

# [Global crossing](https://assignbuster.com/global-crossing/)

It was headquartered in Bermuda, but operated primarily in the United States. In 2000, the wholesale market for bandwidth began to soften. Insufficient revenue to pay the massive debt they had accumulated to build their costly networks/huge infrastructure. In fact, GO has never reported annual profit since its creation, and by the first quarter of 2001, cash was running short. It filed for protection under Chapter 11 of the U. S. Bankruptcy Code, making it the biggest flatfoot of the telecoms bust so far and the fourth-largest bankruptcy in U.

S. History. Key Players: Gary Winning, age 54, a native of New York, who had no particular expertise with the telephone industry. Instead, he was a veteran of Wall Street Junk bond trading and he used his Wall Street connections to raise the funding for GO. Although the endeavor proved to be unsuccessful, Winning did not suffer financially. Through timely stock sales, he earned $750 million in less than 5 years, sufficient to construct one of the most expensive homes in the nation's history.

Funk, 2012)Joseph Prone was the former executive vice president of finance and roomer outside auditor for 31 years with Arthur Andersen ; Co. Though it is common for outside auditors to Jump ship and go in-house at the companies they audit, Person's move was unusual because he was so highly placed at Arthur Andersen. This all piqued the interest of SEC officials, who questioned whether Person's hiring " impaired" Andersen's independence. Ultimately, the SEC was satisfied that Andersen " met the requirements for independence.

Hayes, 2002)Risk Assessment Understanding the Business and the Industry There were multiple factors that contributed to the fall of the GO. Some of them were related to weak corporate culture and governance, but others were related to the saturated market that was going through difficulties due to rapid technological changes. The fast paste of technology change in the telecommunication market and unwise investment decisions by the management of GO and other player led to the fall of some major companies as they relied heavily to fund their major projects such as undersea fiber-optic network through short term and long term financing.

In addition, some companies like Quest and GO started to abuse accounting rules and inflated their revenues and assets with the use Indefeasible Rights of Use (IRU) Swaps in which two telecommunications companies agreed to exchange the rights to use bandwidth on different parts of their fiber-optic networks. While accounting rules debatable allows companies to " treat the two parts of the swap differently, recording the revenue part up front, while deferring the expense leg over time... Global Crossing and other companies were using one portion of a SEC (1999, SEC, 'Staff Accounting Bulletin No. 01') bulletin to Justify up-front recognition of revenues, while using another portion of the bulletin to Justify spreading expenses over time" CITATION Teeth 1 1033 (The Good Auditor-skeptic or Wealth Accumulator? Ethical Lessons Learned from the Arthur Andersen Debacle, 2005). Another factor that was related to the industry was the impact of the Telecommunication Act of 1996 which substantially increased the completion in the " global long distance market by allowing the entry of local exchange carriers" and subsequently leading to overcapacity of fiber-optic networks.

Risk Assessment - Company level GO failure is also related to its weak governance, business execution policies, nonworking internal controls, and unethical management team. The conflict of interests of its audit committee was clear as executives of firms with substantial holdings in the company's stock served on the committee. For example, William Conway, a managing director of the Carlyle Group with 2. 2 million of G's shares created an independence issues as any push by Conway for improved reporting might have led to substantial investment losses by his employer.

The company never asked if anyone needed all of this fiber network, and as there was no market for its age investment so it had to turn to other troubled companies like Quest in the industry to meet its earnings expectations. The company's internal control was weak as we could see that when former Vice Present of Finance, Roy Lollops warned GO in a letter in 2001 about wrong accounting policies, the management ignored him and consequently fired him in the following year. He was critical to the swap contracts as the swaps happened near quarter ends.

G's fraudulent activates worked well until market started to decline in end of 2001 which lead to COG'S stock price to fall to $. 07 in 2002 from $55 in 1999. Prone encouraged employees to design contracts that would appear legitimate. He directed them to create deals so there was " very little payment" that would had to be made. He also forced the sales team to not do any more cash deals CITATION Berea 1 1033 (Barman ; Solomon, 2002). We can see that GO had many other characteristics of a troubled company such as unstable management as 5 Coos were changed in less than five years.

The company also destroyed many key documents in the days before it filed for bankruptcy protection and became a subject of federal investigations CITATION Grata 1033 (Gravelling, 002). All these indicate that the risk of fraud and material misstatement was very high for GO. Assertion Level Risk On the account level, the revenue was very risky due to the industry and G's revenue recognition policies. Company aggressively used swap contracts to book the cash revenue up front as one lump sum, while spreading out the costs of the leased capacity over many years.

As it is presented in the Attachment A, Figure 1, GO sold to companies like Quest a 20-25 year lease on fiber-optic capacity at low rates for $100 million, while Quest sold GO a different IRU for $100 million dollars to basically overstate the revenue whenever they needed to meet the projections CITATION Bribe 1 1033 (Brown, 2002). GO also used Non-GAP measures related to assets and EBITDA (earnings before interest, tax, depreciation, and amortization) to mislead the investors.

By capitalizing the costs it removed the expense from EBITDA calculation, which again shows that there was an elevated risk of fraud and material misstatement related to G's accounts CITATION Teeth 1 1033 (The Good Auditor- Skeptic or Wealth Accumulator? Ethical Lessons Learned from the Arthur Andersen Debacle, 2005). Identifying Fraud Risk from Financial Statements' Analysis: The calculations of indexes related to financial manipulation based on the Beanies Model indicate that the executives of GO were involved in fraudulent transactions prior to bankruptcy in January 2002.

It is important to apply these model to the first year that fraud happened to fully take advantage of this model. This is what makes the fraud detection hard as market observers cannot identify when the company first started to initiate fraud, but a constant monitoring of company's activities can help to detect the read on a timely manner. As indicated in Appendix A, all the indicators for GO was above manipulators and in most cases above indexes related to manipulators. For instance the company had a receivable index of 3. 36 which is higher than 1. 465 mean index of manipulators. This may indicate the existence of factious sales/ receivables or a more liberal credit policy. In addition, it can be a sign that revenue is over stated. This high ratio should trigger an investigation in sales and revenue area. The Asset Quality Index shown in the table is associated with company's cost optimization policies. It measures the proportion of total assets for which the future benefits may be less certain. The G's result of 1 . 70 is higher than the manipulator number of 1. 039 and an investigation is needed as this higher index may be due to intentional inappropriate deferral of costs CITATION 60106 1033 (Golden, Salk, ; Clayton, 2006). Internal Control Internal Control Environment Lack of integrity and ethical values. There should have been an anti-fraud program to prevent any wrongdoing activities like improper revenue reporting and the swap trading GO did with Quest. Board of Directors or audit committee.

The audit committee should have been more cautious on the audit since G's executive vice president for finance is Joseph Prone, a former Arthur Andersen employee who served as partner to GO audits because of his previous experience with Arthur Andersen. Management philosophy and operating style. There is a direct indication that G's management philosophy had much to do with their accounting scandal as management was pushing employees toward revenue misstatements. Moreover, Gray Winning was really into himself. He fired employees who didn't take orders and dad himself surrounded by yes men.

Once he asked a temporary employee if she knew who he was in the elevator. She didn't, so he fired her. Internal Control Assessment " We have significant deficiencies in our internal controls, processes and procedures and may face difficulties in strengthening our internal accounting systems and controls and in our ability to satisfy our financial reporting obligations on a timely basis. " This excerpt taken from the GLIB 10-K filed Mar 16, 2005 and GLIB 10-K filed Mar 16, 2006 Control Activities Performance Reviews.

The management should have reviewed the uncommon or attention fraudulent transactions and activities related personnel's performance to prevent and detect underlying wrongdoing activities. For example, those swap trading with no actual revenue should have been reported by involved staff timely. Information Processing Controls. This control activity is also aiming at preventing and detecting uncommon transactions with suspiciously fraudulent nature. The company should have paid more attention to this control activity so that at least a number of uncommon transactions would have been detected and aborted.

For example, the management should have use specific authorization to examine any transaction with a significant amount of $1 million and over. Physical Controls. The staff should have done physical inspection on a regular basis or on uncommon transactions. For example, there should have been physical inspection of the cash collected or checks received from the swap trading with Quest. Accounting Issues Revenue Recognition From 1997 to 2000, GO took on over $7 billion of debt to build 1. Million miles of fiber-optic cable to transport data in internet linking more than 200 cities in 27 countries in the Americas, Asia and Europe. Due to economic growth slowing down, internet usage was not growing as fast as company management had expected. As a result, company management started to artificially generate revenue by capacity swaps with other companies. For example, GO " sold" $100 million of capacity to Quest Communications, who was also suffering financially, while " buying" an equal amount of capacity from the same firm.

In the transaction, G's cash position did not change because it was an exchange of an asset. However, the company booked $100 million in new sales without offsetting purchase of the capacity as an expense. Instead of Ewing deducted immediately from earnings, the purchase was recorded as a capital investment on the balance sheet, and amortized over several years. Moreover, the traded asset was an unused fiber-optic capacity- known as " dark fiber" - for which there was no demand for years to come. In fact, such swaps accounted for 20% of the total revenue of $3. 2 billion for the second quarter of 2001.

Disclosures GO management did not disclose that its revenues from fiber optic swaps and equipment sales were non-recurring in nature simply because the management knew such disclosure would cause its share price to collapse and call into question TTS ability to service its debts. However, " GAP also requires that information about all investing and financing activities of an enterprise that affect recognized assets or liabilities but that do not result in cash receipts or payments, such as monetary asset exchanges, be disclosed in the footnotes to the financial statements".

Substantive Procedure In 2001 , with business operations looking down, GO began reporting revenue for long term contracts in full at the initiation of the contract, rather than proportionately over its life CITATION Chi 1033 (Chide, 2002). By doing this, revenue was clearly being misstated because revenues were not being reported in the period they were earned.

Analytical Procedure-Rights and obligation assertion Review the long term contract to identify the revenue recognition Inquiry the management for the detail long term contract Inquiry the Board minutes for evidence that the revenue has been recognized in accordance with the contract Compare the revenue amount with the expected amount based on the business operation looking down. Test of Details: Existence---Vouch a sample of sales transaction from the sales Journal to sales invoice back to customer order and service ordered documents.

Valuation and accuracy----compare amounts and terms on a sample of sales invoice with the term to trade to determine whether sales are recorded at the appropriate amount Another instance of improper revenue reporting occurred when GO sold $100 million of telecommunication facilities to Quest Communications International Inc. , in return for a similar valued amount from Quest. Quest did not record this transaction as a sale, however GO did report this as sales revenue despite cash never changing hands CITATION Chi 1033 (Chide, 2002). Analytical procedure

Review the contract with Quest Communications International Inquiry the management and board of directors for the evidence Test of details Existence---confirmation of account receivables with Quest Communications International Inc, Positive confirmation is better here because of higher risk. Invoice back to customer order and service ordered documents. Collect the list of top 10 customers and using unit sampling method to emphasize large items ($100 million) The effect of revenue on the fraud is huge. In 2002, GO restated some of its recent financial statements to reflect " swaps deals" it made with other providers.

Under its restated results, which will affect the nine months ended September 30, 2001 , the company's previously reported revenue of $42 billion for the period would be reduced by $19 million. The company's previously reported net loss of $4. 8 billion would be widened by approximately $13 million. At the same time, the total assets, total liabilities, and shareholders' equity of $25. 5 billion would each be reduced by approximately $1. 2 billion. Its reported net cash provided by operating activities and net cash used in investing activities would be reduced by approximately $770 million, exulting in no change in net cash flow.