Worldcom

ASSIGN BUSTER

The origin of World can be traced to the breakup of AT&T in 1983. The company began as Long Distance Discount Services Inc during 1983. OLD name was changed to World in 1995. To build the economies of scale that were critical success factor in long distance market it was imperative for World to grow its available volume off bandwidth as it lowered the per unit costs.

Also the Telecommunication act of 1996 permitted long distance carriers to compete for local services transforming the industry competitive landscape. Companies went on a war footing note to provide their customers a single source of all telecommunication service World therefore decided to grow largely by acquiring other telecommunication companies notably MUFFS Communication and MIMIC Communication by using its highly valued stock Nature of Accounting Fraud There were several issues and problems which led to one of the history biggest accounting fraud.

Beginning modestly and continuing at an accelerated pace the company under the direction of Beers (CEO) and Sullivan (COOP)) used fraudulent counting methods to mask its declining earnings by painting a false picture of financial growth and profitability to prop up the price of World" s stock. Expense to Revenue (E/R) Ratio The objective of World as stated by Beers in 1997 was not to capture market share or be global. The goal was to be number 1 stock in Wall Street. This led to an unhealthy practice of brining in revenue through any mean even if meant bending or breaking the rules.

World objective was to maintain the EIRE ratio of 42%. However the overheated competitive environment in 2000 and reduced demand for

Telecommunication services triggered by economic recession and dot com bubble burst put a severe pressure on World most important performance indicator the EIRE ratio. The company struggled to maintain the EIRE ratio to 42% on subsequent quarters of 2000 because of above factors and also because of high committed line cost. As the business situation continued to decline, COOP Sullivan used number of manipulated accounting techniques to meet targeted performance. The fraud was accomplished primarily in two ways. Accrual Release General accepted accounting principle requires that the company estimate their expected payments and match the expense with revenue in its income statement. However in order to achieve targeted performance Sullivan asked several Business unit managers to release accruals that he claimed were too high relative to the future cash payment. Over a seven quarter period between 1999 and 2000 World has released $3. 3 billion worth of accrual most at the direct request of Sullivan or Myers.

Several business units were left with accruals for future payment that were well below the amounts they would have to pay when bill arrived in the next period. Expense Capitalization Over a period of time the above mentioned tactics of account accrual release were no longer blade to conclave ten targeted rattle. I Norte Sullivan sakes Its calculate the cost of excess network capacity. Sullivan then convince the staff to treat these period line maintenance cost as a capital expenditure. Doing so would reduce the periodic maintenance expense and will result in higher net income.

In April 2001 amount to the tune of $771 million which were line expense were capitalized into an asset account namely 'construction in progress'. Out of $771 million the account angers were asked to reverse $227 million of the

capitalized amount and to make a $227 million accrual release from Ocean Cable liability. ". In the 10th quarterly report filed with the US SEC, World reported $4. 1 billion of line costs and capital expenditure. Corporate Culture World had an autocratic style of management and followed a top down approach. Each department had its own rules and management style.

There was no outlet for employees to express their concerns. Top hierarchy granted compensation and bonus beyond the company guidelines to a select group of individuals based on heir loyalty to them. Q 2. What are the pressures that lead executives and managers to " cook the books? " The World management philosophy was to be aggressive. The ethical atmosphere created by the leadership at the top had a trickled effect on the employees of World. BothBeerand Sullivan appeared to be less concerned with ethics and focused solely on the bottom line.

Since the management had an autocratic style of functioning, employees felt threatened to raise the voice or challenge unethical practices of financial statement miss-representation. As the employees felt that they did not have an independent outlet for expressing concerns about company policies or behavior most fell in line. The policy of frequently granting compensation beyond the company's approved salary and bonus guidelines to presumable loyal employees set the wrong examples for others to follow.

Lack of appropriate internal control systems also encouraged several employees like Betty Vinson to continue with unethical accounting entries. The internal audit department which should have acted as a strong internal control catalyst was toothless and never eased its concern as it fall under the

direct reporting line of the COOP - Sullivan. As a result many employees believed it to be a non productive exercise to raise any concern to internal audit team. Q 3. What is the boundary between earnings smoothing or earnings management and fraudulent reporting?

To answer this question in an effective manner, it's ideal to understand the meaning of earnings management and fraudulent reporting, and then understand the difference between the two: Earnings Management: Earnings management can also be termed as Creative accounting is a strategy used y the management of a company to deliberately manipulate the company's earnings so that the figures match a pre-determined target. Rather than having consistent years of good or bad earnings, companies keep fluctuating their cash levels from reserve accounts.

We need to understand that the driving force behind managing earnings is to either meet a pre-specified target or be as close to the target as possible. The various methods of earnings management would be to follow a LIFO, FIFO method as suitable, in case of inventory, or cash and accrued based revenue, etc. Fraudulent Reporting: Fraudulent financial reporting is the deliberate action of issuing misleading financial statements in an in order to report desired results or to avoid negative opinions.

This type of reporting may involve omitting relevant data from the report, or even altering figures to convince investors or consumers. This type of reporting only takes place when there is a conscious intention to mislead the financial condition of an entity. Rather than the omissions of certain critical numbers or information happening as an accident, this happens intentionally

by a way of overlooking things to alter the verbal outcome. Boundaries between Earnings management and Fraudulent Reporting: There's absolutely nothing wrong with earnings management because it is within the boundaries of GAP.

We believe that earnings management is beneficial because it potentially enhances the information value of earnings. Earnings management activity is beneficial to shareholders. Earnings management is also seen as something legal and ethical. Earnings management in less transparent firms will also improve overall stock prices. Also, we believe that manipulation is not fraud; it's Just a theology and interpretation of reporting. However, fraudulent reporting is done with the sole aim of misleading facts, people and decisions.

Often, it gets very difficult to distinguish between the two; it really comes down to the point where it depends on the auditors' ability to identify transactions done with an aim of earnings management or fraud. Hence, there is a very thin line that exists between the two. We believe that the only boundary between earnings management and fraud is the compliance with standards. An important way to differentiate between fraudulent ND legitimate action is by understanding the motives behind each because this will help in determining whether the act was deliberate or accidental.

Also, more research needs to be conducted motives behind management decisions. Even in the context of the case, it's evident that while releasing accruals and reflecting them on to the company's income statement is perfect example of Earning management, however doing it with an intention

to mislead and get more shareholders to comply with the company's goal of becoming the No. 1 stock in Wall street and trying to release over-accruals even in case of acquisitions was a clear raid. As mentioned above, the external auditors of the company, I. . Arthur Anderson held a key in identifying the motives behind each action by the management, and hence establishes boundaries between earnings management and fraudulent reporting. This would've certainly brought a lot of critical facts which would've been detrimental to the interest of the firm and not to specific individuals. Q 4. Why were the actions taken by World managers not detected earlier? What management control processes or systems should be in place to deter or detect quickly the types of actions that occurred in World?