

# The rise and fall of worldcom telecommunications term paper

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



## **Abstract**

Accounting scandals are business scandals that arise following the unclinking of financial misdeeds by some trusted personnel in corporations. Some of the misdeeds usually involves some complex methods for embezzling, understating, misdirecting money, overstating the value of assets or in other words, underreporting the available liabilities. This is mostly accomplished in collaboration with workers or affiliate in corporations. In companies with public status, this kind of innovative accounting qualifies to fraud whereby investigations and inquiries are commenced by agencies of the government in place. In United States for instance, some of the government oversight agencies that are eligible to carry out fraud investigations are Securities and Exchange Commission (SEC). Mostly, scandals are just signals that represent the real picture of the company's catastrophic weaknesses. This paper therefore takes an extensive research and deeply investigates the accounting frauds that were carried out in United States' telecommunications giant WorldCom telecommunications in 1990s. This paper also gives a detailed description of WorldCom's growth all through its existence in mergers and acquisitions (Jeter Lynne, 2003)

It is of paramount importance to acknowledge that most of financial abuses that are carried out appear to be absolutely legal or may be quasi legal in that matter. A good example is during the domain of takeovers and privatization of properties. Telecommunication industries have lately been on the receiving end when it comes to real fraud. Most scandals have gone unmasked and the perpetrators escaped scot free. This has been as a result of smart and careful planning of frauds to extents that they lack evidence

that can incriminate anybody.

WorldCom Company started as Mississippi firm that was a small provider of telephone services to long distances. It made many acquisitions of telecommunications' firms during the early 1990s where its revenues raised from 154 million to \$39. 2 billion from the years 1990 to 2001. This made it to be ranked forty two among five hundred Fortune companies. The Noteworthy acquisitions of the WorldCom Inc. included the takeover of MCI in the year 1998. This also made to be the 2rd largest United States long distance carrier. Also the purchases of online data network, CompuServe and UUNet made it to be the leading internet Infrastructure operators in the U. S.

The roles of WorldCom's top management as far as the scandals are concerned, have been taken into discussion during the discussions.

WorldCom, America's second 2nd largest long Distance Telecommunications Company publicly declared on 25th June 2002 that it had overstated the amounts in 2001 and 1st quarter of the year two thousand and two by \$3. 8 billion. This announcement astonished the financial analysts and other corporations which were at the top of problems of accounting and had an impact on the financial markets. The maneuver of accounting that was responsible for classifying overstatement payments of using communication networks of other companies as expenditures was categorized as scandalous by the press. The company's auditor, Arthur Andersen was asked why he did not detect such problems. It then filed a protection for bankruptcy on 21st July. The same year on 8th August, WorldCom manipulated its accounts

which affected additional of \$3.8 billion. In Washington D. C. the response was hurried where the Exchange Commission and Securities charged the WorldCom with enormous accounting frauds in 26th June (Ulick Jake, 2002) It then obtained an order from court barring it from getting rid of financial records which limited payments to current and past executives and required an independent monitor. On 8th July, the House Committee held hearings on the Financial Services and by the end of 30th July the Senate Committee on Transportation, Science and Commerce indicated several officials. The main economic problem that faced the WorldCom was the immense oversupply on the internet growth. The company and other firms of telecommunications faced inadequate demand when the boom of dot-com ended which made its economy to enter recession. The revenues of WorldCom fall below expectations while its debts remained extraordinary high. WorldCom Inc. is not the only company that is facing difficulties. The difficulties of Enron, Adelphia, Qwest Communications, Lucent Technologies and Global Crossing have been majorly reported. These companies in internet ventures had major investments than WorldCom. The investors of WorldCom are the ones who have suffered losses. WorldCom's market value of the stock reduced from \$150 billion to \$150 million in January 2000 to July 2002. Very soon the stock will be worthless depending on the bankruptcy proceedings. The need to postpone or avoid losses of stock market creates the powerful incentives conceals bad news.

The accounting game of WorldCom Company has stunned investors who thought that the loophole of the firm was shut down many years ago.

WorldCom has acknowledged and showed the accounting gimmicks in a way

of capitalizing its costs. In the year 2001, WorldCom realized a profit of \$1.4 billion instead of making a loss which it had made recent years. Instead of subtracting the costs of maintaining telecom systems according to the analysts, it named them the long-term investments. This allowed the company to increase its earnings since the cost of these investments had to be subtracted from overtime earnings and not subtracting them at once.

### **How WorldCom Mislead its Expenses**

The company handled \$3.9 billion improperly in expenses that made it to move below the required standards. This means that the company capitalized its costs improperly in spreading them for many years instead of spreading them once. The following are the steps which analysts suspect how the expenses were mishandled.

Step One- Analysts suspected that the cost pays of the WorldCom Company included salaries and wages paid to workers for maintenance of telecom systems.

Step Two- The costs are not recorded on the income statement as it was required. This has made the company's net income to be higher since its cost is not reduced.

Step Three- The analysts suspects that the costs were recorded on the balance sheet instead of being recorded as an asset on the income statement. They should only do this if they purchase long time equipments.

Step Four-The Company's costs depreciated because they were put on the balance sheet. This is because of being subtracted over time from the net income. A small portion was included on the income statement.

WorldCom has faced the financial fraud which is considered to be the biggest fraud in the world. This has made it to restate its earnings for the last 5 years. Scott Sullivan who was the Chief Financial Officer was fired because he overstated \$3.9 billion cash flow in 2001. The company says that the previous year it could have made a loss instead of the net income that is approximately one point four billion dollars and also a loss of \$1.4 billion net income during the 1st quarter of 2002. According to Tom Laura, a Telecom analyst, the loss of WorldCom could top around one point five dollars in 2001. The Exchange and Securities Commission have commenced a high probe. If any of the executive is found guilty, he/she could be charged with both criminal and civil penalties. The shares of WorldCom dropped to seventy percent according to the CNBC news. The company has got twenty million customers in the world and it serves the largest businesses in the world. In the 1990s, WorldCom was one of the most excellent performing stocks making a profit of \$64.5 billion in the year 1999.

However, WorldCom does not happen to be the first telecommunication company to undergo a financial crisis. Other communication firms that have also undergone the same situations are: Global Crossing, Enron, quest communications among others. Investors in WorldCom have suffered a big blow. Initially, the firm's value in common stock drastically dropped from almost one hundred and fifty billion dollars in January 2000 to something that is less than one hundred and fifty billion dollars by July 2002. It is predicted that as a result of bankruptcy proceedings, its stock may be worthless. The need to suspend the losses in stock market of WorldCom's magnitude leads to the creation of strong corporate management's incentives since

engagement in accounting malpractices are encouraged.

Marlin Tepper (2005) affirms that on 25th statement when the telecommunication firm openly conceded that it classified three point eight billion dollars as capital expenditures instead of the current expenditures. Other telecommunication companies that WorldCom uses their communication networks are paid by line costs. This encompasses transport fees for text messages for WorldCom's clients. \$3.056 billion was unaccounted for in the year 2001 alone and at the same time, \$798 million during the initial financial quarter of the year 2002. Going by the company's information from the top management, there were funds totaling to approximately \$14.8 billion in the previous year of 2001 whereby the cost for lines were categorized under the current expenses. By moving a portion of current expense to capital account, the firm saw the increase of income mainly due to the reason that the expenses were initially understated. At the same time, the increase of assets income was evident because traditionally, all the costs that are capitalized are assumed to be part of investments. Thank God it was disclosed earlier enough because if it had not been discovered, the maneuver could lead to the paralysis of the net income in the following years following the depreciation of assets. As usual, depreciation is known to be part of unnecessary expense that minimizes the net income in businesses.

## **Accounting Discrepancies**

On 28th July, an announcement was made by quest communications whereby it indicated that telecommunications capacity were erroneously

accounted for and that swaps with other firms could restate the previous income. The New York Magazine also indicated that on 24th June, there was a memo which was written by the chief financial officer Mr. Scott D. Sullivan whereby there was a clear attempt to cleanse the capitalization under the basis that the firm was paying for extra capacities which it could require in future. For instance, the costs of lines that were in dispute were the client obtaining cost. In some cases, a professional accounting rule disallows the extra costs of obtaining clients to be capitalized as it is harmful to the organization. According to the previous accounts, the regarding of the costs of lines as capital expenditures was disclosed in May 2002 by the interior auditor Cynthia Cooper.

According to Wsj. com (2011), Cynthia Cooper together with officials from COX went ahead to analyze the misclassification with Scot Sullivan and David F. Myers who was the firm's chief executive. The matter was laid before the chief auditor and the entire WorldCom board of governors. The company's outside auditor was given the obligation to investigate the matter. Arthur Andersen was replaced since he had served for a long time. Following his failure to justify the discussions and treatments, Sullivan was laid off. Mr. Myers followed suit by resigning his position the same day. There was a miscommunication between Mr. Sullivan and Arthur Andersen since Sullivan had failed to consult him about classifying as capital expenditures some line costs. Andersen maintained that he had not been briefed. The Chairman of the House Energy and Commerce Committee Mr. Tauzin reported that the firm's internal documentation whereby emails were



included indicated clearly that the firm's executives were very much aware earlier enough that things were not headed the right direction.

## **Sarbanes-Oxley Act**

Following the enactment of Sarbanes-Oxley Act in July 2002 falling companies were relieved since it came to their rescue. According to emory.edu, companies like Enron and WorldCom were the immediate recipients. Even though the costs of compliance were a little bit on the higher side, hopes of resurrections were around the corner. The act was enacted following the subsequent collapse of WorldCom and Enron. Under the act, Auditor Arthur Andersen in compliance with authors of SOX was determined to renew the trust of investors by addressing most critical areas that were vulnerable. The same law created the Public Company Accounting Oversight Board (PCAOB). This board was obligated to carry out all auditing standards, and at the same time, regulating the auditors and regulate the quality control in all audits in companies. After they were applied in WorldCom, SOX regulations began to positively impact the confidence of investors and the company was slowly beginning to stand on its feet. Following the application of SOX regulation, senior executives were forced to resign from their jobs to pave way for productive investigations. Since then, the company is managing even though the main root of fraud has not been traced (emory.edu, 2005)

## **Conclusion:**

Frauds and fraudsters should be curbed in all means possible. Enacted acts like the Sarbanes-Oxley Act should be applied to all government companies

to prevent accounting anomalies. Through such acts, every single department in accounts department will be filled with professionals who are ready to work positively. People should also work responsibly in their various departments to promote transparency. Companies like WorldCom should be headed by professionals since they hold lives of many people and at the same time, contribute much to the treasury.

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