Worldcom

The story of a Whistleblower

Arber Lika 465972

Introduction

WorldCom Logo

Cynthia Cooper

WorldCom

Founded
1983

Headquarters moved to Mississippi by Bernie Ebbers (CEO)
1997

25th largest corporate in USA
1999

Uncompleted $129 billion merge with Spring Corporation
5th October 1999

Highest stock price
2000

WorldCom changed their Financial Statements

Earnings began to fall
2001

Fraud Revealed
May 2002

Auditing Committee in Washington DC
24th June 2002

Bankruptcy
25th June 2002

Changed their name to MCI.
14 April 2003

Cynthia Cooper

- Joined WorldCom in the early 1990s.
- Left WorldCom for a short time to work at Sky Tel .
- On the mid – 1990s returned to WorldCom to head up it's audit department.
- **On May and June 2002 she unrevealed WorldCom's $ 3.8 billion fraud that ultimately grew to over $11 billion .**
- On December 2002 , she was named as one of "Person of the year " by Time Magazine , along two other whistleblowers : Sherron Watkins of Enron and Coleen Rowley of FBI.

Fraud Reveal

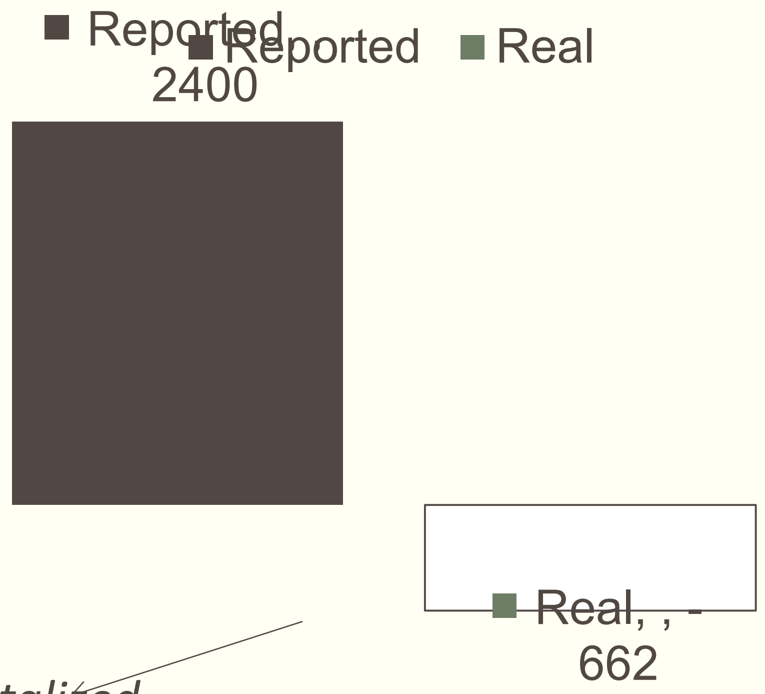
Division's reserve account → $400 M → **Consolidated Income**

She pursued the matter with **Sullivan (WorldCom's CFO)** who told her that there was no problem and that the internal audit shouldn't be focuses on the issue.

→ She approached the external auditors at Arthur **Andersen (same as ENRON)**, who told her that there was no problem at all.

→ After not believing any of them, Cynthia and her team started to investigate on their own.

Fraud Reveal



WorldCom had erroneously capitalized billions of dollars of network lease ***expenses as assets*** *on their books.*

External auditors ***" Arthur Andersen"*** *were covering this by reporting that everything was right.*

Cynthia Cooper’s risks

- Her career.
- Devolution of her investment in WorldCom stock.
- She would experience rejections from other corporates after revealing the fraud.

Fraud Reveal

- **KPMG** replaced **Arthur Andersen (after ENRON fraud was revealed)** as the external auditor.
- The new auditor approved that there were general accounting principles problems .
- On June 24, 2002, Sullivan submitted a three-page memo justifying his accounting treatments.

The expenses, on his view, related to payments for network capacity that would be used in future years as business demand increased and new customers were added to the WorldCom network.

- On June 25, 2002, WorldCom was in bankruptcy.

Cynthia Cooper after the fraud

- She was the key person in the massive federal investigation :
  - As source of information
  - As a potential suspect
- “Very dark place”.
- She continued working for WorldCom (MCI now) for some other years.
- Now she has her own auditing firm.
- On December 2002 , she was named as one of “Person of the year “ by Time Magazine , along two other whistleblowers : Sherron Watkins of Enron and Coleen Rowley of FBI.

WorldCom’s CEO and CFO

Bernie Ebbers (CEO)

- 25 years sentence (to be realized on 2030)
- From $40M he was only left with $50 K.

Scott Sullivan (CFO)

- 5 years sentence (released on 2009 after serving 4 years)

Question 1

- At the time Cynthia Cooper discovered the accounting fraud, WorldCom did not have a whistleblower hotline process in place. Instead, Cynthia took on significant risks when she stepped over Scott Sullivan’s head and notified the audit committee chairman of her findings. Conduct an Internet search to locate a copy of the Sarbanes−Oxley Act of 2002. Summarize the requirements of Section 301.4 of the A.

Answer 1

Each audit committee shall establish procedures for :

- the receipt, retention, and treatment of complaints received by the issuer regarding accounting, internal accounting controls, or auditing matters; and

- the confidential, anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.

Question 2

- Use the Internet to conduct research related to whistleblower processes. Prepare a report summarizing key characteristics for the operation of an effective corporate whistleblower hotline. Be sure to highlight potential pitfalls that should be avoided.

Answer 2

- An effective whistle blowing program must ensure that submissions of complaints related to accounting, internal controls, and auditing are automatically and directly submitted to the audit committee.

- Pitfalls occur whenever the perception of confidentiality or anonymity is breached.
- Employees lose trust in the process, they will no longer feel comfortable submitting potential concerns, so employees must believe that follow-up actions will be taken whenever complaints are submitted.

Question 3

- As Vice President of Internal Audit, Cynthia Cooper reported directly to WorldCom's CFO, Scott Sullivan, and not to the CEO or audit committee. Research professional standards of the Institute of Internal Auditors to identity recommendations for the organizational reporting lines of authority appropriate for an effective internal audit function within an organization.

Answer 3

- International Standards for the Professional Practice of Internal Auditing issued by The Institute of Internal Auditors note that

"The chief audit executive should report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. The internal audit activity should be free from interference in determining the scope of internal auditing, performing work, and communicating results"

Question 4

- Conduct an Internet search to locate a copy of the Sarbanes−Oxley Act of [4] 2002 and summarize the requirements of Section 406 of the Act. Then, search the SEC's web site (www.sec.gov) to locate the SEC's Final Rule: "Disclosure Required by Sections 406 and 407 of the Sarbanes−Oxley Act of 2002 [Release No. 33-8177]. Summarize the SEC's rule related to implementation of the Section 406 requirements?

Answer 4

- **Section 406 of the Sarbanes-Oxley Act of 2002** requires that the SEC issue rules that require a public company to disclose whether the company has adopted a code of ethics and if the company has not, reasons for no such adoption must be disclosed.
- In this section, the term ''code of ethics'' means such standards as are reasonably necessary to promote—
  - (1) honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
  - (2) full, fair, accurate, timely, and understandable disclosure in the periodic reports required to be filed by the issuer; and
  - (3) compliance with applicable governmental rules and regulations.
- ***"Disclosure Required by Sections 406 and 407 of the Sarbanes−Oxley Act of 2002 [Release No. 33-8177]****, requires a public company to* disclose whether it has adopted a code of ethics that applies to the company's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions.

Question 5

- Often the life of a whistleblower involves tremendous ridicule and scrutiny from others, despite doing the “right thing.” Describe your views as to why whistleblowers face tremendous obstacles as a result of bringing the inappropriate actions of others to light.

Answer 5

- Doubts (they doubt their self about what they are claiming)
- No one would like “a spy” ?
- Consequences of their actions. (massive unemployment from the company)
- Wealth loose

Question 6

- Describe the personal characteristics a person should possess to be an effective whistleblower. As you prepare your list, consider whether you think you’ve got what it takes to be a whistleblower.

Answer 6

- Confident.
- Courage to finish what they started.
- Be effective.
- Willing to accept the consequences of their actions.
  - Unemployment
  - Wealth loose
  - Friend loose

Question 7

- Assume that a close family member came to you with information about a potential fraud at his or her employer. Prepare a summary of the advice you would offer as he or she considers taking the information forward.

Answer 7

- Be certain if claims are based on proves or emotional feelings.
- Approach his/her superiors and let them know about your claims.
- End what they started.
- Do everything on legal based.

Question 8

- Conduct an Internet search to locate a copy of the Sarbanes−Oxley Act of 2002. Read and summarize the requirements of Section 302 of the Act. Discuss how those provisions would or would not have deterred the actions of Scott Sullivan, CFO at WorldCom.

Answer 8 1/3

- Section 302 of the Sarbanes-Oxley Act of 2002 requires a public company’s CEO and CFO to certify in each annual and quarterly financial statement report filed with the SEC the following:
- **They have reviewed the report.**
- **That, based on the signing officers’ knowledge, the report does not contain any untrue statements of material fact or omit any material fact necessary to make the report misleading.**
- **The financial statements, based on the officers’ knowledge, are fairly presented.**

Answer 8 2/3

- the signing officers—

a) **are responsible for establishing and maintaining internal controls;**

b) **have designed such internal controls to ensure that material information relating to the issuer and its consolidated subsidiaries is made known to such officers by others within those entities, particularly during the period in which the periodic reports are being prepared;**

c) **have evaluated the effectiveness of the issuer's internal controls as of a date within 90 days prior tithe report; and**

d) **have presented in the report their conclusions about the effectiveness of their internal controls based on their evaluation as of that date;**

Answer 8 3/3

- The signing officers have disclosed to its auditors and the audit committee

a) **All significant deficiencies in the design or operation of internal controls and have identified all material weaknesses identified.**

b) **Any fraud, whether or not material, that involves management or other employees who have a significant role in the company’s internal controls.**

Question 9

- Document your views about the effectiveness of regulatory reforms, such as the Sarbanes–Oxley Act of 2002, in preventing and deterring financial reporting fraud and other unethical actions. Discuss whether you believe the solution for preventing and deterring such acts is more effective through regulation and other legal reforms or through teaching and instruction about moral and ethical values conducted in school, at home, in church, or through other avenues outside legislation.

Answer 9

- Sarbanes−Oxley Act of 2002 should :

1. Give more responsibilities to CEO and CFO, and that would lead to better treatment of financial statements.
2. More strict laws for internal and external auditors.
3. More freedom to internal auditors.

- Ethical values for this case can be teach on financial and economical schools and to make it more effective these values should be controlled by a very stick regulation.

Reference

"WorldCom. The story of a whistleblower" Mark S. Beasley, Frank A. Buckless, Steven M. Glover, Douglas F. Prawitt

http://www.sarbanes-oxley-act.biz
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THANK YOU