets by allowing long-distance providers and local telephone companies to compete in the market. The biggest Competitors were MFS communication and MCI. WorldCom was a U.S based international telecommunications service provider its services included data service, internet-related services, commercial long distance and local voice services, international communications services, designing and managing customers' communication systems. The data services included frame relay, ATMS's and IP networks. Services of internet included high-speed connections, web site management and many more. MCI, which provided wholesale data services, wireless messaging, dial-up internet access and consumer long-distance and local voice services, also formed part of WorldCom in 90's. Ignoring the fact that cash flow of WC was unstable Ebbers(CEO) kept on donating generously to politicians to get their support in taking over other companies. In 1999 WorldCom announced its decision to buy sprint, the 3rd largest U.S telecom for $129bn, But U.S department of justice and European Union blocked the proposed merger. After this event company stock began to slope downwards because this merger was very important for the company to survive in the slump of the telecommunication industry. Ebbers came under pressure by this critical situation so in order to maintain high share price of WorldCom company manipulated its books.

HOW THE FRAUD WAS DONE:

Company did the fraud by reducing reserve accounts to cover liabilities and added $2.8bn to the revenue from these reserves. This act showed the powerful financial statements. Secondly, they mistreated expenses to show high profits . Company's CFO, Scott Sullivan, told key staff members to mark operating costs as long term investments up to $3.85bn Thus, huge losses turned into enormous profits. It inflated the company value in its assets. The company may have been buying paper clips but they were recording those as buildings. The management made the fraud simple by transferring line costs fess to capital accounts. Line cost was the main cost of the company as WorldCom did not have its own lines and therefore had to pay telecom providers a price to use those lines. This transfer made WorldCom appear efficient by keeping high operating margins. This transfer of line costs to capital accounts also affected cash flow positively. WorldCom further lessened their line costs firstly by releasing accruals without any authentic information, secondly by not releasing accruals during the period in which they were identified, and thirdly by releasing those accruals established for other purposes. During 1999 line costs were reduced by $500million, and during 2000 it reduced by $2797million.

By SUSAN PULLIAM and DEBORAH SOLOMON Staff Reporters of THE WALL STREET JOURNAL

October 30, 2002

THE DISCOVERY OF FRAUD!

WorldCom audit panel discovered the fraud during a routine internal audit.. The fraud-finding team consisted of:

Cynthia Cooper, Manager of Internal Audit, reports to Scott Sullivan Gene Morse, Internal Audit, technology expert Glyn Smith, Internal Audit, Senior Manager

In March 2002, John Stupka complained to internal audit about $400 million, he set aside that Sullivan wanted to increase the profit of WorldCom. The internal staff members told the audit team about the changes in the accounts. These acts were against GAP so on March 7th, the SEC requested **for** information from WorldCom. The Internal Audit started digging the grounds of financial statements. They found $2bn that company announced for investing in capital expenditures that were never authorized for capital expenditures. They also found that $500 million in computer expenses were recorded as assets. While searching WorldCom's computers, Mr. Morse found that $2 billion were in questionable entries. The Internal audit team contacted the WorldCom's audit committee on June 14th. Mrs. Cooper asked for documents supporting numerous capital expenditures and no supporting documents were found. Mr. Myers, the controller, admits to internal auditors that the accounting treatment was wrong and stated that no accounting standard supported that accounting. From the period of June20-25th, the internal audit explained irregularities to the audit committee and found that WorldCom announced it inflated profits by $3.8 billion over the past five quarters. On June 26, 2002 the SEC commenced a civil action against WorldCom. Beside SEC, WorldCom was also made answerable to Justice Department ,the House Energy ,and commerce committee. Moreover, some shareholders also sued against WorldCom for fraud charges. WorldCom staff blamed the auditor Arthur Anderson for not considering the irregularities. But Anderson blamed the former CFO Scott Sullivan. Sullivan forwarded it to

Ebbers who knew, according to Sullivan, about the shifted money into capital accounts. Mr. Sullivan was arrested by the police and his maximum possible punishment was $2.5 million in fines and 65 Years in prison. On July 21, 2002 WorldCom filed a case for to the U.S bankruptcy court for protection from its creditors in its bankruptcy state, listing $45.98bn still in liabilities. This helped WorldCom to secure finance, easing the company to pay debts, after flabbergasted creditors demanding immediate payment. The benefit for filing bankruptcy to court was employees were still getting salary, operations were running normally under the management of WorldCom, and assets of the company were still in its possession. But WorldCom was dishonored and businessmen were avoiding doing business with it. If this thing continued the next step for WorldCom was to shut down and liquidate its assets to pay its debts. People believed that hat this was the right solution for WorldCom to come out of bankruptcy.

By Vince Hulbert, Senior Vice President and Deputy Practice Leader for

Corporate/Financial, Hill & Knowlton New York

CAPELLAS 100 DAY PLAN:

Ebbers had already resigned from his post. Sidgmore took over WorldCom in April 2002. There were 17000 job cuts, a sale of assets and workforce. The problem was arranging equipment but many vendors like Cisco wanted their money back. On November, 15 2002 WorldCom hired Micheal D.Capeilas, former chairman of HP and Compaq computers, as a new chairman with the permission of the court. On January 14, 2003, chairman and CEO created a plan to recover the company situation which later followed to plan of reorganization in 2003 later. According to the plan, WorldCom should launch new

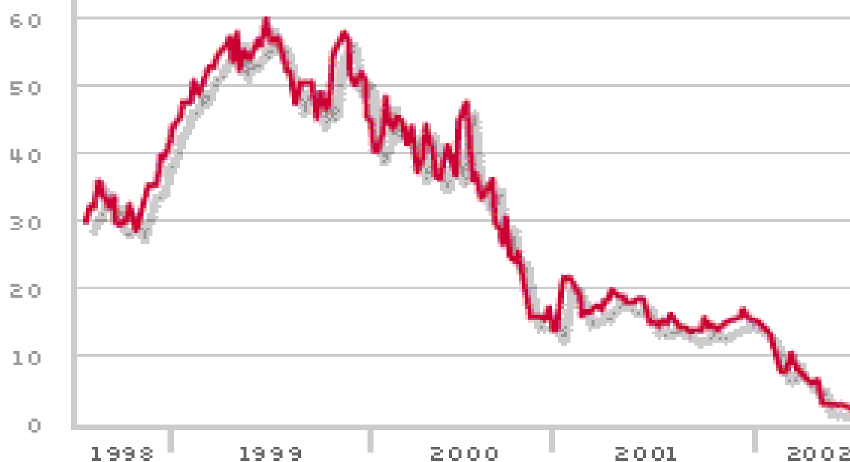
products to gain it's old position back. Micheal D.Capeilas also insured company's commitment to corporate integrity and rebuilding trust among employees and the public.

By siliconindia News Bureau

Thursday,08 May 2003

PLAN OF REORGANISATION

The plan of reorganization included a 3 year business plan outlining the future plans for WorldCom and it was developed to repay 90% of its debts. Most creditors agreed to accept shares or bonds on behalf of those debts. Additionally, WorldCom appointed its new CFO, Robert T.Blakely and the company named changed from WorldCom to MCI. The headquarters was also shifted to Ashburn VA. MCI is trying to improve day by day and it is still the question in minds of people that will it reach again at the peak of the success same like the previous years when its market share was at boom. Graph displaying company's share price from 1998-2002



remained

the most popular topic of 2000 to 2002 in the eyes of media therefore we were able to find sufficient material for our project. For our project we found a lot of data given in articles given on internet which were written by different authors and analysts. Several newspapers wrote about this topic because it was one of the hottest topic in 2002. We found many vast articles in which author s gave their views about WorldCom, its fraudulent accounting practices and it's effect on shareholders and stock market. We used qualitative research technique for finding the data about WorldCom.

CONCLUSION:

WorldCom was able to exercise false accounting practice because its external auditor Arthur Andersen did not perform his duties. Arthur Andresen should have been banned after the unveil of fraudulent accounting practice by many large companies like Enron. After the discovery of many companies Arthur should had been alert and more careful about the accounting records of companies but he was not thus leading to bankruptcy by another big company like WorldCom. He did not verify WorldCom's books but instead he believed that books maintained by WorldCom were accurate.

Auditors should keep strict check on accounts of companies because companies misleading accounting records effect a lot of people disastrously, apart from shareholders, investors , and other people directly linked to the company, Economy is effected a lot by these kinds of bankruptcy by large firms.

REFRENCES:

1) Susan Pulliam and Deborah Solomon, "How Three Unlikely Sleuths Exposed Fraud at WorldCom", October 30, 2002.

http://www.happinessonline.org/MoralCode/LiveWithTrutli/p23.htm

2) Siliconmdia News Bureau, "WorldCom files plan of reorganization, changes

brand to MCI", Thursday,08 May 2003, 13:00 hrs 1ST

http://www.siliconindia.com/shownews/WorldCom_files_plan_of_reorganization_

changes_bran d_to_MCI_-nid-19414.html

3) Ihor Olavsrud. "Capellas Lays Out 100 Day Plan for WorldCom", January 14, 2003.

http://wwwinternetnews.eom/xSP/article.php/l 569551

4) Pabloreis," WorldCom Paper Accounting",20

Apiril,2008. http://www.oppapers.com/essays/Worldcom-

Paper-Accounting/143945

5) Jimsimth0810, " WorldCom",

llDecember,2008.

http://www.oppapers.com/essays/World

com/180255

6) Rebekah A. Sheely," WorldCom: A Simple Recipe for Cooking the Books",

http://www.newaccountantusa.com/newsFeat/wealthManagement/sheely

worldcom.pdf

7) Fotios Harmantzis ," Inside the telecom crash: Bankruptcies, Fallacies and

Scandals- a closer Look at the Worldcom Case", March 30, 2004.

http://papers.ssrn.com/sol3/papers.cfm7abstract id=575881

8) Gil Sadka , "The Economic Consequences of Accounting Fraud in Product Markets: Theoryand a Case from the US Telecommunications Industry (WorldCom) "June 2006.

http://papers.ssrn.com/sol3/papers.cfin7abstract id=906153

9) Cdg052684, "Business Ethics And WorldCom",08 Feburay,2008.

http://www.oppapers.com/essays/Business-Ethics-Worldcom/93038

10) Marianne M. Jennings," Ethics and Investment Management: True Reform",

http://www.istor.org/stable/4480670

11) v. SRIDHAR," The WorldCom collapse"," volume 19 - Issue 15, July 20 - August 02, 2002

12) AICPA,"The WorldCom Fraud",2003

www.aicpa.org/download/antifraud

/121 .ppt

13) Lauren Gard, "WorldCom's "Hit List" Accounting", FEBRUARY 9, 2005

http://www.businessweek.com/bwdaily/dnflasli/feb2005/nf2005029 5503
db017.htm