AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

WRONG NUMBERS: THE ACCOUNTING PROBLEMS AT WORLDCOM

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

JULY 8, 2002

Printed for the use of the Committee on Financial Services

Serial No. 107–74

U.S. GOVERNMENT PRINTING OFFICE

83–079 PDF WASHINGTON : 2002

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

HOUSE COMMITTEE ON FINANCIAL SERVICES

MICHAEL G. OXLEY, Ohio, *Chairman*

JAMES A. LEACH, Iowa
MARGE ROUKEMA, New Jersey, *Vice Chair*
DOUG BEREUTER, Nebraska
RICHARD H. BAKER, Louisiana
SPENCER BACHUS, Alabama
MICHAEL N. CASTLE, Delaware
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
ROBERT W. NEY, Ohio
BOB BARR, Georgia
SUE W. KELLY, New York
RON PAUL, Texas
PAUL E. GILLMOR, Ohio
CHRISTOPHER COX, California
DAVE WELDON, Florida
JIM RYUN, Kansas
BOB RILEY, Alabama
STEVEN C. LATOURETTE, Ohio
DONALD A. MANZULLO, Illinois
WALTER B. JONES, North Carolina
DOUG OSE, California
JUDY BIGGERT, Illinois
MARK GREEN, Wisconsin
PATRICK J. TOOMEY, Pennsylvania
CHRISTOPHER SHAYS, Connecticut
JOHN B. SHADEGG, Arizona
VITO FOSSELLA, New York
GARY G. MILLER, California
ERIC CANTOR, Virginia
FELIX J. GRUCCI, JR., New York
MELISSA A. HART, Pennsylvania
SHELLEY MOORE CAPITO, West Virginia
MIKE FERGUSON, New Jersey
MIKE ROGERS, Michigan
PATRICK J. TIBERI, Ohio

JOHN J. LAFALCE, New York
BARNEY FRANK, Massachusetts
PAUL E. KANJORSKI, Pennsylvania
MAXINE WATERS, California
CAROLYN B. MALONEY, New York
LUIS V. GUTIERREZ, Illinois
NYDIA M. VELÁZQUEZ, New York
MELVIN L. WATT, North Carolina
GARY L. ACKERMAN, New York
KEN BENTSEN, Texas
JAMES H. MALONEY, Connecticut
DARLENE HOOLEY, Oregon
JULIA CARSON, Indiana
BRAD SHERMAN, California
MAX SANDLIN, Texas
GREGORY W. MEEKS, New York
BARBARA LEE, California
FRANK MASCARA, Pennsylvania
JAY INSLEE, Washington
JANICE D. SCHAKOWSKY, Illinois
DENNIS MOORE, Kansas
CHARLES A. GONZALEZ, Texas
STEPHANIE TUBBS JONES, Ohio
MICHAEL E. CAPUANO, Massachusetts
HAROLD E. FORD JR., Tennessee
RUBÉN HINOJOSA, Texas
KEN LUCAS, Kentucky
RONNIE SHOWS, Mississippi
JOSEPH CROWLEY, New York
WILLIAM LACY CLAY, Missouri
STEVE ISRAEL, New York
MIKE ROSS, Arizona

BERNARD SANDERS, Vermont

Terry Haines, Chief Counsel and Staff Director

CONTENTS

	Page
Hearing held on:	
July 8, 2002	1
Appendix:	
July 8, 2002	153

WITNESSES

MONDAY, JULY 8, 2002

Dick, Melvin, former Senior Global Managing Partner, Technology, Media, and Communications Practice, Arthur Andersen	22
Ebbers, Bernard J., former Chief Executive Officer, WorldCom	20
Grubman, Jack, Telecommunications Analyst, Salomon Smith Barney	24
Roberts, Bert, Chairman of the Board, WorldCom	104
Sidgmore, John, President and Chief Executive Officer, WorldCom	102
Sullivan, Scott, former Chief Financial Officer, WorldCom	21

APPENDIX

Prepared statements:	
Oxley, Hon. Michael G.	154
Capito, Hon. Shelley Moore	156
Clay, Hon. Wm. Lacy	157
Ferguson, Hon. Mike	159
Ford, Hon. Harold E. Jr.,	160
Gillmor, Hon. Paul E.	162
Jones, Stephanie T.	164
Israel, Hon. Steve J.	166
Kanjorski, Hon. Paul E.	168
Moore, Hon. Dennis	170
Ney, Hon. Bob W.	172
Royce, Hon. Ed	174
Sandlin, Hon. Max	176
Sherman, Hon. Brad	178
Waters, Hon. Maxine	179
Dick, Melvin	182
Grubman, Jack	186
Roberts, Bert	195
Sidgmore, John	199

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Baker, Hon. Richard H.:	
E-mail from Jack Grubman regarding SSB Bond Research-WorldCom, Inc. June 24, 2002	206
E-mail from Robert Waldman to Scott Sullivan, June 24, 2002	207
Salomon Smith Barney Clarification on WorldCom Report, June 24, 2002	208
Biggert, Hon. Judy:	
ICG letter (with attachments), July 2, 2002	210
The Telecom Manager's Voice Report, May 20, 2002	217
SEC letter to WorldCom, March 7, 2002	225
Ford, Harold E. Jr.:	
Business Roundtable Statement on Restoring Investor Trust, July 8, 2002	235
"The Free Market Needs New Rules" *New York Times,* July 8, 2002	237

Page

Kanjorski, Hon. Paul E.:
Citigroup letter, July 11, 2002 239
Congressman Kanjorski and Congressman Shays Press Release, Salomon Smith Barney's Initial Response on IPO Allocations to WorldCom Executives, July 12, 2002 241
Letter to Jack B. Grubman, Managing Director, Salomon Smith Barney, July 8, 2002 243
Maloney, Hon. Carolyn B.:
"Account-Ability: WorldCom may not turn Eyes from Ebitda," *Dow Jones Newswire,* June 27, 2002 244
"Inflated Profits in Corporate Books is Half the Story," *Wall Street Journal,* July 2, 2002 245
Sherman, Hon. Brad:
SEC letter dated May 21, 2002 246
Sullivan, Scott:
Arnold & Porter letter, July 8, 2002 247
Arthur Andersen, 2001 Audit Plan and Proposed Fee Arrangements for WorldCom, June 6, 2001 250
Arthur Andersen, Report to the Audit Committee of WorldCom Year Ended December 31, 2001 268
Creative Accounting Chart 285
FCC Chairman Michael K. Powell, *press release,* June 26, 2002 286
Salomon Smith Barney Research Report by Jack Grubman with clarification, June 21, and June 24, 2002 287
SEC press release of Sworn Statement of WorldCom pursuant to Section 21(a)(1) of the Securities Exchange Act of 1934 292
State and Local Pension Plans (WorldCom Losses) Chart 297
WorldCom Insider Sales (1996 to Now) 298
WorlCom Minutes of the Regular Meeting of the Audit Committee of the Board of Directors, February 6, 2002 299
WorldCom Minutes of the Regular Meeting of the Audit Committee of the Board of Directors, March 6, 2002 302
WorldCom Minutes of the Special Meeting of the Board of Directors, April 29, 2002 307
WorldCom Minutes of the Special Meeting of the Board of Directors, May 21, 2002 310
WorldCom Minutes of the Quarterly Meeting of the Board of Directors, May 23, 2002 313
WorldCom Separation Agreement for Bernard J. Ebbers 319
WorldCom Table of Events 326

WRONG NUMBERS: THE ACCOUNTING PROBLEMS AT WORLDCOM

Monday, July 8, 2002

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to call, at 1 p.m., in Room 2128, Rayburn House Office Building, Hon. Michael G. Oxley [chairman of the committee] presiding.

Present: Representatives Oxley, Leach, Roukema, Baker, Bachus, Castle, Royce, Barr, Kelly, Manzullo, Green, Toomey, Shays, Shadegg, Grucci, Hart, Capito, Ferguson, Tiberi, King, Gillmor, Lucas of Oklahoma, Biggert, Cantor, Rogers, LaFalce, Frank, Kanjorski, Waters, Sanders, Maloney of New York, Watt, Ackerman, Bentsen, Maloney of Connecticut, Hooley, Sherman, Sandlin, Meeks, Lee, Inslee, Moore, Gonzalez, Jones of Ohio, Capuano, Ford, Hinojosa, Lucas of Kentucky, Shows, Crowley, Clay and Ross.

Also Present: Representative Wu.

The CHAIRMAN. The committee will come to order. This hearing of the Committee on Financial Services will begin. As you all know, we have a number of witnesses to hear from today. The Chair would strongly urge all Members to submit opening statements for the record in order to allow more time for questioning the witnesses. Without objection, all Members' opening statements will be made part of the record.

The CHAIRMAN. The Chair now recognizes himself for 5 minutes for an opening statement. I would like to begin by thanking my colleagues for returning early from their Independence Day district work period in order to take active roles in this important hearing. On July 4, we celebrated the 226th anniversary of the issuance of the Declaration of Independence, which opened the door to freedom and self-government for Americans and eventually all mankind. We celebrated American ideals such as selflessness, respect for others and obedience to a higher law. We honored the ultimate sacrifice of our heroes who long ago and just last year placed those virtues above self-interest and beyond the temptations of affluence, protecting others instead of themselves.

Unfortunately we must return to the peoples' House today to investigate an historic and outrageous contrast to those ideals and yet another example of the decline of ethics in American culture during the 1990s. The latest company to abuse the public trust is WorldCom. It appears now that senior WorldCom executives deliberately hid almost $4 billion in expenses disguising its true performance in order to keep earnings in line with analysts' estimates.

The announcement of this fraud turned WorldCom from a world beater into a penny stock and forced it to lay off thousands of blameless employees.

If these charges are proven, WorldCom executives who participated in the fraud should have to return any profits from stock sales made during the five quarters of misreported earnings. It would be simply wrong to allow them to profit from criminal behavior. I would note that the committee's corporate and accounting reform legislation, CARTA, which passed this House on a strong bipartisan vote on April 24, includes a disgorgement mechanism for situations like this.

During the telecom boom of the 1990s WorldCom stock was highly prized and was held by State pension funds, institutional investors and millions of average Americans. The stock has plummeted from a high of nearly $65 a share just a few years back. This betrayal to the spirit of the Fourth of July by senior WorldCom managers is so immense that it could cost tens of thousands of workers and average citizens their livelihood and life savings.

How could something like this happen, and what could be done to try to prevent a recurrence? To get the answers we have invited a number of individuals here today who know or should have known what happened. They owe this committee and the public a thorough explanation. Our witnesses include former and current CEOs of WorldCom, its chairman of the board of directors, its former chief financial officer, its former comptroller, the Arthur Andersen partner in charge of the WorldCom audit, and Jack Grubman, a telecom analyst from Citigroup's Salomon Smith Barney unit who had an unusually close relationship with WorldCom executives and was for years WorldCom's biggest advocate on Wall Street.

In the committee's ongoing inquiry into the research practices of equity analysts, we want to explore the nature of these relationships and try to determine whether Mr. Grubman's failure to recommend that investors sell their WorldCom stock until it became virtually worthless can be explained by the hundreds of millions of dollars in underwriting fees that his firm collected from WorldCom. In the late 1990s, many so-called experts proclaimed there was virtually unlimited potential for telecommunication companies to carry high-speed data over their fiber optic networks. As we have seen recently with the difficulties experienced by Global Crossing and others, that demand did not materialize.

During my two decades of service in this House, I worked on telecommunications issues of all kinds. It was long ago clear to me that the value of a robust, competitive telecommunications environment is met through America's economy and our continued role in the forefront of the world marketplace. While different companies dealt with a changed market reality in a variety of ways, none as yet has shown the audacity to commit fraud on a scale that has been alleged here.

I am hopeful that we will be able to learn a great deal from our witnesses today. At the same time I am also aware that the concurrent investigations by the SEC and the Department of Justice will continue, as will this committee's efforts, until a loud, clear message has been sent that accounting fraud and all businesses' ille-

galities will simply not be tolerated. I fully expect the results of the investigations of the SEC and the Justice Department to return to the American public the confidence needed to invest in America's telecommunications companies and other industries.

On Wednesday our committee agreed to a request from the Justice Department to assist them by not calling Ms. Cynthia Cooper, vice president for internal audits for WorldCom, and Mr. Max Bobbitt, a member of WorldCom's board of directors and chairman of its audit committee, to testify today.

The thousands of fired WorldCom employees who face an unknown future and the millions of investors who lost so much of their retirement savings all apparently due to the greed and selfishness of a few rich insiders demand that we engage in a search for truth and justice. And make no mistake, the consequences of this sort of criminal activity should it be proved should be severe, and it may mean time in Federal prison.

From the Founding Fathers to the heroes of 9/11 to our soldiers fighting the war against terrorism, Americans have always proven themselves willing to take risk and do so in an honest and forthright manner. Today we urge corporate America to live up to those ideals.

[The prepared statement of Hon. Michael G. Oxley can be found on page 154 in the appendix.]

The CHAIRMAN. The Chair's time is expired, and the Chair recognizes the Ranking Member, the gentleman from New York, Mr. LaFalce for an opening statement.

Mr. LAFALCE. I thank the Chair. Once again, our committee is beginning an inquiry into fraudulent accounting practices at a major United States corporation. This time the company being investigated is WorldCom. Even after the string of revelations and failures that we have suffered through over the past year and a half, the magnitude of WorldCom's deception is staggering. The disclosure that WorldCom had improperly accounted for $3.8 billion in expenses sets yet another new record for the largest corporate financial restatement. This news dealt a profound blow to market confidence, one that threatens to undermine a sustained recovery of our markets and our economy.

No more proof should be needed that Enron, Global Crossing and others using deceptive accounting practices were not aberrations. Earnings manipulation has become all too common a practice amongst our publicly traded companies, both large and small. The simplicity and the audacity of the deception at WorldCom provides ample evidence of a profound change in culture within our publicly traded corporations. The imperative of meeting analysts' quarterly projections has trumped the interests of shareholders and indeed threatened the long-term prospects of the companies themselves. The safeguards we have relied upon to protect investors have failed at every level. Auditors, audit companies and boards of directors have not been able to provide the protections to which shareholders are entitled, and the markets alone cannot provide change of the magnitude needed to restore these safeguards.

There is an urgent need for strong and reasoned legislation to restore the market confidence that has been squandered by greed, incompetence, fraud and weak regulation. This committee squan-

dered our earlier opportunity to craft legislation that would truly address the systemic problems we have seen, producing only a weak bill that included no real reform. Today, however, the Senate will begin floor debate on a much stronger bipartisan bill produced by the Senate Banking Committee, a bill with many provisions quite similar to those we advanced both in committee and on the House floor and that were rejected on basically a party-line vote. Our hearings today should provide impetus to us to deepen our resolve and strengthen the House approach, and I hope the Senate will strengthen the Sarbanes bill, making it even more similar to ours, and then pass it expeditiously.

To provide the reform we need, legislation must at a minimum, one, create a tough public regulator for auditors; two, strengthen corporate governance; three, ensure that corporate executives are held responsible for their actions; four, restore the independence of auditors; and five, eliminate the conflicts of interest faced by securities analysts.

I look forward to going to conference and to enacting a strong bill that addresses all of these vital concerns. I look forward to President Bush's speech tomorrow where I hope after a year and a half he will finally join with us in trying to effectuate these reforms. Given the impact that each new revelation of accounting fraud has had on our markets, we cannot afford delay. Our country and our markets are looking to us to enact meaningful, not cosmetic, reform, and the health of our economy depends on our efforts.

I thank the Chair.

The CHAIRMAN. The gentleman's time has expired. Other Members seeking to give an opening statement?

Gentleman from Iowa Mr. Leach is recognized for that purpose.

Mr. LEACH. Thank you, Mr. Chairman.

The issue of the year is moral clarity. In international affairs the President suggested that there are tactics such as terrorism which civilized societies cannot countenance. Likewise with corporate governance.

Moral clarity requires that CEOs of public corporations not put personal interests above shareholder values. To put it plainly, it is self-dealing for a corporate head to give himself a multi-$100 million loan, and it is a dereliction of duty for a board to go along.

Moral clarity requires that certified public accountants make clear that 2 minus 3 doesn't equal plus 1. If there is no confidence in numbers, there can be no confidence in our market system.

Moral clarity requires that investment advisers shed conflicts of interests. Trust based on independence of judgment must be the bottom line.

Moral clarity requires that American corporations abide by American law and regulation and not be allowed to seek shelters from taxes and rules to protect the public by removing assets to lax regulatory jurisdictions and offshore tax havens. Companies can't have it both ways, the protection of our government and the stability of our market system, without the responsibility to shoulder a share of the cost of maintaining a free society based on the rule of law.

Moral clarity requires that Congress, the peoples' body, shine the spotlight of accountability on wrongdoing and establish the institu-

tional means to reestablish trust in our system. A small but significant step this Committee could take is to insist on the merger of the SEC and the Commodity Future Trading Commission (CFTC.) If people think there is a case for a new Department of Homeland Security because the FBI and CIA do not communicate well, the case for regulatory streamlining is even more compelling. White collar crime committed by company officers under a corporate veil must be pursued as vigorously as common street crime. Indeed, because trust in the system is at stake, white collar crime must be pursued more vigorously.

Finally although this is not a WorldCom issue, Congress is obligated to pass legislation to ensure that derivative contracts are automatically netted in the event of bankruptcy. One of the lessons of the past few months is the rapidity with which significant companies can falter. Laws must be put in place which assure systemic stability as well as require individual accountability.

Moral clarity requires that we both look and that we act.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from Massachusetts is recognized.

Mr. FRANK. I pass.

The CHAIRMAN. The gentleman passes.

The Chair would indicate that a number of Members wishing to give opening statements—and I have had some conversations with the Ranking Minority Member—if it would please the committee, we would limit the opening statements to 2 minutes—and—let me finish—and the Chair then would be pleased then to be generous with the 5 minutes for questions. I think that would allow us to get our statements on the record as well as get to questions for the panel.

Gentlelady from California.

Ms. WATERS. Mr. Chairman, I respect the fact that this is a large committee, and you have to do everything that you can to manage it. However, we are confronted with one of the biggest problems facing America. We are besieged with comments and questions from our constituents, and people are asking what do we feel, what are we going to do. And I intend to use this time to put on the record in a very clear and certain way exactly how I feel, what I intend to do about it. I think it is important that we have the 5 minutes that you would normally give to all of the members of this committee who wish to have it.

The CHAIRMAN. The gentlelady yield back?

Ms. WATERS. Yield back the balance of my time.

The CHAIRMAN. The gentleman from New York.

Mr. LAFALCE. You and I did have a prior conversation when I indicated that I could understand the rationale behind your desire to have Members voluntarily go along with the 2 minutes, and if the Members could go along with the 2 minutes voluntarily, I think it could be good because it is still going to be an hour and a half before we get to the panelists if we just speak 2 minutes apiece. But if some Members such as Mrs. Waters believe they must take longer, I would hope the Chair would be able to make an exception.

The CHAIRMAN. We will try to accommodate the Members.

Further opening statements. The gentleman from Louisiana?

The gentleman from Pennsylvania.

Mr. KANJORSKI. Mr. Chairman, we meet yet again to examine the legal problems plaguing America's corporations. As more and more scandals have come to light in recent months, the business section of our newspapers have read more and more like the crime page. WorldCom's recent announcement that it overstated its earnings by at least $3.8 billion in 2001 and in the first quarter of 2002 is only one of the latest examples of this unacceptable behavior.

With the revelations of WorldCom's questionable accounting practices, it has become increasingly apparent that these scandals do not result from some idle mistakes or a few fraudulent acts. For me the WorldCom deceit is just the latest development to make clear that there is a systemic problem with accounting irregularities, executive abuse, and corporate governance and misconduct in our country's securities markets. It also greatly troubles me how so many corporate insiders, outside auditors, investment bankers, research analysts and countless others could miss the simple, yet staggering accounting deception.

The corporate misdeeds at WorldCom, Tyco, Adelphia, Rite-Aid, Exxon, Global Crossing and Enron have also challenged the credibility of corporate financial reporting systems. Congress must therefore take strong, decisive and quick action to bolster investor confidence. Only a strong law will restore confidence in the integrity of the market, protect our hard-earned investments made by millions of middle-class Americans.

Accordingly, I hope the Senate will pass a strong corporate accountability bill in the coming days. We must hold corporate executives accountable, enhance the independence of auditors, improve oversight of the accounting profession, and end stock analysts' conflicts of interest. Before the August recess we must send to the President's desk legislation that is much stronger than the weak bill passed by the House in April.

Moreover, as we work to hold America's corporate leaders accountable, we hope that our Nation's top executive will take accountability within his own White House. In recent days we have heard much about President Bush's repeated failing to file timely reports with the SEC regarding his insider sale of Harken energy stock in the early 1990s. His staff has unfortunately analogized these late filings as getting caught driving 60 miles per hour in a 55-mile-an-hour zone. Nevertheless I hope the President in his speech tomorrow will refute his aides' careless dismissal of the SEC rules. If the President seriously wants to strengthen corporate accountability, he needs to send a message that everyone must follow the law. We cannot allow the environment of permissive attitudes toward enforcing our country's securities regulations to continue.

In closing, Mr. Chairman, investors expect to be able to trust the information the companies provide to them. Congress must therefore examine what went wrong at WorldCom and other companies to restore investor trust and protect our Nation's overall economic health. Congress must also quickly pass, the President must sign, real corporate accountability reform. I will continue working toward that important goal.

The CHAIRMAN. I thank the gentleman's cooperation.

[The prepared statement of Hon. Paul E. Kanjorski can be found on page 168 in the appendix.]

The CHAIRMAN. Gentleman from Louisiana, Mr. Baker, chairman of the Capital Market Subcommittee.

Mr. BAKER. Thank you, Mr. Chairman, for calling this important hearing. The circumstances which bring us to this point today were actually unimaginable 12 months ago in that a series of Fortune 500 corporations could fall precipitously to ashes after recurring revelations of corporate mismanagement. The amazing fact, in my opinion, is that in this aftermath, our capital markets remain sound, and the economic fabric has not been torn, although I do believe it needs a pretty good washing.

It is clear that this committee's responsibility is to act and to examine all of the consumer protections that seemed to have failed in these instances. In this effort, however, we should recognize we have the obligation not to make matters worse. In drafting reform we should not construct rules so that capital markets cannot function efficiently. We cannot ensure that no one ever experiences a loss. Investing is inherently risky. Companies do succeed, but companies fail. The end product of this process should be a plan that provides accurate, real-time information to investors and shareholders to enable confident decision-making. All the material facts relevant to the true financial condition of a company should be made available in a real-time manner in a valid reporting system for all market participants.

The benefits of such a system are multiple, but two principal ones are clear: real transparency that yields investor confidence, and dramatic reduction in market volatility that exists today when management attempts to beat the street with 90-day earnings estimates.

When any part of the capital market system fails to meet professional standards of conduct, there should be clear, decisive action to punish those responsible. Providing the SEC with the necessary resources to pursue enforcement action is an essential part of the reform, but it is not necessary to create an entirely new agency with new budgets to perform the task.

We only recently have succeeded in passing legislation to bring about pay parity for the SEC. FASB today still relies principally on the sales of reports and publications to generate the funds for its operation. Critical resources should be utilized in the most efficient manner possible through the experience and enforcement staff of the SEC. Any proposal to build additional agencies for the purpose of performing the work of that agency just doesn't make financial or common sense.

In the course of this examination today, disclosures should be made that are helpful to the committee's work and understanding where the rules were inadequate or where professional decision-making failed. It is increasingly clear reform of major proportion is required. It is not clear, at least to me, that every CEO, every accountant, every analyst, every broker or investment banker is a crook.

We should legislate to minimize the opportunity for aberrant actors to manipulate the system with impunity while facilitating the orderly conduct of the most vibrant capital market in the world.

There are many ways to that end. The SEC and other regulators have accomplished much in the past 6 months. This committee's own action with regard to rules governing analyst conduct issued last fall was an important step forward. I am hopeful when the Senate concludes the work on this subject this week, a productive conference can be initiated that will lead to a bill we can all support.

In the end it is to no one's advantage to have continued restatements of financial condition or, worse, business failures resulting from any inappropriate or unprofessional conduct. What is even more troubling to me, however, is that a corporation may comply with all the current disclosure requirements, be examined by a competent firm, reviewed by all the market analysts, and be found to be compliant with all the rules while at the same time have material underlying financial deterioration that is not observable with the current disclosure requirements. This must change.

Today it will be unfortunate indeed if our invited witnesses choose not to be forthcoming in responding to inquiries of the committee. Withholding critical information from the Congress will only exacerbate expedient resolution, strengthen our resolve to achieve our goal, and ultimately bring about criminal penalties for those who abuse their corporate authority. Corporate management does work for shareholders, but shareholders are our constituents to whom we have a high obligation to ensure they receive fair treatment.

I thank you, Mr. Chairman, for your continuing leadership on this important matter.

The CHAIRMAN. Gentleman's time has expired. Further opening statements?

The gentlelady from California Ms. Waters.

Ms. WATERS. Thank you very much, Mr. Chairman. I sincerely thank you for calling this hearing, and I really do appreciate your patience in allowing me and other Members to take the time that we need in order to give our opinion about what is going on.

Americans are watching and waiting to see if the Members of Congress are going to get serious about investigating corporate crime and supporting tough legislation to prevent the corporate fraud schemes we have seen unveiled in recent weeks. WorldCom, Incorporated, joins a growing list of corporations accused of wrongdoing and criminal activities, Enron, Arthur Andersen, Tyco International, Adelphia Communications, Rite-Aid, Global Crossing, Xerox and more to come, corporations whose executives stand accused of abuse of stock options, sweetheart loans, conflict of interest, excessive compensation and severance pay, and now the Securities and Exchange Commission has filed a fraud lawsuit in Federal court against WorldCom, Incorporated. This suit alleges WorldCom, Incorporated, was directed and approved by top managers to keep earnings in line with Wall Street expectations and to support WorldCom stock prices.

In essence, WorldCom has revealed they inflated their books by $3.9 billion. They treated ongoing operating costs as capital investments. They reduced their operating expenses, that is, the costs they paid to other carriers for using their networks, by spreading the costs into the future. This improper accounting is no error, no

mistake. It is calculated to enhance the company's net income and to hike its earnings before interest, depreciation, taxes and amortization. This made WorldCom appear healthier than it was and thus more attractive to investors.

A syndicate of banks holds $2.6 billion in unsecured loans and bondholders about $30 billion of WorldCom bonds, all of which are in jeopardy. The banks could call in their loans, and the WorldCom bonds could be thrown into default. My own State of California public employee retirement pension funds could lose approximately $580 million. WorldCom could easily file the largest bankruptcy in history. The impact of such a bankruptcy will be felt around the world. Aside from the 17,000 WorldCom employees, thousand of employees in related industries could be laid off. Thousands of pensioners could lose their pensions, and the damage to our economy is incalculable.

This cowboy capitalism must stop. The President of the United States cannot simply treat this as damage control for its future election of stump speech with the right sound bites is not good enough. The President of the United States must support tough legislation, and he must use the power of the White House to get the support of the usual course of defenders of the megathieves of corporations to vote to live up to their tough on crime rhetoric with mandatory minimum sentences.

The shameful corporate culture of old boy relationships where major banks led by Citigroup, with J.P. Morgan, Bank of America, Fleet Boston, Bank One and Wells Fargo, made billions of dollars of uncapitalized loans to WorldCom without any due diligence, but at the same time cannot find in their corporate hearts a way to provide home mortgages to working families to own a home, and it is disgusting.

The analyst, Mr. Jack Grubman from Salomon Smith Barney, with close ties to WorldCom—and, by the way, he refers to close ties and conflict of interest as synergy—is the one who recommended WorldCom as a good investment while WorldCom was on the brink of collapse, and he should be indicted. The founder Mr. Ebbers, the board of directors, and certainly the auditor of the now infamous Arthur Andersen should have known and should be held responsible. Mr. Sullivan committed the simplest, most easily detectable accounting fraud. He lied about operating costs, his debt, and is still trying to justify operating costs as capital costs. Everyone should have known, and I believe they did know.

I was alerted that the principals we have here today will take the Fifth Amendment, and that is their constitutional right to do so. However, I expect the Justice Department to determine if there was a conspiracy to commit fraud. I expect the Justice Department to go after WorldCom's auditor, the consistently insider conflict of interest wrongdoer Arthur Andersen, once again. I expect Mr. Sullivan to return the $10 million retention bonus given to him. And I expect the SEC and the Justice Department to delve into the sale of his WorldCom stock to determine if he benefited from the inflated stock prices that he created.

The CHAIRMAN. The gentlelady's time has expired. I Wish to wrap up.

Ms. WATERS. Fraudulent accounting practices even at the risk of jeopardizing the completion of his multimillion-dollar mansion.

I expect the Justice Department to examine Mr. Ebbers' WorldCom loans and stock options to determine if he benefited from the cooking of the books.

I demand the SEC to exercise its authority to getting to the details of the WorldCom fraud. What other operating expenses have been reported as capital expense? How can we protect the pensioners, and how will MCI and other customers be protected?

The immoral and unconscionable practices of corporate America have been festering for a long time. Corporate America in general and some particular corporations such as Enron and WorldCom have gained power and influence by their connection to politicians by the way of campaign contributions and cozy relationships. These—

The CHAIRMAN. The gentlelady's 6 minutes have expired.

Ms. WATERS. Unanimous consent for 30 seconds.

Mr. GREEN. I object.

The CHAIRMAN. Gentleman objects. Let me indicate the gentlelady can submit the rest of her written statement for the record, as all Members may do.

[The prepared statement of Hon. Maxine Waters can be found on page 179 in the appendix.]

The CHAIRMAN. The Chair now recognizes the gentleman from Alabama.

Mr. BACHUS. Thank you Mr. Chairman.

What this hearing and the Enron hearing and all these hearings really boil down to is the accuracy of financial and accounting records. The American people need to have the confidence that those records are accurate, and that—and if they don't have that confidence, it actually undermines something that I am a strong advocate and supporter of, and that is our capitalistic system.

Now, the word "capitalism" has taken a beating in the past several months, as has "free market." And, in fact, there are some in this Congress who would use this opportunity to undermine our capitalistic system and our free market system. We can't allow that to happen, and the best way not to allow that to happen is for us to be vigilant in defending capitalism, but also vigilant in rooting out the excesses and rooting out wrongdoing, and that primarily will have to be the job of the Securities and Exchange Commission, not of this Congress. It is the Securities and Exchange Commission that will do the investigations.

And because of the urgency of the matter, there cannot be any sacred cow. We have to do everything we can do to effectively restore the confidence of the American people. In that regard, Chairman Pitt is an honest man, he is a good man, he is a capable man, and I think he has done a good job at the Securities and Exchange Commission. However, I will say that there is now some question over whether he is the right person and this is the right time for him to be Chairman of the Securities and Exchange Commission. I say that as a supporter of the Bush administration. I say that as a supporter of the job he has done. But we have to have someone heading up that agency that does not have to recuse themselves in

over half the cases that are at the Securities and Exchange Commission.

We can defend capitalism, we can defend the administration, and we can defend the honor of Harvey Pitt and still ask that question.

The CHAIRMAN. Gentleman's time has expired.

The gentleman from Vermont.

Mr. SANDLIN. Thank you, Mr. Chairman, and thank you for holding this important hearing. I look forward to the question period, but would like to make a more general statement at this time.

We are here today no doubt to be absolutely shocked again and disturbed again that WorldCom has apparently cooked the books with the help of Arthur Andersen to the tune of some 3.9 billion. A few months ago we were absolutely shocked and disturbed of Enron's nefarious ways. We are also shocked at Xerox, Global Crossing, Adelphia and Tyco. And I suppose that we are also shocked that, according to the Huron Consulting Group, over the past 5 years nearly 1,000 companies were forced to correct their financial statements.

The two important questions that we have to address today and in the future are, first, what is going on in our country today that allows for the kind of corporate thievery and deception that we are seeing; and secondly, what are we in Congress really beyond sound bites going to do about it? How do we change the culture in this country and the role of Congress and the White House so that we put an end once and for all to this outrageous corporate behavior that we are seeing?

Let's talk a little bit about general culture. Last month, as you know, Mr. Chairman, the Republican Party held a fund raiser here in Washington and in one night raised $33 million from some of the largest corporations and wealthiest individuals in this country. And in truth the Democratic Party has had similar type of events. It is no secret to any American that the wealthy and the powerful, because of their campaign contributions, have enormous influence over the political process that goes on here. Why else would they contribute hundreds of millions of dollars to the President, to the chairmen of congressional committees and to most of the Members in Congress?

So number one, Mr. Chairman, before we lecture those guys, let us have the honesty to do the right thing and to call for real campaign finance reform so that this institution does not get swamped with money that comes from the wealthy and the powerful. Let us limit the amount of money that can be collected and spent on elections and let us move toward a public funding of elections.

Secondly, through words and legislation, Congress must make it very clear to corporate America that the kind of outrageous greed that we are seeing there cannot form the basis for a healthy society or a stable economy. Forget for a moment the scandals that we are dealing with today. Let everybody know today that without these scandals, the average CEO of a major corporation is earning 500 times what the workers in those companies are earning. Today while CEOs pocket tens of millions in salaries, bonuses, golden parachutes and other benefits, they cut back on the wages, health care and pensions of their workers. The result is that the people on top earn obscene sums of money while millions of workers are

working longer hours for lower wages than they were 20 years ago. The wealthiest 1 percent of the population today, including those gentlemen, now earn, own more wealth than the bottom 95 percent. And because of government inaction, while the rich get richer, our veterans can't get the health care they need at the VA hospital, our kids aren't getting the education that they need, our seniors are not getting prescription drugs, and on and on it goes.

[The prepared statement of Hon. Max Sandlin can be found on page 176 in the appendix.]

The CHAIRMAN. Gentleman's time has expired. Gentleman from Illinois Mr. Manzullo.

Mr. MANZULLO. Thank you, Mr. Chairman.

Every situation has a face to it, and the congressional district that I represent, Rockford, Illinois, there are 1,000 faces. These are the employees at the MCI in Rockford, Illinois, who are watching this on C-SPAN back home, hoping and praying that as a result of what has happened to the corporate hierarchy, that they will retain their jobs. Rockford, Illinois, has unemployment at 8 percent, a city that has been savaged by a real hit to the manufacturing sector, and a city that in 1981 led the Nation in unemployment at 25.9 percent. But to the 1,000 families out of a city of 150,000 people, they are the ones we should be talking about. They are the ones that we ultimately should be concerned about. It is their lives, their families.

MCI in Rockford is the largest minority employer in the northern part of the State of Illinois. What they are doing at that center is nothing less than miraculous. As they come in there, this is the opportunity for people to become entrepreneurs and earn high commission-based salaries. When they change shifts, the people that come into work are as happy as those that are leaving work, high five, shouts of exclamation, people really enjoying working, enjoying the spirit of freedom and entrepreneurship. It is to their interests that ultimately we should look. They are the ones who are the innocent victims.

The CHAIRMAN. Gentleman yields back.

Are there further opening statements?

The gentlelady from New York.

Mrs. MALONEY OF NEW YORK. Thank you, Mr. Chairman.

As our constituents view this hearing today, they are rightfully outraged. This time the company's name is WorldCom, and the damage is the evaporation of 150 billion in stock market value, the layoff of tens of thousands of innocent workers, 300 million in losses for New York State's pension funds, and yet another damaging blow to the overall reputation of American business.

United States' markets are based on trust. Investors around the world seek out this country because we are usually honest, transparent and a safe haven where rules are enforced. From the facts we now have, it appears that several of our witnesses epitomized the absence of ethical behavior that is plaguing some companies in our country.

As a Congress, it is our job to recognize the recurring series of real and apparent conflicts of interest in the recent scandals. Clearly the Sarbanes bill in the Senate addresses these conflicts—some of these conflicts, and I hope it will pass the Senate and the House

and be enacted into law. It recognizes that we need to separate auditing and consulting and to create an independent oversight board with real powers. We need to address the independence and ethics of stock analysts and corporate boards of directors.

At Enron members of the board were compensated $350,000 a year to rubber-stamp management's proposals that allowed the company to hide its true financial condition off the books. The WorldCom board allowed hundreds of millions of low-interest loans to Mr. Ebbers. While it is uncertain exactly what the Enron board did to earn its money, it did approve a very high-minded book on its code of ethics, and I have it here, and it is on the Internet, and it talks about their high standards of honesty. Yet this board took the unusual step of overwriting their own code of ethics to approve some of their financial deals. So we clearly need steps to strengthen corporate governance and the independence of boards.

I for one would like to hear more from the honest CEOs, CFOs, managers and workers in our country about ways that we can improve the system so that this does not happen again and damage workers, damage pensions, damage the trust in the American system. I really believe the real strength of our system is the trust that people have in our financial markets and our management, and it has been severely damaged by the actions of some companies.

The CHAIRMAN. Gentlelady's time has expired.

Mrs. MALONEY OF NEW YORK. I would like to end with something very positive, because we still have to remember, Mr. Chairman, that we have the deepest and the strongest financial market in the world, and we need to keep it that way, and we need to take the steps to correct the wrongs that have happened. Thank you.

The CHAIRMAN. Further opening statements?

The gentleman from Wisconsin Mr. Green?

Mr. GREEN. Just like you I eagerly await the testimony from our witnesses and the questions of those witnesses, and as such I'll submit any comments I have for the record.

The CHAIRMAN. Other opening statements?

Gentleman from California Mr. Sherman.

Mr. SHERMAN. Mr. Chairman, I have little fear that we will hear big rhetoric on this issue, but my fear is that we will take tiny action, and then with the audacity that would make David Duncan blush will announce that we've solved the problem.

There are many ideas on how to strengthen the system. I would like to bring to the committee's attention two new ones and two old ones. The first new one is that perhaps the top 1,000 companies should be audited every 6 months instead of every year. This would only modestly increase audit costs. The world operates more than twice as fast as it did when the 1933 Securities Act was adopted, and I think WorldCom might have found it more difficult to misstate five different quarters if they had been audited every other quarter.

Second, we ought to have a way of certifying as independent those stock analysts who do not work for investment banking firms and get no compensation from underwriters, consultants or issuers. Now, anyone can pontificate on the value of a stock, but perhaps investors would learn to trust those who do not have their bread

buttered by those who would like to see only positive results or positive recommendations.

Mr. Chairman, this committee rejected on a rather close vote, one vote, instructing the SEC to read the filings of the top 1,000 companies, and instead we passed a provision saying it was the sense of Congress that the SEC do so, but we are not instructing them to do so. This suggestion has been reacted to with great hostility by Chairman Pitt, who as of yet has not resigned. Chairman Pitt not only hates the idea, or virtually any idea, but he has reneged on his promise to this committee to even provide a cost estimate for that concept.

Second, WorldCom is another Arthur Andersen client.

The CHAIRMAN. Gentleman's time has expired.

Mr. SHERMAN. Perhaps we ought to look at the structure of Arthur Andersen, as Mr. Tauzin did on the morning shows yesterday, and we'll find the need for reform there.

[The prepared statement of Hon. Brad Sherman can be found on page 178 in the appendix.]

The CHAIRMAN. Is there further—gentleman from Connecticut Mr. Shays.

Mr. SHAYS. When we looked at Enron, every part of this system seemed to fail, and almost everyone connected with the system, the board of directors, the management, the employees who had knowledge of bad practices, the rating agencies, the banks, the investment houses, auditors, law firms, consultants, regulators. So now we look at WorldCom, and we are going to be looking at other companies in the future. When E.F. Hutton used bogus movement of funds, they were fined, and no one served time in jail.

I represent one of the richest districts, a district that has a lot of the important folk who seem to run our businesses, and they as well as the poorest in my communities have all come to me and said, you have all the laws on the books, enforce them. We need regulators who enforce them, regulators who don't have to recuse themselves. But ultimately they all ask this: Could some of these crooks spend time in jail?

The CHAIRMAN. Gentleman's time has expired.

Further—gentleman from Washington State Mr. Inslee?

Mr. INSLEE. Thank you, Mr. Chair.

Strikes me that at this moment of substantial risk to our whole economic system, that we owe the people something more than weak tea. And when you think about it, this is sort of a Teddy Roosevelt moment, and Teddy Roosevelt did not say, speak loudly and carry a small twig.

When I went home this week, the sounds I heard were not just firecrackers, but there were people who were outraged not just at the culprit sculduggery that's going on, but also at the House and the administration who has given them nothing but weak tea to date, and I would suggest we need perhaps fewer speeches and more action.

I am going to suggest too, Mr. Chairman, that we need to see in the next 24 hours in this country. Number one, the President of the United States needs to ask for Mr. Pitt's resignation, and he needs to do that because this country right now needs an agent of change, not someone you have to drag kicking and screaming every time

you want to regulate in the most modest way one of his former clients. We need something of a cop that doesn't take 6 months to figure out how to define armed robbery. We need somebody more like Eliot Ness and less like Barney Fife on this important job when the whole economic system is in question with confidence in our financial markets right now.

Number two, it is not just the administration that needs to get serious. This committee needs to get serious.Mr. Chairman, I would ask you to reconvene this committee not just for a hearing, but for an action, for a vote to revote that pathetically ineffectual bill that we sent over to the Senate when we voted on it April 11 when we had a lot of my good friends on the Republican side of the aisle who refused to understand how systemic, how broad, how deep, how threatened this problem is, who voted time and time again against meaningful reform, against having a really, truly independent accountancy board.

The CHAIRMAN. Gentleman's time has expired.

Mr. INSLEE. Mr. Chairman, I think you need to call a revote. Since April 11 this is a new world, and I hope some of my Republican friends decide to be more like Teddy Roosevelt, less like some other folks who haven't done the job and haven't cut the mustard.

The CHAIRMAN. Gentleman from California Mr. Royce.

Mr. ROYCE. Thank you, Mr. Chairman.

Today this committee has been summoned to address a 3.8 billion misstatement of earnings at WorldCom through 2001 and the first quarter of 2002. This restatement at WorldCom marks for us yet another example in a seemingly endless parade of corporate accounting scandals in which corporate managers are found to have manipulated financial data, and are found to have enriched themselves by hundreds of millions of dollars, while leaving shareholders to suffer the consequences when the truth about their company's financial health finally becomes public.

The same culture of deceit and self-interested behavior by management that contributed to the demise of Enron, that contributed to Global Crossing's problems also appears to have afflicted the management at WorldCom. Executives who engage in this type of deceit should be divested of their ill-gotten gains. I note that WorldCom filed a lawsuit on Friday seeking to reclaim a $10 million bonus given to its former CFO.

Earlier this year I asked SEC Chairman Harvey Pitt when he appeared before this committee if there were mechanisms available to the SEC that would allow him to effectively prosecute and to collect and return for the benefit of shareholders all corporate managers' compensation obtained through misconduct. That compensation obtained through misconduct should be returned to the shareholders. He indicated that there were. He indicated that he would do that. Well, his job will hinge on whether he demonstrates the capability to accomplish this task.

Now, the President will disclose tomorrow a new requirement that top executives personally certify that their companies' public financial reports are accurate. If this certification should prove false, if there are self-dealings, they should go to jail.

[The prepared statement of Hon. Ed Royce can be found on page 174 in the appendix.]

The CHAIRMAN. Gentleman's time has expired.

The gentleman from Oregon Ms. Hooley.

Ms. HOOLEY. Thank you, Mr. Chair.

So many scandals, so little time. The list of corporate greed running rampant and unchecked by the government grows everyday. Look no further than the front page of today's Wall Street Journal over the last 3 years. Merck booked 12.4 billion in revenues it never received. In Oregon, 2,000 employees lost their pension because of Enron.

I could go on and on, but this is the bottom line: This committee and this committee alone has the responsibility to not only find out who knew what in the WorldCom scandal, but to actually legislate solutions to the deficiencies that have brought us here today. If fire walls need to be implemented, if new accounting rules must be promulgated, if executives need to be held liable for their executive business decisions, we need to get moving. It is painfully obvious that reform is needed. Until we do so, investor behavior will rightfully be tepid and unpredictable, which, as you undoubtedly will agree, is the last thing this economy needs as it strains to throw off the effects of last year's recession.

We need to get this done now, and we need to do it right, and I yield back the remainder of my time.

The CHAIRMAN. Further opening statements?

The gentlelady from Illinois Mrs. Biggert.

Mrs. BIGGERT. Thank you, Mr. Chairman.

On the brink of the biggest bankruptcy court filing in U.S. history, and in the wake of yet another announcement today that a company cooked its books to inflate its profits, an advertisement appeared in the Washington Post which I think best sums up the sentiments of the investors and employees across America: Enough is enough. When even one corporate leader betrays the trust of his or her employees and the millions of Americans who invest their future on Wall Street, it erodes the strength of our capital markets, it erodes trust in the foundations of capitalism, and it unnecessarily puts our economy at risk.

Unfortunately, no one has felt the repercussions of this corporate greed more than the 100 plus employees in my district. At last count over 500 Andersen employees have lost their jobs in the fallout, and an additional 500 WorldCom employees may now face the same fate. Enough is enough, and clearly we must make changes in order to rebuild the confidence of the American people. We must restore the integrity of the accounting industry, and we must ensure that those who broke the law will serve prison time and return their ill-gotten gains.

Our bill in the House, H.R. 3763, accomplishes two very key things. First, it gives the SEC the authority to bar persons accused of malfeasance from serving as officers or directors of public companies. And second, the bill helps to ensure that CEOs or other corporate executives do not profit from erroneous financial statements. If a company inflates its earnings, and restates them later on, executives who profit must return their bonuses and other gains to the company on behalf of their shareholders.

At the end of the day, I think the House bill will empower the SEC to punish the crooks, not the honest brokers. Enough is enough, and I yield back.

The CHAIRMAN. The gentleman from Kansas Mr. Moore.

Mr. MOORE. Thank you, Mr. Chairman, for conducting this hearing. Due to constraints on our time, I would like to use my time to ask a few questions, and I hope that these witnesses and future witnesses at future hearings will answer. I ask unanimous consent that my written statement be included in the record.

The CHAIRMAN. Without objection.

Mr. MOORE. Question: What can and should Congress do to make sure Enrons, Global Crossings, WorldComs, Xeroxes and Mercks don't keeping happening again and again and again?

Question: How many more are there?

Question: Who watches the corporate money, and who watches the CFOs and the CEOs? How independent are directors of corporate boards? Should corporate officers and management be permitted to sell or dispose anything of value they receive from the corporation when employees are in a freeze or lock-down period, especially when the value of company stock is in free-fall? Corporate internal auditors for WorldCom, what could they have done that would have brought to management's attention sooner the fact that $3.8 billion was misplaced or misstated? And how can misplacing $3.8 billion happen without other corporate officers or directors or auditors knowing it?

Question: Do whistleblowers have enough protection and incentive to blow the whistle on the kind of practices that were apparently going on at WorldCom?

Question: Do shareholders have a right to expect that financial reports and audits will contain complete and accurate information that will clearly state the value and financial condition of the corporation? How do we protect investors without overregulating business? What should happen to corporate executives who knowingly and innacurately book corporate assets and expenses to manipulate earnings, and should their sentences be mandatory with no opportunity for probation or parole? Are outside auditors really independent? And finally, when is this all going to end?

[The prepared statement of Hon. Dennis Moore can be found on page 170 in the appendix.]

The CHAIRMAN. Gentleman from Pennsylvania Mr. Toomey.

Mr. TOOMEY. Thank you, Mr. Chairman. I want to thank you for conducting this hearing today.

The nature and the magnitude of the fraud that was committed at WorldCom is simply appalling, and it has been devastating to employees, to investors, but most importantly, in my judgment, to the trust and confidence that is absolutely vital to the functioning of our capital markets, the markets, after all, upon which our way of life depends.

I think it is hard to overstate the magnitude of the havoc that's been wrought evidently by some of the people in this room. I hope we will learn today, among other things, who is responsible for this and why the fraud was not discovered earlier. If instead witnesses choose to hide behind the fifth amendment, I am confident that in-

vestigators, both civil and criminal, will no doubt get to the truth, and our judicial system will bring the appropriate people to justice.

Meanwhile, Mr. Chairman, it is for us to determine if there are weaknesses in legislation or regulation or in the enforcement of existing legislation and regulation that we can correct and begin our part of the process of rebuilding the investor confidence that is critical to all our well-beings. I think this committee took a constructive step in that direction with the legislation we have already passed, but I think we need to keep an open mind about other measures that may be necessary, and I yield the balance of my time.

The CHAIRMAN. Gentleman yields back.

The CHAIRMAN. The gentleman from Massachusetts.

Mr. FRANK. To clarify, there was a reference earlier to the putative firm of Salomon Barney Frank. I just wanted to report that that merger is highly unlikely, and certainly has not yet taken place.

The CHAIRMAN. I am relieved to hear that. The gentleman from Texas wishes to be recognized.

Mr. GONZALEZ. Thank you, Chairman Oxley, and thank you Ranking Member LaFalce. In order to save time, I would like to ask unanimous consent that my statement be entered into the record.

The CHAIRMAN. All the statements will be made part of the record.

Mr. GONZALEZ. I yield back the balance of my time.

The CHAIRMAN. I thank the gentleman.

Are there further —

Ms. WATERS. Mr. Chairman, unanimous consent to please correct the record and make sure that Barney Frank is not accused of anything.

The CHAIRMAN. Without objection.

Mr. FRANK. Well, not of anything. Don't go too far.

The CHAIRMAN. The gentleman from Mississippi seeks recognition?

Mr. SHOWS. Thank you, Mr. Chairman, members of the committee. The events that bring us here today are tragic. Thousand of workers have already been laid off, and indeed more layoffs are sure to follow.

Countless Americans invested their money and their trust in WorldCom only to see their savings vanish. Confidence in corporate management across the board has been shattered and Wall Street has taken a beating.

Mr. Chairman, this probably hits me harder than any of us because WorldCom's headquarters is in my district. This is not a happy day for any of us. WorldCom is a homegrown Mississippi company, the first to make the Fortune 500. WorldCom's success was a source of pride for its employees, shareholders throughout the State, and all Mississippians, many Mississippians invested in WorldCom because of that.

On June 25th, the announcement that WorldCom misrepresented its profits margin by hiding nearly $4 billion in expenses dealt a serious blow to consumer confidence, investors across the country and to all Mississippians directly and indirectly tied to the corpora-

tion. So when the world learned of WorldCom financial abuses we in Mississippi took it harder than most.

To the people where I come from, small town values mean a lot. We go to church, work hard, and we trust each other, and we try to give each other a helping hand when it is needed. We live by the Golden Rule and try to treat our neighbors as they would treat us. Corporate greed is not a Mississippi value. Fraud is not a Mississippi value.

Trust, honor, integrity represent the values Mississippians expect in our community leaders, business leaders, political leaders and religious leaders. In Mississippi we believe that a handshake is the ultimate contract and your word is your bond. Mississippi families need to know and want to know who is responsible for and knew about the accounting irregularities at WorldCom and how can we ensure that no more employees, investors and businesses are casualties to corporate greed.

Those responsibilities must be forthcoming, so that the investigation into WorldCom is expedient and thorough. No longer will investors, employees, regulators and officials accept elusive answers or half-truths. Honesty is the only acceptable policy, period.

So now I address the WorldCom executives. WorldCom is not the first corporation that has been caught practicing dishonest accounting, and we don't want them to be the only one accused of it. A few at WorldCom have made the decision that investors have tainted the work and reputation of many honest, hard working employees. Shareholders who trusted and believed in your company and its leaders and investors whose pensions were tied to WorldCom stock must piece together their portfolios in retirement.

Now is not the time to characterize an entire company and all its employees based on the illegal actions of a few individuals. Now is the time for answers. Now is the time for sound policies, not rhetoric. It is my hope that this hearing will foster the resolve of government leaders and corporate America to end corporate fraud and accounting irregularities. At the very least, we should all come away from this hearing demanding tougher penalties for those who misrepresent financial information. Those who are responsible should and must be held accountable.

As the Congressman who represents WorldCom headquarters, I pledge to WorldCom employees, former employees, investors and the American public my wholehearted effort to get to the bottom of this tragedy.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman's time has expired. The gentleman from New Jersey.

Mr. FERGUSON. Mr. Chairman, I just ask unanimous consent that my opening statement be entered in the record.

[The prepared statement of Hon. Mike Ferguson can be found on page 159 in the appendix.]

The CHAIRMAN. Without objection, all the opening statements will be made part of the record.

The Chair will now introduce our first panel of witnesses.

Mr. Melvin Dick, former Senior Global Managing Partner, Technology, Media, and Communications Practice, Arthur Andersen, appearing voluntarily; Mr. Bernard J. Ebbers, former Chief Executive

Officer of WorldCom, appearing under subpoena; Mr. Scott Sullivan, former Chief Financial Officer of WorldCom, also appearing under subpoena; and Mr. Jack Grubman, Telecommunications Analyst, Salomon Smith Barney, appearing voluntarily.

Gentlemen, you are aware that this committee is holding an investigative hearing, and when doing so the Chair may decide to take testimony under oath. Do any of you have any objection to testifying under oath? The Chair then advises each of you that under the rules of the House and the rules of the committee you are entitled to be advised by counsel at the table. Do any of you desire to be advised by counsel during your testimony today?

Mr. SULLIVAN. Yes.

The CHAIRMAN. The gentleman, Mr. Sullivan, wishes to be represented by counsel at the table?

Mr. SULLIVAN. Yes.

Mr. DICK. Yes.

The CHAIRMAN. And Mr. Ebbers as well?

Mr. EBBERS. Yes.

Mr. DICK. Yes.

The CHAIRMAN. In that case, would you please identify your counsel for the record, Mr. Sullivan.

Mr. SULLIVAN. Irv Nathan.

The CHAIRMAN. Mr. Dick, did you indicate you wished to be represented by counsel as well?

Mr. DICK. Yes.

The CHAIRMAN. And would you indicate the name of your counsel, please?

Mr. DICK. Yes, it is Eliot Lauer, of Curtis Mallet-Prevost Colt and Mosle.

The CHAIRMAN. And Mr. Ebbers.

Mr. EBBERS. Reid Weingarten.

The CHAIRMAN. And I would ask the counsel, the aforementioned counsel to pull up chairs beside the witnesses, or as close as you can get.

Counsel, you may move forward to sit at the table. Counsel, will you be giving testimony today? Simply in an advisory capacity. In that case, I would ask the witnesses to rise and raise your right hand.

[witnesses sworn.]

The CHAIRMAN. You are sworn in. Each of you is now under oath. You may now give up to a 5-minute summary of any written statement that you may have, beginning with Mr. Ebbers.

TESTIMONY OF BERNARD J. EBBERS, FORMER CHIEF EXECUTIVE OFFICER, WORLDCOM

Mr. EBBERS. Good afternoon, Mr. Chairman and members of the committee.

I served as CEO of WorldCom for 17 years. During that time I helped a small company rise to one of America's largest corporations. I am proud of the work that I did at WorldCom, and I believe that despite its recent problems WorldCom continues to be a valuable company that provides important services to many Americans and to the United States Government.

Within the last 2 weeks, following a restatement of earnings by WorldCom, officials at the Department of Justice, the SEC, various Congressional committees, and other law enforcement agencies have launched a number of investigations and proceedings relating to WorldCom.

Countless reports in the media have suggested that my conduct as a WorldCom CEO may be examined in these inquiries. During the last week I retained counsel to represent me in connection with these proceedings. Although I would like, more than you know, to answer the questions that you and your colleagues have about WorldCom, I have been instructed by my counsel not to testify based on my fifth amendment constitutional rights.

After careful consideration I have decided to follow my counsel's instructions, even though I do not believe I have anything to hide in these or any other proceedings. I have reached this decision because, one, the investigations appear to be open-ended examinations of a variety of activities at WorldCom, details of which have not been provided to me.

Second, I have not been advised of the specific conduct of mine that is being called into question, and, third, I understand that preliminary statements can be taken out of context, as inquiries such as these become focused over time.

I hope the committee will not draw a negative inference based on my assertion of these constitutional protections on the instruction of my counsel or attempt to subject me to ridicule by asking inflammatory questions, knowing that I will not answer them.

I do not believe that I should be subject to legal harm as a result of my exercise of a basic constitutional protection found in the Bill of Rights. When all of the activities at WorldCom are fairly aired, and when I get the opportunity, and I am very much looking forward to it, to explain my actions in a setting that will not compromise my ability to defend myself in the legal proceedings arising out of the recent events, I believe that no one will conclude that I engaged in any criminal or fraudulent conduct during my tenure at WorldCom.

Until that time, however, I must respectfully decline to answer the questions of this committee on the basis of my fifth amendment privilege.

Thank you, Mr. Chairman.

Mr. SANDLIN. Mr. Chairman, may I ask a question?

The CHAIRMAN. The Chair is recognizing the witnesses. If the gentleman would suspend.

Mr. SANDLIN. Yes.

The CHAIRMAN. Mr. Sullivan.

TESTIMONY OF SCOTT SULLIVAN, FORMER CHIEF FINANCIAL OFFICER, WORLDCOM

Mr. SULLIVAN. Mr. Chairman, I have no prepared statement. Based upon the advice of counsel, I respectfully will not answer questions based upon my fifth amendment right to the United States Constitution. I ask that the record be entered for my counsel's written letter this morning to the committee.

The CHAIRMAN. Without objection. The letter will be considered part of the record.

[The following information can be found on page 247 in the appendix.]

The CHAIRMAN. Mr. Dick.

Mr. DICK. Chairman Oxley—

Mr. SANDLIN. Mr. Chairman, can I ask a procedural inquiry before we go further?

The CHAIRMAN. The gentleman will suspend. The gentleman from Texas.

Mr. SANDLIN. Mr. Chairman, Mr. Ebbers appeared before us today. He took an oath. He then attempted to make an affirmative statement, self-serving statement before this committee, and then attempted to take the fifth amendment. It is my position he has waived the fifth amendment. He is subject to the jurisdiction of this committee. He must testify. I am asking the committee to hold him in contempt, that it be submitted to the floor of the House, that the U.S. Congress hold him in contempt and he be required to testify.

To come up here and say that he has engaged in no criminal activity and to set forth his affirmative statements in his defense and then to refuse to testify is an outrage. It is not in conjunction with the United States Constitution.

I suggest that he consult with his attorneys and then that we hold him in contempt until such time as he elects to go along with the subpoena of the committee and testify before us. He did not take the fifth. Mr. Sullivan did it properly. Mr. Ebbers is required to testify, and we should make him do that, hold him in contempt until he decides to become forthcoming.

The CHAIRMAN. The gentleman's—it will be taken under advisement. We now turn to the witness, Mr. Dick.

TESTIMONY OF MELVIN DICK, FORMER SENIOR GLOBAL MANAGING PARTNER, TECHNOLOGY, MEDIA, AND COMMUNICATIONS PRACTICE, ARTHUR ANDERSEN

Mr. DICK. Chairman Oxley, Congressman LaFalce, members of the committee. I am Mel Dick. I am a graduate of the University of South Dakota. Upon graduation in 1975 I joined Arthur Andersen as a staff auditor. I was a partner at Andersen until I left Andersen on June 1st of this year. I have spent the majority of my career working with diverse telecommunications companies.

Beginning with WorldCom's fiscal year ended December 31, 2001, I became the engagement partner responsible for Andersen's audit of WorldCom. In addition to the year-end audit, Andersen's work included quarterly reviews for the first, second and third quarters of 2001 and the first quarter of 2002.

On June 1st, 2002, I resigned from Andersen. I am presently serving as the Executive Vice President and Chief Financial Officer for an apparel company. One week ago today, on July 1, while I was on a business trip, I was contacted by counsel for the committee and invited to attend today's hearings. Through my attorney I offered my full cooperation with the committee's work, and I agreed to attend this hearing voluntarily.

The chairman's letter of invitation refers to the disclosure by WorldCom on June 25th that approximately 3.1 billion in expenses were improperly booked as capital expenditures in 2001, an addi-

tional 797 million of expenses were improperly booked as capital expenditures in the first quarter of 2002. The newspaper reports that I have read alleged that senior financial management at WorldCom improperly transferred line costs to capital accounts in the company's accounting records.

Let me state clearly, and without any qualification, that prior to June 21, 2002, when Andersen was first contacted about this matter, neither I, nor any, to my knowledge, nor any of my team members had any inkling that these transfers had been made.

In fact, in connection with our quarterly reviews and our year-end audit, the Andersen audit team specifically asked WorldCom senior financial management whether there was any significant top-side entries. On each occasion, management represented to Andersen that there were no such items.

The fundamental premise of financial reporting is that the financial statements of the company, in this case WorldCom, are the responsibility of the company's management, not its outside auditors.

WorldCom management is responsible for managing its business, supervising its operational accounting personnel and preparing accurate financial statements. It is the responsibility of management to keep track of capital projects and expenditures under its supervision. The role of an outside auditor is to review the financial statements to determine if they are prepared in accordance with generally accepted accounting principles, and to conduct its audit in accordance with generally accepted auditing standards, which require that auditors plan and perform and obtain the audit, to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Our audit and our reviews of WorldCom were performed by experienced audit professionals. Our audit plan was the product of a deliberative and diligent evaluation of a global telecommunications company with over $100 billion of assets.

As with any audit, we planned our audit of WorldCom in general reliance on the honesty and integrity of management of the company. One of the key elements of evidence all auditors rely upon is management's representations. As all auditors do, we also tested and, based on our tests, concluded that we could rely on management's process and internal controls, including the internal audit function.

We relied on the results of our testing and the effectiveness of these systems in planning and performing our audit. At the same time we approached our work with a degree of professional skepticism, alert for potential misapplication of accounting principles.

Additionally, we performed numerous analytical procedures at various financial statement line items, including line costs, revenues in and plant and service, in order to determine if there were significant variations that required additional work. We also utilized sophisticated auditing software to study WorldCom's financial statement line items, which did not trigger any indication that there was a need for additional work.

In performing our work we relied on the integrity and professionalism of WorldCom senior management, including Scott Sullivan, WorldCom CFO, and David Myers, WorldCom Controller, and their staff. If the reports are true that Mr. Sullivan and others

at WorldCom improperly transferred line costs to capital accounts so as to misstate the company's actual performance, I am deeply troubled by this conduct.

In addition, if reports are true that WorldCom's internal auditors discovered these entries, I would be very interested to know how and when they discovered these entities. I do not know the specifics of what Sullivan did or directed others at WorldCom to do, and I have not had an opportunity to review the entries at issue here.

I understand that Mr. Sullivan has acknowledged that he never told Andersen about the accounting he is said to have employed. At this point, however, while I can explain our general approach to the WorldCom audit and explain generally the work we did, I do not have enough information to comment on the entries that WorldCom senior financial management are said to have made or how they were hidden from Andersen auditors.

Mr. Chairman, I will answer any questions you or the members of the committee may have for me.

[The prepared statement of Melvin Dick can be found on page 182 in the appendix.]

The CHAIRMAN. Thank you, Mr. Dick.

Mr. Grubman.

TESTIMONY OF JACK GRUBMAN, TELECOMMUNICATIONS ANALYST, SALOMON SMITH BARNEY

Mr. GRUBMAN. Thank you, Mr. Chairman. My name is Jack Grubman. I am a telecom analyst at Salomon Smith Barney. I appreciate your invitation to appear before this committee today, and I voluntarily did so.

Let me say I am saddened by why we are here. I am saddened that people lost money. I am saddened that people lost jobs. I am saddened that a major company is enmeshed in a major scandal. But I want to commend you and everybody on this committee for acting quickly to try to find out what went wrong here.

WorldCom is a company that I believed in wholeheartedly for a long time. It fit my long held, honestly held investment thesis that the newer, more nimbler companies would create value. It evolved into a company that had an unparalleled array of global network assets and a huge customer base after its merger with MCI. That view of the company made me believe it was best positioned to grow within this industry.

However, beginning in March of this year, we began a series of downgrades of our views due to a variety of reasons, SEC inquiry, changing CEOs, continued guidance changes downward of earnings, continued rating agency downgrades. On March 18th, we increased our risk profile to high from medium. On April 21st, I and others downgraded WorldCom stock from buy to hold based on new company guidance.

We increased our risk rating again on May 9th to speculative, our highest risk rating. And finally on June 21st, we did a one-notch downgrade to market underperform. With respect to that last June 21st downgrade, I am aware that there is speculation that I had advance knowledge of this fraud. That speculation is categorically false. I had no advance knowledge whatsoever of this fraud.

The June 21st downgrade was normal course business. We were doing our end of quarter reviews for all of our companies.

Before our downgrading, on Monday, June 17th, S&P downgraded the debt two more notches. A day before our downgrade Moody's downgraded the debt two more notches. In addition, we were concerned about yet lowering numbers again. We were concerned about continued softness in corporate America and what that meant for telecom spending. We were concerned about the bank facility and the negotiations around that.

The June 21st downgrade was just the latest in a series of downgrades that we have done over the past 3 months, and we were not alone in that. Many firms on Wall Street, including Sanford Bernstein, who is a pure research house with no investment banking, downgraded WorldCom's stock opinion several times, and several had buy ratings til the bitter end, including Sanford Bernstein.

As far as the topic of this hearing today, the fraud at WorldCom, of course it influenced our analysis. The company's public financial statements are a starting point for our work. If the public statements are fraudulent, I and other analysts have flawed information to go on. If we had had a truer picture of WorldCom's financial results earlier, no doubt our opinion would have changed. An equity research analyst has a job to make judgments, to make forecasts about the industry and companies they follow. You use publicly available information, and you augment that by regular relationships and conversations with company management, suppliers, customers, regulators, et cetera.

Audited financial statement are very important in how we do our work. That is a starting point of our work. But we are not auditors, internal or external. Our judgments are only as good as the public statements.

Two other quick topics before I end my statement. As far as my relationships with managements of WorldCom and other companies, I value close relationships with management. It gives me the ability to put context around the numbers and assess whether management can execute their business plans.

As far as investment banking conflicts with analysts, it goes without saying in full service firms that research is a product used by the bank. If a research analyst has stature and credibility with investors and happens to have a favorable view of a company, that will help get banking business. If, on the other hand, you have an unfavorable view that will hurt. In all instances, the lifeblood of an analyst's reputation and credibility is integrity and honestly held research opinions with investors, and that is something that I have always practiced.

I have certainly made mistakes. I clearly did not call the collapse of the telecom space over the last 2 years. All of my beliefs have been honestly held, and I look forward to answering all of your questions.

Thank you, Mr. Chairman.

[The prepared statement of Jack Grubman can be found on page 186 in the appendix.]

The CHAIRMAN. Thank you, Mr. Grubman. The Chair will begin the questions.

Mr. Dick, your responsibilities included the full range of Arthur Andersen's Global Technology, Media and Communications Service; that is, audit, tax and consulting, and you were the lead engagement partner at USWest from 1987 through 1996, at Level III Communications from 1998 through 2000. As you know, Andersen billed WorldCom hundreds of dollars per hour for your services, and yet you apparently missed the massive fraud perpetrated by the WorldCom execs in 2001 and the first quarter of this year, which included transfers of expenses to capital expenditures exceeding $600 million in each of the five quarters.

The obvious question is, how could your audit team miss that senior financial managers were doing this and also fail to identify transfers of such a massive amount during the annual audit?

Mr. DICK. Chairman Oxley, we performed our audit in accordance with generally accepted auditing standards, and let me explain what that means. Initially, as we go through that process of designing our audit plans and carrying out our audit plans, we gain an understanding of the company's business. And in the case of WorldCom we did. WorldCom was a company with a hundred billion dollars of consolidated assets, $35 billion of revenues for last fiscal year, roughly $15 billion of line costs, and some $40 plus billion of plant and service.

In performing our audit, we gained an understanding of the business. We gained an understanding of the transaction processing systems that WorldCom used to produce those financial statements. As you can imagine, a company of WorldCom's size has literally thousands and thousands of transactions that flow through its systems, of processing its billings, collecting its cash from its customers, paying its bills, et cetera.

As we planned our audit and executed our audit, we tested those systems. But we didn't just test those systems, we also looked at the financial statements as a whole. We looked for significant variations between accounts, between year end. We planned our audit in accordance with results from previous audits. We plan our audits in accordance with the integrity of the management controls and systems that are in place. And we carried out our audits in those.

In addition, we used some very sophisticated software that analyzes the financial statement line items and the relationships on those line items, to determine if any additional work needed to be done.

In addition to that, we did inquire of WorldCom's senior management, their financial management, if they made any top-side entries of the type that are purported to have been made, and we did that on a quarterly basis and in connection with our annual audit. In fact, we submitted a written list along with that request and other schedules or analysis that we wanted from the company.

The CHAIRMAN. Who did you submit that list to?

Mr. DICK. That list would have been submitted to senior financial management, people underneath the direction of Mr. Sullivan and Mr. Myers.

The CHAIRMAN. And who is Mr. Myers?

Mr. DICK. Mr. Myers is the former Controller of WorldCom.

The CHAIRMAN. And you have records of that, of that correspondence?

Mr. DICK. We do.

The CHAIRMAN. Let me turn to Mr. Grubman. Mr. Grubman, you have been saying that you over years had a personal relationship with Mr. Ebbers, that you forged a close relationship, I think, over pool games and greasy hamburger joints.

In light of this unusually close relationship, did you ever receive inside information about WorldCom that other investors and analysts were not privy to?

Mr. GRUBMAN. I had a good working relationship with Mr. Ebbers and other managers within the telecom industry. And let me—I will answer your question directly, but let me put this in context. Like I said in my opening remarks, and in the broader statement I filed with the committee, I think it is very important for analysts to get to know management.

You have to put context around the numbers. You have to assess their ability to run their business. In some of those occasions there are social events. When you talk to a management team, there is information that you glean that may not be public but may not be material. For example, if an analyst talks to companies regularly and learns about their views on pricing in an industry, demand trends in the industry, their opinion about regulatory policies, that is appropriate color to get from management. And, in fact, Regulation FD contemplated that with their new rules a couple of years ago.

The CHAIRMAN. Let me ask you this. Did you ever attend a board meeting for WorldCom?

Mr. GRUBMAN. Yes. And there are occasions when an analyst does get material, nonpublic information. Analysts, including myself, always try to avoid that. It conflicts you. You can't talk to investors. And those instances occur very infrequently and for short durations.

The CHAIRMAN. How many times did you attend a WorldCom board meeting?

Mr. GRUBMAN. To the best of my recollection, I have been to maybe three WorldCom board meetings over the years.

The CHAIRMAN. Is it rather unusual for analysts to attend board meetings?

Mr. GRUBMAN. It is rare, as it has been for me over the years. When you attend, it is usually in connection with a specific event.

The CHAIRMAN. Were you the only member of the analyst community at those particular board meetings?

Mr. GRUBMAN. At the particular board meetings that I attended, it was just myself and other members of my firm.

The CHAIRMAN. And so your testimony is that you attended the board meetings, but that none of the information that you received at that point were in any way used in your analysis or recommendations?

Mr. GRUBMAN. My testimony is, when I attended these board meetings, which was only perhaps only three times over 12 years, it was for a specific transaction that Salomon Smith Barney was advising WorldCom on. At those board meetings I was privy to material, nonpublic information, that was then released and publicly

disseminated, usually within 1 to 2 days after those board meetings. After then I was able to conduct my business as normal.

The CHAIRMAN. It is safe to say that you did have a special relationship with Mr. Ebbers and the board?

Mr. GRUBMAN. I think I had a good working relationship with Mr. Ebbers. I don't think I had a special relationship with the board, no.

The CHAIRMAN. The gentleman from New York.

Mr. LAFALCE. It is my understanding that in November of 2000, investors filed a securities fraud complaint charging that MCI WorldCom, Messrs. Ebbers, Sullivan and other insiders had concealed material, false information about its receivable and earnings performance while personally unloading almost $80 million of stock at inflated prices.

It is my further understanding that ultimately that case was combined with others, and plaintiffs filed a consolidated amended class action complaint in June of 2001. Mr. Dick, Mr. Grubman, as the auditor and as the analyst, were you aware of the gravamen of those lawsuits?

Mr. DICK. I am sorry? Was I aware of?

Mr. LAFALCE. The gravamen, the importance of them, the thrust of them, the primary allegations of them?

Mr. DICK. Yes, I was aware of the lawsuit.

Mr. LAFALCE. And Mr. Grubman, were you aware?

Mr. GRUBMAN. I can't recollect now if I was aware at the time. I am sure subsequently though I became aware.

Mr. LAFALCE. At some time subsequent to November of 2000, when it was initiated, as perhaps the premier analyst for WorldCom are you telling me you weren't aware?

Mr. GRUBMAN. I am saying at the specific moment you asked, I am not—

Mr. LAFALCE. How about sometime between November of 2000 forward?

Mr. GRUBMAN. Yes. I probably became aware of that lawsuit.

Mr. LAFALCE. Now, their complaint did allege that the company, quote, "resorted to a myriad of improper revenue recognition and sales practices in order to report favorable financial results." In March of 2002, the U.S. District Court for the Southern District of Mississippi, did dismiss that complaint. But the Court said that the reason it was dismissing it is because it couldn't attain, quote, "the heightened pleading standard requirements for this type of case."

By the way, those heightened pleading standards were standards that were enacted by Congress when they passed the PSLRA, the Private Securities Litigation Reform Act. But the Court went on to say, that in reviewing the complaint, quote, "the reader reacts by thinking that there must have been some corporate misbehavior."

Well, shouldn't the auditor and shouldn't the analyst have reacted by concluding that there must have been some corporate misbehavior, or is this something that just a federal court judge on a casual reading of a complaint would conclude?

Mr. Dick.

Mr. DICK. When we performed our audits for 2001, our audit testing and processes included looking at the company's revenue

systems, their billings to their customers. And we tested that and did not find any—

Mr. LAFALCE. What didn't you find that you should have found? And why didn't you find it?

Mr. DICK. Well, as I said, when we performed ouraudit —

Mr. LAFALCE. Not when you performed it. Looking back now, what didn't you see that in retrospect you should have seen?

Mr. DICK. Chairman, sorry, Congressman, I can't respond specifically to that question. I can only respond to the audit work that we did do, because I do not know—

Mr. LAFALCE. Let me ask you this. If you are an auditor for a publicly traded corporation and serious lawsuits are brought, does that not create some type of heightened requirement on the part of the auditor to at least investigate more carefully what the allegations of wrongdoing are?

Mr. DICK. Yes. In connection with our audit, we did do work on WorldCom's revenue systems, and we also discussed this with WorldCom's corporate counsel and their external counsel representing them in this case, and satisfied ourselves as to the appropriateness.

Mr. LAFALCE. Did you discuss this with the counsel for the investors?

Mr. DICK. No, I don't believe so.

Mr. LAFALCE. Do you think that might be a good idea in the future?

Mr. DICK. I can't speak to that, Congressman. I don't know.

Mr. LAFALCE. You don't know whether that would be a good idea or bad idea?

Mr. DICK. Not necessarily being considered—

Mr. LAFALCE. Mr. Grubman, as the premiere securities analyst, what heightened diligence did you adopt when you did determine that there were these serious allegations of corporate misbehavior?

Mr. GRUBMAN. As a matter of course, the receivables write-down of course we were all aware of, because they did it in the third quarter of 2000 on their publicly disseminated earnings call, went through the reasons for that. As far as this specific instance, I don't recall specifically the type of things we did. But, broadly speaking, when an inquiry like this comes up—

Mr. LAFALCE. Broadly speaking means you just don't know what you did with respect to WorldCom; is that correct?

Mr. GRUBMAN. No. What I am saying is, again, we start with the public financial statements. We obviously questioned all companies, including WorldCom, about the reasonableness of those numbers and what is behind their numbers. But we don't have, nor are companies required to give equity analysts access to invoices, audit trails and the like.

Mr. LAFALCE. Let me ask this question of Mr. Dick and Mr. Grubman. Mr. Dick, it is my understanding that the consulting fees for Arthur Andersen were about twice as much or more as the auditing fees, and I am wondering if you had any responsibility for pursuing consulting fees. And Mr. Grubman, I am wondering what the investment banking fees were for your company for WorldCom and whether or not your compensation was in any way related to

the amount of investment fees that were generated for your company.

The CHAIRMAN. The witness may respond. The gentleman's time has expired.

Mr. DICK. The Arthur Andersen fees, 2001, were approximately $16.8 million, of which 4.4 million related to the annual audit services, 7.6 million related to tax services, another 1.6 million that related to nonfinancial statement audit services, and then all other fees of $3.2 million, none of which included any fees for work on financial systems, design or implementation.

Mr. GRUBMAN. As far as the fees to Salomon Smith Barney, I don't know the precise number. But I will estimate that from about 1998 through 2001, cumulatively, I want to say roughly $80 million, but I don't know an exact number. As far as my compensation, it is a function of many factors, one of which that goes into that factor is banking revenues to the firm. I have no direct tie to banking revenues in terms of a direct percent of banking revenues or fee-by-fee type of thing.

And just to try to be a little more responsive to your last question, when things like lawsuits come public for a company, unlike with auditors, where there is one auditor per firm, there are dozens and dozens of analysts and thousands of investors and rating agency folks that follow a company like WorldCom, very widely followed, very widely held. So the entire body of research community, debt and equity, buy side and sell side, in a continuum continually question the company, especially when something like this happens. But again, we can only start with what is filed publicly.

The CHAIRMAN. The gentleman from Iowa, Mr. Leach.

Mr. LEACH. Well, thank you, Mr. Chairman. I wanted to return to a comment of Mr. Manzullo earlier when he said issues come down to faces. I represent 3,000 WorldCom employees in Cedar Rapids, Davenport and Iowa City, Iowa. Let me tell you, they are pretty upset. They wonder what happened at the top. They wonder about their futures. They are hard working, decent folk.

I also represent an insurance company that informed me this weekend that they held millions and millions of dollars of WorldCom debt. They have assets to easily handle this, but they are fit to be tied. And like everyone on this panel, we represent thousands of people who held WorldCom stock, thousands more who didn't but whose stock has gone down because of the loss of confidence in the market, because of companies like WorldCom.

And what I would like to get at a little bit, first on the accounting side, we learned from the Enron circumstance that Arthur Andersen followed in its view generally accepted accounting practices even though Enron had 2 or 3,000 off-shore entities that clearly booked profits in such a way that they didn't reflect a fair view of the company, and it is a fair view of the company which is the most important thing.

We hear today a very different story from Andersen, which is, as I hear it, that the wool was pulled over your eyes. Now, the question I have here is that accounting is the one profession that you are supposed to, as early as possible, to see evil, hear evil and report evil, none of which occurred here.

And so one of the larger queries from an accounting perspective is that it is, as I understand it, one of the duties of certified public accountants to look diligently for fraud. It is one of the duties of a certified public accountant to be particular suspicious if there are aspects of the company that seem to be getting in a little bit of difficulty. And there seems to be what appeared, in retrospect, to be efforts to report profits even though they might not have existed.

And so when we get down to this, the question is, you have a very major company that you are looking at. Did you have adequate personnel? Did you have adequate diligence? Did you look at this circumstance as one in which the public interests, the employee interests was first and foremost your concern, or was it one of just doing a job that was related to other jobs that were also created for your company in other kinds of ways?

Mr. DICK. No. We did in fact look at and approach this audit with those views in mind. I led a very experienced team, including other partners and managers that worked on the audit of Enron. We planned our audit, took into consideration our previous experience from prior audits, took into consideration our understanding of the company's business environment, their processes, their procedures and their controls. And we tested it, and we did not see anything that came to light, as has been purported to come to light.

Mr. LEACH. Well, all of us know we have done things in life that have been less perfect than otherwise. But the fact of the matter is that we rely in our system on good numbers, and we rely on certified public accounts for a vigorous effort.

And when things go astray, they are truly remarkable in their consequences. And this consequence is not just to a few officers, but to all of the employees, and in a systemic way, to American society.

And I think the lessons here are very large for public accountants. And of all of the professions I know of that we want to reinvigorate with trust, it is your profession. And yet of all of the circumstances that have developed where it is pretty hard to do it at this time, it is your company.

And so I am wondering if you want to tell the Committee if you think you had a systemic problem within your company, or is this an aberration. As we also heard this morning that you are no longer the largest series of losses, you have got another company that is almost triple the size of your losses that were perhaps improperly booked, or profits that were improperly booked, by also your company.

Did your company pursue a strategy of easy accounting to get clients?

Mr. DICK. I don't believe our company did. I can tell you, as we executed on our audit of WorldCom in addition to all of the testing we did, basic premise, as I mentioned in my opening remarks, is that in addition to relying on the management processes and procedures and the controls in place, we do as auditors, as all auditors do, rely on the integrity and the competence in management. And based on our planning, we had no reason to believe there would be any indication that the purported activities would take place or did in fact take place.

You know, your responsibilities under generally accepted auditing standards is to make sure when we do our audit that we prop-

erly plan it, we properly execute it, that we consider the processes and procedures, and that the financial statements are free of material misstatement, be it from misapplication of accounting principles or from fraud. In—not all cases, though, can there be absolute assurance that there will not be the type of activities that are purported to have taken place at WorldCom.

Mr. LEACH. Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman's time has expired. The gentleman from Massachusetts, Mr. Frank.

Mr. FRANK. Mr. Chairman, first just a statement about Mr. Ebbers' statement, not about WorldCom, but about the legal profession. Your counsel did not instruct you to do anything unless you are working for him, which would be an odd relationship. Counsel may advise you. You may follow the advice or not. But people often like to blame lawyers for even more than lawyers ought to be blamed for. And they are not in a position to instruct their clients.

Mr. Dick, I was somewhat struck, I am learning, as a lot of my colleagues are, about various things. There may be less to accounting than meets the eye.

On page 2 you say, ″The fundamental premise of financial reporting is that the financial statements of a company...are the responsibility of the company's management, not its outside auditors.″ .

Now, I hadn't thought that an either/or proposition. What you are telling me here is—in English—it is not your responsibility. I must say I felt a little bit like Mr. Grubman, too. I will get to this, but I have had occasion to quote the great sage Tom Lyra, and it is the Wernher von Braun song when he talked about the V-2 rockets: When the rockets come up, who cares where they come down? That is not my responsibility said Wernher von Braun. And I think we are getting a little bit of that here.

Audited statements from one of the big accounting firms are not the responsibility of the outside auditors? Is that correct?

Mr. DICK. Well, the financial statements themselves and the preparation of those financial statements—

Mr. FRANK. Mr. Dick, we know what we are talking about. We only have like 5 minutes. Do you really mean to say that the financial statements are not the responsibility of the auditing firm? They can be the responsibility of both. Is there no—is there no responsibility on the part of the auditing firm for the audited statements?

Mr. DICK. Well, the auditing firm's responsibility is to perform their audit in accordance with generally accepted—

Mr. FRANK. What do you guys do, just check the arithmetic, give them a gold star if they added right? This is a very minimalist function that you are describing. I am reading your statement. Clearly what this conveys is that you have no responsibility for those statements. The fundamental premise is that the financial statements are the responsibility of management, not its outside auditors, no responsibility on your part for the statements?

Mr. DICK. The outside auditor's responsibility is to perform an audit of those financial statements and to plan and perform that audit to—

Mr. FRANK. Mr. Dick, you are not answering the question. Do you have any responsibility for the statements? None whatsoever?

Mr. DICK. In my prepared remarks I indicated that the audit is—

Mr. FRANK. I just read your prepared remarks. We know what is in them. I am trying to get you to tell me if you stand behind them. Is it your position that the auditors have no responsibility, what this would imply, for the financial statements?

Mr. DICK. Well, the audit responsibility is to audit in accordance with generally accepted auditing standards, and to ensure—

Mr. FRANK. I understand. But I asked you a direct question whether or not you have responsibility. If someone reads a financial statement and it says audited by X accounting firm, should I think that the firm takes some responsibility for that?

Mr. DICK. Well, those statements are prepared by management and audited by the accounting firm.

Mr. FRANK. Gee, I congratulate you on your ability to evade so calmly, Mr. Dick. I think what we are getting here, frankly, is an underassessment. Let me put it to you this way. I think in general, in other contexts, auditing firms don't give themselves such a small role.

Mr. Grubman, a couple of questions here. When you mentioned going to the board meetings, I was a little surprised because you said you went to those board meetings to help them with financial transactions. That is part of the conflict that bothers me. You are an independent analyst, theoretically, but then you go to board meetings and help structure transactions which you then later independently analyze? Does not that cause you some troubles?

Mr. GRUBMAN. I didn't say that. What I said is on the few occasions that I went to those board meetings it was to comment on pending announcements of mergers.

Mr. FRANK. Well, I am pretty sure you said, we can check the transcript later, because you were doing transactions with them.

Mr. GRUBMAN. When I say transactions, I meant merger and acquisition.

Mr. FRANK. Were you advising on those?

Mr. GRUBMAN. Salomon Smith Barney—

Mr. FRANK. No, you, Mr. Grubman.

Mr. GRUBMAN. No. I as the research analyst when I am—

Mr. FRANK. I know what you are. We only have a few minutes.

Mr. GRUBMAN. I am trying to answer this.

Mr. FRANK. You went to the board meeting, your company, Salomon Smith Barney, is advising on a merger. You are there as the analyst. Who is paying you to go there to do what?

Mr. GRUBMAN. I am there only to provide the market color, the likely—

Mr. FRANK. The market color? What are you, Phil Rusito? What do you mean, the market color? I don't understand. You do the chatter? What does that mean?

Mr. GRUBMAN. I am there, as other analysts in similar situations and other transactions are there, to provide what is the likely investor reaction to a deal that is—

Mr. FRANK. But you have given them advice which they should take into account, presumably, when you tell them what you think the investor reaction is going to be; that is something presumably that they take into account in making decisions, correct?

Mr. GRUBMAN. It is—my involvement comes in—

Mr. FRANK. Mr. Grubman, how cautious can you be? You mean you tell them things and the assumption is they are going to pay no attention whatsoever you do. What are you there for, lunch?

Mr. GRUBMAN. No. What I am saying is after a transaction has already been contemplated, and decided to go forward, I am then there in a very short period—

Mr. FRANK. You are telling me you give that information only after the final decision has been made? It is never a factor in the decision?

Mr. GRUBMAN. That is typically the—

Mr. FRANK. I didn't say typically. Don't be so cautious where you don't answer my question. I am asking, in any of those instances, were you giving advice before the transaction was completed, advice about how the market was going to react, advice of any kind?

The CHAIRMAN. The gentleman's time has expired. The gentleman may answer.

Mr. GRUBMAN. As I said, I typically—

Mr. FRANK. I didn't ask what you typically did. I said what you actually did.

Mr. GRUBMAN. I am trying to—

Mr. FRANK. You are trying to not answer the question. But what did you actually do in these three cases? Did you give information before the transactions were completed?

Mr. GRUBMAN. In all three cases, right before the transactions were completed I was asked to give investor reactions. How far before—

Mr. FRANK. Which reaction you subsequently shaped or helped shape?

Mr. GRUBMAN. Well, you know, once the transactions are publicly disseminated, there are a lot of people who follow this stock, a lot of investors. I am a voice. I am not going to not acknowledge that I have a significant voice. But I am one of many voices.

Mr. FRANK. We have—I just would say one thing. We have increased substantially the modesty factor in the financial profession, at least for today.

The CHAIRMAN. The gentleman from Louisiana, Mr. Baker.

Mr. BAKER. Thank you, Mr. Chairman. Mr. Grubman, I want to thank you for your voluntary participation here today. I think it is a value to have those involved in this misfortune to give some perspective on what occurred so we can, in some form or fashion, move to remedy this for future instances.

I need ask a few background questions before I get to my main point. Page 3, third paragraph, you say: "Let me say again I have no advance knowledge of any kind about WorldCom's accounting fraud. I first heard about it when it was reported late in the day June 25 on CNBC."

To what fraud were you making reference?

Mr. GRUBMAN. To the $3.8 billion fraud.

Mr. BAKER. I assume that, for the record, you have a professional working relationship, or had with Mr. Scott Sullivan at the time that these activities were engaged?

Mr. GRUBMAN. Yes. Mr. Sullivan and I had a good working relationship over the years.

Mr. BAKER. For the same purpose, you have a professional working relationship with Mr. Robert A. Waldman, Salomon Smith Barney corporate bond research analyst?

Mr. GRUBMAN. Yes. He is the bond analyst.

Mr. BAKER. And, Mr. Grubman, for the record you were the senior telecommunications analyst for Salomon Smith Barney at the time of these transactions?

Mr. GRUBMAN. At the time of?

Mr. BAKER. Of the event.

Mr. GRUBMAN. Yes.

Mr. BAKER. For the record, Mr. Chairman, I want to make it clear that the statement of Mr. Grubman in his written testimony, verified orally, establishes no prior knowledge of any accounting fraud, specifically a $3.8 billion off balance sheet transaction, prior to June 24th. I have been provided e-mail, and don't know the varacity of these, Mr. Grubman. So I will say that in that light. But they are very troubling.

Mr. Robert Waldman sends an e-mail to Scott Sullivan on the morning of June 24th at 10 o'clock. Quote, "things are nuts again. Latest rumors are now that WCOM," I assume that is WorldCom, "has an undisclosed 3 billion off balance sheet liability, and that by not buying on the MCI PFD dot," whatever that is, "the company has no ability to upstream cash. I cannot overemphasize how important communication is with the market. Even if there is not anything new, it still gives the market access to you, Bob."

At 10:42 a.m. on June 24th: "Good afternoon. Our bond analyst, Robert Waldman, published a WorldCom note which we thought would be of interest to our clients. Please see attached." That is from you to an undisclosed recipient because the name was redacted.

I then turn to a June 24th Salomon Smith Barney publication from the Corporate Bond Research Division which indicates "we want to clarify a couple of statements to the bond market made in a recent research report by Jack Grubman." And one of the signatories on that document is Mr. Robert Waldman.

I raise that to only establish that there appears to be a day-to-day business relationship between the three principals to whom I make reference, and that it would be a very difficult thing for me to conclude that a memo coming into the office at 10 o'clock in the morning, making reference to the off balance sheet transaction on which you would then make further comment at 10:42 to the undisclosed recipient, that there was not some communication as to the potential downside consequences of the discovery of the WorldCom off balance street transaction.

Can you give me your response?

Mr. GRUBMAN. Yes. First of all, the e-mail you referred to coming from me to clients attaching Waldman's corporate research note, that was his separate corporate research note that we became aware of that he publicly disseminated to his clients. The e-mail that you refer to from Mr. Waldman to Mr. Sullivan I knew nothing about. In fact, I did not know a thing about it until this morning when members of my firm told me about it, and I actually did not physically see it until literally when you were talking and it was given to me.

Mr. BAKER. Well, you can understand my reason for concern. Three professionals who work on a day-to-day basis transacting this sort of business activity, sharing perspectives and comment for the benefit of your clients and that at 10 a.m. a document comes in which you today say you had not seen.

Mr. GRUBMAN. I never saw it.

Mr. BAKER. And then 42 minutes later a transmission is out of the office which makes reference to something which was not disclosed to me. Mr. Chairman, I wanted to insert all three documents for the record. I think it warrants further inquiry at the appropriate time.

The CHAIRMAN. Without objection.

[The following information can be found on page 206—208 in the appendix.]

Chairman BAKER. Mr. Ebbers, did you authorize or did you, or were you aware of the $3 billion off balance sheet transaction which resulted in the restatement at a subsequent time?

Mr. EBBERS. On the instruction of counsel I respectfully decline to answer on the basis of my fifth amendment constitutional right.

Chairman BAKER. Mr. Chairman, I would like to raise a point of order established earlier in the record wherein the gentleman did invoke his fifth amendment privilege pursuant to a statement of purpose for being in appearance before the committee today.

It is my understanding on counsel's advice from the committee, at your instruction, Mr. Chairman, that anything brought to the attention of the committee in the gentleman's statement may be within the purview of appropriate question. Matters not raised by the gentleman in his defense statement would be subject to fifth amendment protection.

Could the Chair advise as to whether or not that is the ruling?

The CHAIRMAN. The Chair would first ask the witness. Mr. Ebbers, is it your attention to refuse to answer all questions based upon your fifth amendment right against self-incrimination?

Mr. EBBERS. Yes.

The CHAIRMAN. At this time the Chair would note that the witness, Mr. Ebbers, has invoked his fifth amendment right against self-incrimination. It appears to the Chair that questions closely related to the matters discussed by Mr. Ebbers in his opening statement may be permitted. However, in the event the witness chooses to refuse to answer such questions, any vote on a contempt of Congress resolution would occur at a later time after proper committee consideration.

Because the Chair does not have a copy of the witness' opening statement, it is impossible to determine as to which matters he has waived his fifth amendment privilege against self-incrimination. Therefore, the chairman would reserve the right to recall the witness in the future to answer such questions as concern matters he discussed in his opening testimony.

Mr. BAKER. Just to follow up, I have clear recollection, and I think it will be in the public record without any question, that the gentleman expressed some concern that he had not yet been, as of this date, been made aware of the actions which would cause questions of his conduct.

The gentleman, Mr. Grubman, referred to the fraudulent acts on questioning as the transaction involving the $3.8 billion off balance sheet fund allocation which resulted in the downgrading of the stock and the significant stock losses that occurred thereafter.

It is my opinion, Mr. Chairman, and I ask for your ruling, that to ask Mr. Ebbers, pursuant to his fifth amendment invocation notwithstanding, that questioning the gentleman with regards to the transaction relating to the off balance sheet $3.8 billion fund move is within the scope of his statement, because he has indicated he is not aware of what he did that related to the alleged fraudulent conduct, which is the movement of the $3.8 billion.

I would suggest to the chairman that failing to answer that question is now clearly in contempt of the committee's actions.

The CHAIRMAN. If the gentleman would yield, the Chair would indicate that he will keep that under advisement. We will check the testimony in the presented record, the official record, in that regard.

Mr. BAKER. If I may, Mr. Chairman, just reserve, with the indulgence of the minority, reserve at an appropriate time, pursuant to advice of House counsel, to revisit the issue at the appropriate time during the hearing when judgments have been rendered.

The CHAIRMAN. Without objection.

Mr. SANDLIN. Point of order, Mr. Chairman.

The CHAIRMAN. The gentleman from Texas seeks a point of order.

Mr. SANDLIN. I am not aware of this new theory of selective fifth amendment. I believe clearly that the witness appears before our committee under subpoena. He was sworn in. The jurisdiction of the committee was invoked. He made affirmative statements, as has been indicated by my colleague and friend from Louisiana, attempting to absolve himself of liability and indicating he had no knowledge of the information before us, and then refusing to testify.

It is my position he has waived his fifth amendment protections for all purposes. He is now before the committee to testify on a broad range of issues any question we may ask him. In the event that the Chairman wants to examine this further as far as his statement, his written statement should be provided to the committee forthwith, that we should right now hold him in contempt of court. The Chairman should—contempt of the committee. The Chairman should set a hearing now for the contempt proceeding, and we could at that time take testimony from Mr. Ebbers, an explanation to show cause order or whatever to show cause why he should be held in contempt.

Mr. BAKER. Would the gentleman yield?

Mr. SANDLIN. I would yield.

Mr. BAKER. I would suggest in deliberative fairness that we check the record with regard to his statement in response to the question asked relative to the movement of $3.8 billion off the balance sheet. Should it be determined at that time that that was within the purview of the—not within the fifth amendment privilege, at that time it would be appropriate—or I would suggest that a motion should be offered with regard to finding the gentleman in contempt.

Mr. SANDLIN. Reclaiming my time. That would be fine. But, Mr. Chairman, I want to make sure we go forward with this and take care of it. It is important to the committee, and while I agree with my colleague from Louisiana that the information concerning the $3.8 billion in the accounting practices were clearly waived, I believe we should also look at the issues as far as the fact that every protection of the fifth amendment has been waived. He is now before the committee for all purposes.

The CHAIRMAN. I thank the gentleman.

The gentleman from New York Mr. LaFalce.

Mr. LAFALCE. Mr. Chairman, of course it was my desire that Mr. Ebbers would come before us and testify, and I would have been amazed if he decided to do so, and I would have been amazed given the gravity of the allegations that have been made had he not invoked the fifth amendment privilege.

The question of waiver of a fifth amendment privilege is a complex legal issue, and I personally would like to have time for our staff to do the legal research that I think is necessary in order to make an objective judgment as opposed to a political judgment as to how we should proceed. So I reserve judgment myself and trust that the Chair, too, will reserve judgment until such time as we are able to do appropriate, thoughtful legal research and then render a judgment.

Mr. FRANK. Mr. Chairman.

The CHAIRMAN. Mr. Frank.

Mr. FRANK. Mr. Chairman, we have a lot of things that we want to correct in this world, terrorism and now some, although not comparable, terrible financial abuses, but there's a common thread, and that is we still have a Constitution. And while I agree that we could do research here, I want to say now—and I don't know what we'll be dealing with when we come back—I am in favor of a pretty broad view of the U.S. Constitution. We are, after all, a legislative body. Our major role is to try to make laws. I think we should make some.

I think we suffer here from a system in which there's a kind of an aggressor's law going on in which bad practices drive out good practices or diminish them because people get a competitive advantage for doing things that they don't really do. But we are not a prosecutorial body, and my own view is that we ought to be very, very reluctant to be narrowing constitutional protections.

And I don't want to make our constitution protections traps for the unwary. I think it would be a mistake for us to try and come up with a new theory of waiver in this sort of a situation, and the Chairman would have had a right to say, if you're going to plead your right of self-incrimination, you don't get to make a statement. But I myself would want to have a much more explicit waiver before I would want to say that constitutional rights get subordinated.

And I just think that this is a time when we have to be very careful that our determination to deal with a lot of problems doesn't lead to any diminution of the Constitution. I would rather err on the side of overinterpreting rather than underinterpreting constitutional rights.

The CHAIRMAN. The Chair is prepared to rule. It's obvious that the gentleman will continue—

Ms. WATERS. Will the gentleman yield?

The CHAIRMAN. It is obvious that the gentleman will continue to invoke his fifth amendment rights. That being the case, the Chair has no option but to excuse this witness from further testimony today. The Chair would instruct the witness that he reserves the right to recall Mr. Ebbers at any time, and the witness is therefore—

Ms. WATERS. Mr. Chairman. Mr. Chairman.

The CHAIRMAN. Are there further questions for the witnesses?

Mr. Kanjorski.

The CHAIRMAN. For the purpose of questioning the witnesses?

Ms. WATERS. On the ruling that you just—

The CHAIRMAN. Gentlelady from California.

Ms. WATERS. Mr. Chairman, I recall very specifically that in Mr. Ebbers' opening statement, he admonished us not to ask him questions because he intended to exercise his constitutional fifth amendment right. It's all right for him to exercise that right, but it's not all right for us to comply with his request—well, not request, his direction to us not to question him. I intend to question him, and if he wants to exercise his fifth amendment right, he can do it once, he can do it twice, he can do it thrice, he can do it a thousand times, but to excuse him and accommodate him because he does not wish to be questioned is not acceptable, and I yield back the balance of my time.

The CHAIRMAN. The Chair would indicate that the witness may leave.

Mr. SANDLIN. Mr. Chairman, could we have a vote on that, or do we have an opportunity to object to the ruling of the Chair?

Mr. MOORE. Point of order on that, Mr. Chairman.

The CHAIRMAN. The gentleman from Kansas.

Mr. MOORE. Mr. Chairman, I would inquire at this point of the Chair is your ruling is that he is released at this time, but not released from the subpoena, but free to go at this time, or he is released from the subpoena?

The CHAIRMAN. As the Chair has indicated, I would maintain the ability to recall the witness at any time. I think it's important, as the gentleman from Massachusetts and the gentleman from New York stated, that we want to be on solid legal grounds here, and to make a decision at this point without the full record and the full advice of counsel I think would be a mistake, and that's why the Chair made that decision.

Mr. SANDLIN. I would like to object to the ruling of the Chair. We can have the statement read back right now.

Mr. MOORE. Mr. Chairman, one further statement. He is advised by counsel. He is not here without counsel. I was a prosecutor for 12 years. There is an appropriate way to take the fifth amendment and not an appropriate way to take the fifth amendment. He said that he was going to assert the fifth amendment privilege, and then he went ahead and testified and denied any wrongdoing. So I think he has waived his privilege, and I would ask counsel to conduct further legal research before a definitive ruling is made here.

The CHAIRMAN. The counsel will be doing an appropriate response, both Minority and Majority counsel.

The gentleman from Massachusetts.

Mr. CAPUANO. Mr. Chairman, I really don't want to vote to overturn your ruling, but I would respectfully ask you to rescind it for the simple reason if Mr. Ebbers wants to leave, let him leave. That's his prerogative if he wants to do that. If nobody wants to ask him questions, you don't have to ask him questions. If he doesn't want to answer them, he doesn't have to answer them. But I don't feel compelled as a member of this committee to be nice to Mr. Ebbers after what he has done both to this committee, to my constituents and the American public. If he wants to leave, there's ramifications for it, go ahead and leave. He didn't have to come in the first place. There's ramifications for that as well. But to be nice to him simply so he can go off and count his money, I don't understand what message that is sending to the American public. He doesn't have to answer questions.

I respect what you are doing, and I agree with you we should wait to get legal rulings on whether he has or has not given up his fifth amendment right, but that doesn't mean that he shouldn't be here.

The CHAIRMAN. I appreciate what the gentleman is saying. Let me say this: I—the Chair thought it would be in the best interest of getting information that we didn't have the parade of questions to Mr. Ebbers which he would obviously not answer. It may make for good television, but it doesn't make for good legislating or information gathering. That was the purpose of what the gentleman wanted to do.

Now, I would ask the Members to consider that when we're trying to get at this information, and it's obvious that he's not going to answer those questions under advice of counsel. That is his constitutional right, as the gentleman from Massachusetts pointed out.

Mr. FRANK. Mr. Chairman, yield for 10 seconds. I understand you wanting to focus on getting information. I would just say it's been experience we weren't getting that much information from Mr. Dick and Mr. Grubman either.

The CHAIRMAN. The gentleman from Louisiana.

Mr. BAKER. Mr. Chairman, I understand the Chair's ruling and would only for the record to establish that I did ask Mr. Ebbers a question which I do believe was within the scope of his testimony, and I certainly understand the need for deliberative research before we reach final conclusions, and we are awaiting on House counsel to advise the committee as to whether or not the question was or was not within the scope of the testimony. We are also waiting at this time for transcriptions of the gentleman's oral statement of which we do not have a copy yet. Upon receipt of the statement, and upon a determination by House counsel of the question being within the scope, I think the Chairman is indicating that you would then extend an invitation to Mr. Ebbers if necessary, subpoena Mr. Ebbers to again return to this committee to answer appropriately questions that are within our fifth amendment right to ask. Is that the Chairman's position at this time?

The CHAIRMAN. That is correct. And let me just simply say that we would—I would simply request that the witness stay. We will

proceed with regular order, but I would ask the Members to understand that the questions are not going to be answered and that we need to move on. So with that— .

Mr. GONZALEZ. Chairman, point of order.

The CHAIRMAN. Gentleman from Texas.

Mr. GONZALEZ. Do we not have to ask the witness a question for him to invoke? If we discover that we are correct that there was a waiver, because he did use it as a sword and not a shield, and that is a basic precept of law, then all this time would have been wasted today with Mr. Ebbers being here. I think we should be allowed to ask the questions. He may be invoking his privilege, but in the future if we discover later today or tomorrow, whenever, that he did, in fact, waive his privilege—

The CHAIRMAN. Members may ask any question they want. I simply ask the Members to be judicious in that regard so that we can move.

Who seeks recognition for questions?

Mr. Kanjorski.

Mr. KANJORSKI. Thank you, Mr. Chairman.

Mr. Dick, I have got to go back to you because you are really shaking up my faith in the auditing system. Following on what Mr. Frank had indicated to you, you're indicating that you just checked the mathematics of whatever management gives you, and that's what you consider an audit?

Mr. DICK. No. Let me just reemphasize again that the preparation, the actual financial statements themselves are prepared by management. The auditors' responsibility is to perform an audit on those statements to make sure they are—

Mr. KANJORSKI. Just the statements, not the underlying materials that those statements are based on. The only thing you do is look at the actual—they provide you with a balance sheet and profit/loss statement, and you just check over that to make sure that's accurate?

Mr. DICK. When auditors perform their audits, they do a number of things.

Mr. KANJORSKI. What did you do in these things, and what are you trying to tell us, that you didn't have a responsibility to pick up this 3.8 billion? You didn't pick it up, and what—we're interested in why didn't you pick it up, or aren't you the proper party? Should we have a government auditing or government accounting office that handles major corporations and take the accounting firms out of it, because apparently—apparently from what you told me, anything Mr. Sullivan or the inside financial people within that company told you, you are going to presume their honesty. And if you presume their honesty, I don't know why we have to spend $4-1/2 billion and have some writing at the bottom that Anderson looked this over and it's all good, because it doesn't mean a damn thing. If they are liars at the top, all you do is certify their fraud or abuse.

Mr. DICK. We simply did not rely on management's representation. When we performed our audit, we did specific testing.

Mr. KANJORSKI. This wasn't off balance sheet material, was it? The 3.8 million was just recorded in the wrong area. It was recorded as a capital investment as opposed to a normal expense. It

appeared on the balance sheet. I just heard my colleagues saying these are off balance sheet records. It appeared, didn't it?

Mr. DICK. I have not specifically seen what they have done but based on what I have read—

Mr. KANJORSKI. You mean you certified this audit and didn't look at it before you came here today?

Mr. DICK. With regard to the 3.8 billion—

Mr. KANJORSKI. You weren't curious enough to know how these guys snookered your outfit to certify something that misstated 3.8 billion, and you didn't figure out what they did yet?

Mr. DICK. Congressman, that information has not been provided to me. What we did when we did our audit was to test the underlying transactions. We did analytical reviews.

Mr. KANJORSKI. Do you know where you missed it? Do you know now where this 3.8 billion was placed by Mr. Sullivan and his cohorts, or don't you?

Mr. DICK. I do not because I have not been provided the information as to what they did or did not do.

Mr. KANJORSKI. Isn't that a public record now or not?

Mr. DICK. I don't know if it is or isn't. It has not been made available to me.

Mr. KANJORSKI. You really did prepare yourself to testify and explain and assist the Congress as to what we should do or shouldn't do in helping proper accounting in American corporations because you are the principal party. You're paid $4-1/2 million, and over the last month you didn't take the opportunity to find out, gee, I fouled up, I wonder if I should find out what I did, or did I foul up? Who fouled up? We don't know. You can't tell us.

Mr. DICK. I don't think we know yet.

Mr. KANJORSKI. We don't know.

Mr. DICK. That information was not provided to me.

Mr. KANJORSKI. Mr. Grubman, information has come to me—and you're a little bit more here—more than an analyst. You sat at these three board meetings. You were telling the color of the market, whatever the hell that means. But I have information that Salomon Smith Barney was offering special IPO information to executives of WorldCom on a specialized basis. Do you have any knowledge of that?

Mr. GRUBMAN. I have no recollection of that.

Mr. KANJORSKI. No recollection. You have no recollection, no knowledge, no nothing.

Mr. GRUBMAN. I—

Mr. KANJORSKI. Mr. Grubman, be very serious about this now. Do you know or have you heard or are you in possession of any indication that special friend IPO offerings were made available to certain executives and members of the board of WorldCom from your investment banking company?

Mr. GRUBMAN. I'm trying to think if I can answer that specifically yes or no. I just don't recall, because that's not something that I would be involved with, so I can't recall. I'm not saying no, I'm not saying yes. I just can't recall.

Mr. KANJORSKI. Did you make any offerings or indications of those offerings in those hamburger sessions or pool sessions with Mr. Ebbers?

Mr. GRUBMAN. Not that I can recall.

Mr. KANJORSKI. You can't recall that. For an analyst as brilliant as you are, you have a terrible recollection.

Mr. GRUBMAN. That's not what I do for a living. I can't recall anything along those lines.

Mr. KANJORSKI. Your testimony is you can't recall, but you can't deny on behalf of your company that special IPO offerings were made available to the executives and members of the board of WorldCom?

Mr. GRUBMAN. My company is a big company, so therefore I cannot say definitively one way or the other if what you're saying is true or not.

The CHAIRMAN. The gentleman's time has expired.

The gentlelady from New York.

Mrs. KELLY. Thank you very much, Mr. Chairman.

Mr. Ebbers, since you're still here with us, I just want say something to you. You had a great idea. You put together a great company, a large company. A lot of people bought into your idea, and there's no real reason why you weren't entitled to have a good substantial amount of pay. It was your idea, you ran the company. I don't see any problem with that.

The problem I see is what's happened. The problem I see is the severance package you walked out of that company with. It's my understanding you get $1.5 million for life. You get time on the private company plane. You get a full insurance package for both life and health. I have a real hard time explaining that to the people who live in my district, the single mom who decides if she has a little extra money left over at the end of the month whether to take her kids to McDonald's or Burger King. She doesn't have packages like you have.

It's okay you got compensated, Mr. Ebbers, but I sure wish you could find it in your heart to say something besides the fact that you will not answer the questions for this committee. I think you throw a terrible, terrible burden on the committee by your being uncooperative, and I think you certainly demonstrate to the single moms and to the families and to the rest of America that it may be okay for somebody to try to get by. That's not a model we want our kids to know about. It's not the right thing. So I just have that to say to you.

Now, Mr. Dick, I want to talk to you a minute. The public has a certain amusement in the Wild West atmosphere of business, but we really think of the accountants as being the cavalry, and in this instance it's sort of like you were General Custer, and the people at WorldCom were the Indians, and you got slaughtered. I have tried to figure out how. We need to know that piece of information.

I want to know what system was in place, who talked to whom? You have repeatedly said, well, that information was not made available, and yet we have to understand that there were some really serious problems here. You had, for instance, journal entries given to you, I assume. Were the journal entries given to you?

Mr. DICK. No.

Mrs. KELLY. You had no journal entries given to you?

Mr. DICK. When we performed our audit, we had a step in our audit, we requested in connection with our quarterly reviews and

our audit if there were any top side journal entries. These would be journal entries that would be made to the financial statements outside of the normal transaction processing system of the company.

Mrs. KELLY. Didn't that raise an alarm with you, Mr. Dick?

Mr. DICK. Well, in addition to asking that, in addition to all of the other work we performed, when we looked at it in the analytical procedures we looked at, it didn't raise any unusual items.

Mrs. KELLY. When you say you looked at it with analytical proceeding. What kind of analytical proceeding could you possibly have followed if you were auditing books—you didn't get the journal entries, and we know now that Mr. Sullivan spread this out apparently over a great course of accounting. At some point when you're going in and getting these smaller pieces of information, didn't any red flags appear?

Mr. DICK. Well, when we performed our audit, as I mentioned before—

Mrs. KELLY. Who gave you the information you performed your audit on? Where did it come from; Mr. Sullivan?

Mr. DICK. The information we are auditing comes out of the transaction systems and the processes of the company. And so we—

Mrs. KELLY. No, sir. I want a name. I want to know who was running those systems.

Mr. DICK. The company's transaction processing systems were ran under the direction of Mr. Sullivan and Mr. Myers. Mr. Myers was the controller of WorldCom.

Mrs. KELLY. And they gave you the information from those systems; is that correct?

Mr. DICK. Well, when we do our audits, we are working with people throughout the company, and we're looking at and testing transactions from a variety of their systems, be it their billing systems, be it their systems to pay their bills, to pay their employees, et cetera. And when we're testing those systems, we are taking selected transactions, looking at those transactions, and looking at the specific processes and procedures and controls that are in place by the company to ensure that those transactions are processed properly through those systems. And based on that testing, we then place reliance on the numbers that come out of those systems that go into the financial statements.

That's just one aspect of our audit. In addition to that, we look at the overall financial statements and the overall ratios of things that go through the company's financial statements. For example, I mentioned in my opening remarks, we have software that we used that has been developed and analyzes the relationships on the financial statements, for example, the relationship of sales to accounts receivable, and look at that.

The CHAIRMAN. The gentlelady's time has expired.

The gentlelady from California Ms. Waters.

Ms. WATERS. Thank you very much.

Quickly, Mr. Dick, do you not have the responsibility for looking at the capital outlay and determining whether or not those kind of dollars have really been spent in a fashion that complies with the definition of capital outlay? Would it have been $10 billion? You

don't know or can't sense or tell whether or not it has been that kind of capital outlay that would cause you some concern?

Mr. DICK. When we performed our audit, we did, in fact, look at the processing and the procedures and the transactions that related to capital outlays.

Ms. WATERS. But you wouldn't know whether or not they bought new buildings, machinery or equipment. You don't see that is what you're saying?

Mr. DICK. For those transactions that we would have looked at and audited and selected in our sample, we would have taken what's called authorization for expense.

Ms. WATERS. Do you have anything to do with helping to determine depreciation on these capital outlays that fall within the capital accounting?

Mr. DICK. Our audit procedures would have covered testing of the depreciation.

Ms. WATERS. Well, you didn't do that. That's what the trick is all about. The accounting trick here is they took operating expenses that would have been debt out of their operating costs and put it over into this column that says we have $3.8 billion in capital outlays, and you never detected the difference. That's what you're telling us? Yes or no?

Mr. DICK. When we performed our audit, we looked at those transactions that we tested and determined—

Ms. WATERS. Couldn't you tell that the operating expenses simply were payments for access to the right of way that they were paying to companies in order to use their lines?

Mr. DICK. When we did our testing, we did test selected transactions.

Ms. WATERS. How did you determine that they were correct, that that was exactly what had happened?

Mr. DICK. For those transactions—

Ms. WATERS. Okay. That's enough.

Mr. Ebbers, why did you borrow $408 million from the company, what did you spend it on, and do you have—is it capitalized in any way, and what's your repayment schedule? What arrangements do you have to repay the money? Do you have a sweetheart deal or not? Mr. Ebbers?

Mr. EBBERS. On the instruction of counsel, I respectfully decline to answer to the basis of my fifth amendment constitutional rights.

Ms. WATERS. Thank you.

And now I would like to ask Mr. Grubman, did you ever consult or discuss with Mr. Ebbers, Mr. Bobbitt, Mr. Sullivan or any of the WorldCom management prior to downgrades, during downgrades or after downgrades, and did you carefully and slowly downgrade, which helped to keep WorldCom investments possible; and given that there are investors who specialize in marginally troubled corporations, didn't this keep WorldCom afloat until a very special date that you didn't mention, June 24? You talked about what happened from March up to June 17. On June 24, you took an action prior to something public happening on June 25.

So will you start at the top and first answer, did you ever consult with or discuss with Mr. Ebbers, Mr. Bobbitt or anybody else what you were going to do before you downgraded?

Mr. GRUBMAN. First of all, just to correct, it was June 21 when we issued our last downgrade, as I said in my opening statement, and that is the date of the report.

Ms. WATERS. What did you do on June 24?

Mr. GRUBMAN. We didn't do anything on June 24.

Ms. WATERS. You didn't have a sale report?

Mr. GRUBMAN. On June 21, we downgraded the stock from neutral to market underperform. There's actually a lower rating called sell. That was done on June 21.

Ms. WATERS. When did you do sell?

Mr. GRUBMAN. We never did.

Ms. WATERS. So you never advised sell.

Mr. GRUBMAN. We had a market underperform, and then the accounting fraud was unveiled. The stock stopped trading, and then at that point there's nothing for us to do.

Ms. WATERS. So, all right. Start at the top. Let's go to the top. Did you ever discuss downgrades with any of the people that I mentioned or anybody else in management prior to downgrades, during or after?

Mr. GRUBMAN. Typically when we change a rating on a stock—

Ms. WATERS. No, no, no. I don't want what you do typically. I want specifics. Did you ever discuss with Mr. Ebbers, Mr. Bobbitt or Mr. Sullivan, or any other management—

Mr. GRUBMAN. I do not ever recall, and I am quite sure we did not prior to downgrading a stock discuss the possibility that we were going to downgrade. After we actually released a rating change as a matter of course on any company—

Ms. WATERS. Did you ever discuss downgrades with any of the people I have identified or anybody else in the WorldCom management before, during or after?

Mr. GRUBMAN. Well—

Ms. WATERS. Let's start with before. Did you ever do it before?

Mr. GRUBMAN. I do not believe I ever discussed before—

Ms. WATERS. But you may have.

Mr. GRUBMAN. I don't think I have.

Ms. WATERS. But you don't know for sure.

Mr. GRUBMAN. Well, I'm cognizant of not giving a categorical answer if I don't have 100 percent memory, but I am quite confident we never did. That was never our practice.

The CHAIRMAN. The gentlelady's time has expired.

The gentleman from Alabama Mr. Bachus.

Mr. BACHUS. Thank you, Mr. Chairman.

It's my understanding that the privilege against self-incrimination can be waived in one of three ways: By failing to assert it, by specifically declining to assert it, and the third way is by testifying as to matters—testifying as to matters and then later attempting to assert a privilege. Now, it's my understanding that Mr. Ebbers said his conduct at all times was appropriate. So I'm going to ask him a question about his conduct knowing that he's already testified as to his conduct. In fact, he said his conduct at all times.

My question is this: Did your conduct, Mr. Ebbers, ever include discussing accounting practices with other employees of WorldCom?

Mr. EBBERS. On the instruction of counsel, I respectfully decline to answer on the basis of my fifth amendment constitutional rights.

Mr. BACHUS. Were you aware of accounting practices which included certain line costs, including telecom, access and transport charges, being booked as capital expenditures?

Mr. EBBERS. On the instruction of counsel, I respectfully decline to answer it on the basis of my fifth amendment constitutional rights.

Mr. BACHUS. Thank you.

Mr. MOORE. Point of order, Mr. Chairman.

The CHAIRMAN. The gentleman from Kansas.

Mr. MOORE. I would ask the Chair to reserve the gentleman from Alabama's question, and ask that the witness be cited in contempt of Congress or this committee for failure to answer the question, and ask the Chair to reserve ruling.

The CHAIRMAN. The Chair has indicated that he has already reserved ruling on that, and I thank the gentleman.

Mr. BACHUS. Mr. Grubman, let me ask you these questions. You said in making your downgrades and observing the conduct of WorldCom in making your ratings, you relied on the—you relied on such documents as public companies—well, I'm sorry, you relied on the accuracy of its audited financial statements and other SEC filings; is that correct?

Mr. GRUBMAN. Correct.

Mr. BACHUS. So that means you examined their audited financial statements?

Mr. GRUBMAN. Yes.

Mr. BACHUS. In observing their audited financial statements, did you observe their practices of booking certain line costs as capital expenditures?

Mr. GRUBMAN. I want to answer that, but I want to get back to Congressman Waters. Can I just clarify an answer I gave to her?

Mr. BACHUS. Why don't you clarify—

Mr. GRUBMAN. I need to clarify one thing.

Mr. BACHUS. Not on my time.

Mr. GRUBMAN. Could I clarify one thing?

The CHAIRMAN. I will grant the gentleman extra time.

Mr. GRUBMAN. What you're referring to, Congresswoman Waters, was a voice mail we sent out June 24. I was thinking about a written report. That voice mail on June 24 was just as I put into my larger statement that I submitted to the committee, a—in a sense an update to what we put out June 21. And in that voice mail I said that, you know, the reasons for our downgrade are what we reported, but that I did not believe WorldCom was a bankruptcy candidate, because I was, you know, worried that some people thought that is what we were thinking. I think that's what you are referring to on June 24, but there was no rating change.

To answer your question, and thank you for your indulgence, that is an extremely good question because it gets to the heart of the matter of how could all these analysts, myself included, not figure this out, really. Well, first of all, let's think about what happened. Allegedly line costs got shifted to capital expenditures over a five-quarter period. In the—

Mr. BACHUS. Possibly as much as 10 years.

Mr. GRUBMAN. Okay. I'll leave that to others to uncover. At the beginning of 2001, just like at the beginning of every year,

WorldCom and other companies give financial guidance, as you know. In their case their capital expenditure guidance was 7-, $7-1/2 billion. That's what they reported. So red flag number one would have been if they reported $9 billion of cap ex. So they didn't overrun that.

Secondly, that was quite a bit lower from their year 2000 capital expenditures, which were around 10- to $11 billion. Furthermore, during the course of 2001, they filed an 8(k) where they actually lowered cap ex a little bit more.

Two, on the other side of the equation, the line cost side, if you look at the consolidated WorldCom, Incorporated, and compare that to their only real competitor, AT&T, 2000, 2001, first quarter 2002, the EBITDA margins that Ms. Waters referred to in her opening remarks, for WorldCom, Incorporated, the trends were 36 percent, 30 percent, 27 percent first quarter 2002 on the reported numbers; AT&T's, 38 percent, 32 percent, 29 percent. So for those of us who are looking at both companies, the level and trajectory of the reported EBITDA margins seemed right.

Mr. BACHUS. We are talking about their audited financial statements. If you looked at their audited financial statements, you should have looked at operating expenses and should have seen—

Mr. GRUBMAN. You mean the financial statements that were publicly filed?

Mr. BACHUS. Right.

Mr. GRUBMAN. That's what I'm saying. Based on the financial statements that they filed, their capital expenditures were in line.

Mr. BACHUS. But it didn't reveal what those capital expenditures were. It revealed those were line costs, right?

Mr. GRUBMAN. No.

Mr. BACHUS. So they misrepresented that on their filings.

Mr. GRUBMAN. They did not reveal anything like that within their capital expenditures. But what added to the sense of comfort, if you will, on Wall Street is WorldCom actually had a lot of transparency in their capital expenditures. Each quarter they would break out where they went, what part of the world.

Mr. BACHUS. Where did they say they were taking the line cost including the telecom access? Where did they say they were booking that as capital expense?

The CHAIRMAN. The gentleman's time has expired.

Mr. GRUBMAN. There was a line called line cost in their income statement, which is where we thought they were.

The CHAIRMAN. The gentleman from Vermont Mr. Sanders.

Mr. SANDERS. Thank you, Mr. Chair.

According to news reports, just five people at WorldCom received over $600 million in loans compensation and stock over the past few years. Much of this wealth was apparently created due to an alleged $3.8 billion fraud, which led to the firing of 17,000 workers and the loss of more than $150 billion in shareholder wealth, including billions in lost pension assets. My question is, wouldn't it be a good idea to use this $600 million fund to compensate the 17,000 WorldCom employees who have lost their jobs and the pensioners who have lost their life savings as a result of WorldCom's alleged fraud? My question is to Mr. Ebbers and Mr. Sullivan.

Mr. SULLIVAN. Congressman, based on the advice of counsel, I decline to answer the question based upon my fifth amendment to the U.S. Constitution.

Mr. EBBERS. On the instruction of counsel, I respectfully decline to answer on the basis of my constitutional rights.

Mr. SANDERS. Mr. Grubman, you have indicated that you have had a close personal relationship with Mr. Ebbers. According to the Washington Post, you waited until June 24 to advise your clients to sell WorldCom stock, just 1 day before the company announced to the world that it improperly accounted for 3.8 billion in expenses over the last five quarters. The other telecom firms that you have recommended over the years, as I understand it, are such companies as Windstar Communications, XO Communications, Qwest Communications International and Global Crossing, and all of those companies are either in bankruptcy or now trade for pennies a share.

My question for you, Mr. Grubman, did you have close personal relations with some of the management in those companies as well?

Mr. GRUBMAN. Okay. First of all, as I said, I had a good working relationship with Mr. Ebbers and with other management teams, some of the companies you mentioned.

Mr. SANDERS. Windstar.

Mr. GRUBMAN. Not really.

Mr. SANDERS. XO Communications?

Mr. GRUBMAN. To some degree. Qwest and in some cases Global Crossing.

Mr. SANDERS. And every one of those companies are now in bankruptcy or trading for pennies per share; is that correct?

Mr. GRUBMAN. Well, yes. But that's not the cause and effect.

Mr. SANDERS. Well, what the cause and effect is, you were telling people to buy those stocks, and you had a personal relationship.

Mr. GRUBMAN. No.

Mr. SANDERS. No?

Mr. GRUBMAN. Just to correct one thing again, our downgrade from neutral to market underperform is June 21.

Mr. SANDERS. I am quoting from the Washington Post.

Mr. GRUBMAN. They are incorrect. It is June 21.

Mr. SANDERS. Let me ask you this, Mr. Grubman.

Mr. GRUBMAN. Can I—

Mr. SANDERS. Very briefly.

Mr. GRUBMAN. We had a long-held investment thesis in the telecom industry, and for many years it worked quite well, and people made a lot of money. Unfortunately over the last 2 years, the entire telecom sector collapsed. The broader technology sector collapsed. In terms of sheer market values, there has been more loss in Cisco by a factor of three than in WorldCom.

So the fact is, yes, I did not either recognize or understand the depth and length of a lot of the factors.

Mr. SANDERS. Let me pick up on that point and suggest a reason why. WorldCom, AT&T Wireless and Windstar alone generated 449 million in investment banking fees for your firm from '97 to 2001, according to Thompson Financial. Don't you think that there is an inherent conflict of interest for firms that provide, quote/unquote,

independent analysis of the same companies, presumably what you were supposed to be doing, while these companies are giving the firms hundreds of millions of dollars in investment banking fees?

Mr. GRUBMAN. This is an important issue, and it's an issue that a lot of people are looking, NYSE, SEC, NASD. Merrill Lynch adopted some policies which we adhere to.

Mr. SANDERS. What do you think?

Mr. GRUBMAN. Well—

Mr. SANDERS. Your firm is making substantial sums of moneys in investment fees, and you are giving advice.

Mr. GRUBMAN. An analyst can maintain, as I think I have, notwithstanding the poor stock performance, honestly held opinions and integrity and can still be part of a full-service firm because at the end of the day the—

Mr. SANDERS. I respectfully disagree with your assertion, and I want to ask Mr. Dick a question.

Mr. Dick, it appears very clearly that Arthur Andersen failed in their audit of WorldCom. You failed in the audit of Enron. You failed in the audit of Sunbeam. You failed in the audit of Waste Management. You failed in the audit of McKesson. You failed in the audit of Baptist Foundation of Arizona. What was Arthur Andersen doing? I mean, how do you—it is incomprehensible to me that a major accounting firm can have such a dismal record in trying to determine what the financial health of a company is. It's almost beyond comprehension.

Mr. DICK. I can only speak to my work on WorldCom.

Mr. SANDERS. You did speak to that, and I don't think many of us were convinced by what you said.

The CHAIRMAN. The gentleman's time has expired, and the gentleman may respond.

Mr. DICK. As I mentioned, we did perform our work, and we did the appropriate tests under generally accepted auditing standards, including looking at the various financial ratios.

Mr. SANDERS. Thank you.

The CHAIRMAN. The gentleman from Illinois Mr. Manzullo.

Mr. MANZULLO. Mr. Ebbers, could you tell us when you found out about the improper accounting activities at WorldCom/MCI?

Mr. EBBERS. On the instruction of counsel, I respectfully decline to answer on the basis of my constitutional rights.

Mr. MANZULLO. Thank you.

Mr. Grubman, in your statement you state on page 2, analysts do not have access to internal company info such as audit trails and internal entries, invoices and the like. In short, analysts are not auditors.

And then I go to Mr. Dick's statement, who says, the fundamental—deferring to the auditors, you base your opinion upon them. And the auditor says, the fundamental premise of financial reporting is that the financial statements of a company, in this case WorldCom, are the responsibility of the company's management, not its outside auditors. So we're trying to find out who's responsible for the information.

I have before me, Mr. Dick, from Black's Law Dictionary a definition of the word "audit," and it says, inspection and verification—this is IRS—of a taxpayer's return or other transactions possessing

tax consequences. When the IRS does an audit, they go behind the statement. If somebody says he bought a building, they go and look at the deed. If somebody says he went out and acquired inventory, they look at documents, checks, receipts, things of that nature. And Black's also says a systematic inspection, not spot; systematic inspection of accounting records involve analyses, tests and confirmations.

What did you do to confirm that the information given to you by WorldCom-MCI was correct in the process of your doing the audit?

Mr. DICK. When we performed our audit test on various transactions, we would have looked at the underlying supporting documentation that you referred to.

Mr. MANZULLO. No, no, no, beyond that. Did you ever go to the courthouse, for example, and look at a deed? Did you look at any other documents, any documents other than what WorldCom gave you?

Mr. DICK. We looked at those underlying documents that we deemed appropriate to finish our audit.

Mr. MANZULLO. Did you look at any documents to verify or confirm the statements of WorldCom/MCI other than the documents that they gave you?

Mr. DICK. Well, we look at the systems, we look at the controls.

Mr. MANZULLO. You're not answering my question.

Mr. DICK. With all due respect, I am not trying to avoid your question.

Mr. MANZULLO. I understand what you do, and you failed. My question to you is this: Did you at any time ever go beyond the documents furnished to you by WorldCom/MCI to confirm, verify or to test their accuracy?

Mr. DICK. In certain instances we would have obtained—for example, when we're looking at material contingencies and legal matters, we do get confirmation from outside counsel as to the—

Mr. MANZULLO. Not outside counsel. I'm talking about factual documents, not opinions of lawyers.

Mr. DICK. There are other cases when we might get confirmations relative to the accounts receivable of the companies. We would look at appraisal documents relative to the underlying security for receivables the company may have had.

Mr. MANZULLO. For example, on the—when you see something that's amortized over a period of time, that would show up in the audit; isn't that correct?

Mr. DICK. That's correct.

Mr. MANZULLO. Did you ever take a look to see what was exactly amortized and if it was amortized over a correct period of time?

Mr. DICK. We did testing in that area for amortization and depreciation, yes.

Mr. MANZULLO. And the testing did not show this is where the books were cooked; isn't that correct?

Mr. DICK. When we did our testing, our testing of those transactions were that they revealed that they were appropriately recorded.

Mr. MANZULLO. How could anybody rely upon an audit of any corporation in America?

Mr. DICK. I think, as has been reported, the company has—it's been reported that the company made entries outside of their normal transaction systems. We asked if they made those entries. We obviously would have looked at the underlying support.

Mr. MANZULLO. You asked somebody if they're dishonest?

Mr. DICK. No. We asked if they had made those entries. Obviously if they had made those entries and they would have been given to us, we would have looked at the underlying support for those entries.

Mr. MANZULLO. But at what point do you notice a red flag?

Mr. DICK. Again, as I mentioned, when we did our audit work, we tested the underlying procedures. We did—

Mr. MANZULLO. But you did it all wrong.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from New York.

Mr. LAFALCE. Thank the Chairman.

Mr. Wu from the State of Oregon has indicated great interest in these hearings, and I ask unanimous consent that he be allowed to sit in on the hearing; not to participate in them, but merely to observe the proceedings.

The CHAIRMAN. Without objection.

The gentlelady from New York Mrs. Maloney.

Mrs. MALONEY OF NEW YORK. Thank you, Mr. Chairman.

Mr. Ebbers, you testified earlier that you did not engage in any criminal or fraudulent conduct, that your conduct was appropriate, and I would like to ask a question about your conduct. First of all, do you meet regularly with your auditors, and was the question of capital expenditures ever discussed? And what was the normal procedure for your review of the financials at the close of each quarter?

Mr. EBBERS. On the instruction of counsel, I respectfully decline to answer on the basis of my fifth amendment constitutional rights.

Mrs. MALONEY OF NEW YORK. Mr. Dick, did your firm also provide tax consulting to WorldCom?

Mr. DICK. Yes.

Mrs. MALONEY OF NEW YORK. So you provided tax consulting, regular consulting, and you were the auditor, and with all of this assistance, you couldn't see any problems.

Mr. DICK. We did, in fact, provide all those services.

Mrs. MALONEY OF NEW YORK. Did WorldCom certify to you that their financials were accurate? That is one of the reforms that Secretary O'Neill is calling for, that CFOs and CEOs verify that their financials are accurate and they face criminal penalties if they lie. Did they certify to you that these are accurate?

Mr. DICK. We would have received a representation letter from them.

Mrs. MALONEY OF NEW YORK. They did certify. How did you not see some red flags when the filed taxes of WorldCom were so different from what they reported as their earnings?

And I would like to place in the record, Mr. Chairman, an article by Alan Murray in the Wall Street Journal in which he reports between the years of '96 and 2000, WorldCom reported 16 billion in earnings, yet at the same time they had less, much less, than a bil-

lion that they paid in taxes. So how can you be having $16 billion of earnings and then not report to the IRS such a different story?

The CHAIRMAN. Without objection.

Mrs. MALONEY OF NEW YORK. And you prepared both sets of books; is that right? So you prepared the earnings that were 16 billion and then the set of books for the IRS that was far less; is that correct?

Mr. DICK. Arthur Andersen was not responsible for preparing the tax returns for WorldCom.

Mrs. MALONEY OF NEW YORK. Did you look at the tax returns?

Mr. DICK. I don't know if we looked at the tax returns during those years that you referenced.

Mrs. MALONEY OF NEW YORK. Certainly that would have raised a red flag that the tax returns were different from what the earnings were. And some have called for a reform that publicly held companies reveal their taxes so analysts have more information and the public has more information, and I would be concerned that a company has multibillions in earnings, and yet their taxes—Enron had billions in earnings, and yet they paid no taxes and reported losses to the IRS.

Mr. DICK. I can't speak to the specific circumstances that you refer to.

Mrs. MALONEY OF NEW YORK. Would that have helped you maybe conclude or maybe do a better audit if you had looked at the tax return? Would that have helped you possibly uncover the fraud?

Mr. DICK. In connection with our audits, we would have reviewed the tax accruals that are made on behalf of the company in connection with our 2001 audit. It's not uncommon that companies will report a different amount in their financial statements for their book income as opposed to their taxable income. Those differences—

Mrs. MALONEY OF NEW YORK. Don't you think it would be helpful to have a unified definition of both book income and tax for purposes—

Mr. DICK. I believe there is a commonly accepted definition of book income and tax income.

Mrs. MALONEY OF NEW YORK. Well, I would like to ask Mr. Grubman, you testified that you really believed in WorldCom.

Mr. GRUBMAN. For a long period of time.

Mrs. MALONEY OF NEW YORK. Did you buy stocks yourself? Did you invest yourself?

Mr. GRUBMAN. I have been on Wall Street since 1985, and I never personally owned a stock that I follow.

Mrs. MALONEY OF NEW YORK. Now as we speak, Attorney General Eliot Spitzer is reviewing your e-mails and other analysts' e-mails and reviewing the internal documents of analysts. Will his investigation reveal that your internal e-mails were the same as what you said publicly, or will there be a difference?

Mr. GRUBMAN. I believe that when that investigation is complete and our internal e-mails are revealed, that there will be a consistency between our external and internal views.

The CHAIRMAN. The gentlelady's time has expired. The gentleman from Wisconsin, Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman. First off, I have a question for Mr. Ebbers. And I want to follow up on questioning that both Mr. Bachus and Mr. Manzullo have presented to you. If you were aware of accounting—the accounting practices that Representatives Bachus and Manzullo referred to. That is shifting certain expenses to capital expenditures, whose counsel and advice did you use to make such a decision? And furthermore, were you aware that that decision that you made, if disclosed, would be questioned and controversial publicly.

Mr. EBBERS. On the instructions of counsel, I respectfully decline to answer on the basis of my fifth amendment constitutional rights.

Mr. GREEN. My next questions are for Mr. Dick. Mr. Dick, in your written testimony, you talk about working, when you conduct an audit, when an audit is conducted, that you work with people throughout the company in conducting an audit. Can you tell me, in this case of WorldCom, who it was you worked with in preparing the outside audit? Who did you turn to in preparation for the outside audit?

Mr. DICK. That's a very broad question in terms of a company the size of WorldCom. But we would have worked with, and I will be very brief here.

Mr. GREEN. Kind of management positions.

Mr. DICK. People involved with the revenue processing systems, billing the customers, collecting the cash from the customers. People involved with the processing of the capital transactions or the authorization for expenditures, as I mentioned before. They would have been people in the accounting organizations throughout the company responsible for paying the bills and so forth.

Mr. GREEN. You just indicated that you'd be working with people who authorized transactions and expenses. You couldn't have worked with them too closely if you weren't able to discover the decisions that have—the bookkeeping decisions that led to this whole fiasco.

Mr. DICK. Well, as I mentioned before, when we tested the systems, we did not find—we were satisfied that we had done sufficient amount of work and that the transactions that were tested and those systems could be relied on. That is what we call compliance testing. In addition to that, we reviewed the overall financial statements and looked at certain ratio analysis in the context of the financial statements. WorldCom had consolidated net assets of 104 billion, they had property and services 49 billion, revenues of 35 billion and line costs of about 15 billion.

And we looked at those numbers. I believe Mr. Grubman mentioned trends that had been reported, and in the context of that review, plus our using our software that we have that analyzes the financial statement line items, nothing came to our attention that would suggest we should do additional work now, we didn't stop there. As I mentioned before, we did ask, had the company made any type of top side or journal entries. And these are entries, as I understand it, based on what's been reported, the company made entries to their accounting systems that were outside of the normal transaction system.

Mr. GREEN. So you—you asked that question of those whom you worked with and just took the answer at face value, no further questions. That was the end of the analysis.

Mr. DICK. We asked that question, and in addition—and we asked and provided a listing request that those type of journal entries be made available to us.

Mr. GREEN. Well, let me ask you this. My time's running short. When you're presented with information for your audit, does anybody at a company, a client like WorldCom, are they required to swear to the information that's given to you? I mean, do you do anything to have individuals guarantee the veracity and accuracy of that information?

Mr. DICK. Well, we look for collaborating evidence. We look for backup support.

Mr. GREEN. I understand that. Do you ask anyone?

Mr. DICK. We get management representations.

Mr. GREEN. But do you have them, in writing, sign off, swear to the accuracy of the information?

Mr. DICK. Yes, in writing they sign off as to the accuracy of those financial statements.

Mr. GREEN. Well, I would sort of suggest that given the beating that Andersen's been taking here, if you got it in writing and it was sworn to, you may want to contemplate your own legal action given the damage that all of this is doing to Andersen.

The CHAIRMAN. The gentleman's time is expired. The gentleman from North Carolina, Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman. Mr. Grubman, can I presume that if you had gotten accurate financial information you probably would have given some different advice to your investors? Yes?

Mr. GRUBMAN. Well, that is correct. If we—

Mr. WATT. Okay. That's not a trick question.

Mr. GRUBMAN. Well, I know.

Mr. WATT. I just wanted to—Okay. So you relied on, to some extent, the financial information that you got and goodwill and relationships and things and you feel like you gave what, at the time was reasonably good advice, in retrospect, probably not good advice, but at the time you gave it, you gave it in good faith and you thought it was good advice.

Mr. GRUBMAN. Yes.

Mr. WATT. Okay. Mr. Dick, based on everything I've heard from you, you followed generally accepted accounting principles. You asked Mr. Sullivan and Mr. Myers the right questions. You had a computer model and they just lied to you, I take it, is what you're—and—but you took what they were saying in good faith and you say that generally accepted accounting principles allows you to do that, so this obviously is not your fault; is that right?

Mr. DICK. That's correct.

Mr. WATT. Okay. So then we're back to Mr. Sullivan and Mr. Myers and all the other people who were lying to you. Mr. Sullivan, of course, is not lying today because he's not testifying today. He's not moving his mouth so he's not lying. But I guess the question I'm stumped on is we have some generally accepted accounting principles. They didn't work. You applied them. They didn't work.

Are there changes that we should be contemplating, either in this committee or at the SEC as our governmental agency that would, in the future, prevent this kind of thing from happening? Mr. Dick, I'm addressing that question to—

Mr. DICK. Yeah. I might just start by answering, when we apply—generally accepted auditing standards, our standards that are out there—

Mr. WATT. I didn't ask that question. I'm asking you are there some things that should—some changes that should be made either in the law, or in generally accepted accounting principles that we could adopt or the SEC could adopt to prevent this kind of thing from—I'm not even looking retrospectively. I've taken your word. I've taken Mr. Grubman's word. He didn't do anything wrong. I've taken your word that you didn't do anything wrong.

What I'm trying to do is look forward at what we can do as a committee, as a Congress, as a SEC to prevent this kind of thing from happening again, because if Mr. Grubman didn't do anything wrong, and you didn't do anything wrong, then some where the system is broken, and we need to figure out how to fix the system to make sure that this doesn't happen again. I mean, it's happened with Enron, it's happened with WorldCom. I mean, you know, you reach a point where you have got to make some adjustments. And I'm trying to figure out what kind of adjustments we need to be contemplating to make sure that this doesn't happen again.

Mr. DICK. It's probably not in my place to—

Mr. WATT. Well, you're a witness and I asked the question, so it's in your place today, whether you like for it to be in your place or not. It is today in your place to give me your opinion about what we could do to adjust the laws or general accounting principles to make sure that this doesn't happen again. I mean, you were at the center of this and I'm asking you for advice about how we can keep this from happening. I'm not beating up on you. I have taken your word for it.

Mr. DICK. That is a fair comment.

The CHAIRMAN. Okay. The gentleman's time has expired. The witness may respond.

Mr. WATT. Mr. Chairman, just for inquiry purposes, since I didn't make an opening statement and you promised those of us who didn't make an opening statement extra time, I'm going to hold you to your promise.

The CHAIRMAN. You have a long memory except for the baseball game.

Mr. WATT. I lost that game. I remember that. I lost last year's game. I remember that. I've got a long memory there, too.

Mr. DICK. Congressman, your comment is a fair comment. And as I understand it, numerous things are being proposed by this committee.

Mr. WATT. I want to know what you would recommend, Mr. Dick. That's—I mean, that's all I've asked today. I want your recommendations, if you have any.

Mr. DICK. I don't have any specific recommendations. I'm aware that a number of proposals have been put forth before a number of other people.

Mr. WATT. I know about the number of proposals. I want to know what you are recommending. I mean, you saw this. You now understand the consequences of what happened. Surely, in the middle of this, you would have some kind of suggestion to make to us that would prevent this from happening. Otherwise, Bell South or all of the other communications companies, or any other corporate official who tells you a lie, that you—that you can't correct, detect, we're going to be back here again next week.

Mr. DICK. I think some of the proposals that have been put forth would address some of those. I will tell you, I don't believe there is a way to build 100 percent fail-safe system in terms of, again, what's been purported to have happened here, where entries were made and there's questions as to whether those entries were appropriately made, and whether people were misled or not.

So, I'm not trying to evade your question, sir. I'm just saying there isn't a way to build a fail-safe system to possibly avoid this kind of a situation that's been purported to have happened.

The CHAIRMAN. The gentleman's time has expired.

Mr. WATT. I am distressed, Mr. Chairman, I just want to say I'm very distressed about that because basically, what you're saying is you, being hands on, can't give us any advice that would allow us to tell the public that a system that has worked for years when somebody lies in the system, it breaks down and we can't guard against that.

The CHAIRMAN. The gentleman's time has expired. The gentleman from Connecticut, Mr. Shays.

Mr. SHAYS. Thank you, Mr. Chairman. Mr. Dick, how many employees at Arthur Andersen oversee WorldCom's account, approximately.

Mr. DICK. Approximately there would have been say, eight to 10, 12 individuals involved with the audit at various times throughout the year.

Mr. SHAYS. Not hundreds?

Mr. DICK. Well, I'm speaking in terms of full-time people on a global—

Mr. SHAYS. Right. You're playing games with me. You know, the equivalent number, whether they're part-time employees, you have a hundred employees who work half-time.

Mr. DICK. The equivalent number would have been probably been 10 to 12 full-time people.

Mr. SHAYS. During this time you have stated that you were unaware of why this happened. And you show no curiosity it appears as to finding out. Aren't your employees in WorldCom as we speak?

Mr. DICK. No, they are not. We are no longer the auditors of WorldCom.

Mr. SHAYS. In the transactions that took place, it's your testimony that you complete a year to year analysis. You go from year to year and you compare numbers; is that correct?

Mr. DICK. That's correct.

Mr. SHAYS. Okay. What was the profit of the company in 1999?

Mr. DICK. I don't recall the profit for '99.

Mr. SHAYS. Was it approximately $3.8 billion?

Mr. DICK. That sounds probably right.

Mr. SHAYS. What were the transfers?

Mr. DICK. I'm sorry?

Mr. SHAYS. What were the illegal transfers? What were the amounts?

Mr. DICK. I don't know if there were any transfers for '99.

Mr. SHAYS. Wasn't that 3.8 billion?

Mr. DICK. It's been reported that it was 3.8 billion during 2001 and the first quarter of 2002.

Mr. SHAYS. So it was equal pretty much to the profit of the company. Would you explain to me why you would not notice if you looked at an account from one year to the next, why you wouldn't have noticed 3.8 billion transfer? Just comparing it. And then looking at the profit of the company.

Mr. DICK. In comparing the company's line cost between 2000, 2001, in both years they were approximately $15 billion.

Mr. SHAYS. How about in 1998?

Mr. DICK. I don't know what the numbers were for 1998.

Mr. SHAYS. Thank you. Mr. Grubman, would you tell me how many times did you meet with the board?

Mr. WATT. As I said earlier, I think perhaps two or three times, not, you know, in that zone. I don't know the exact number.

Mr. SHAYS. Did you ever receive remuneration for appearing before the board?

Mr. GRUBMAN. Me personally, no.

Mr. SHAYS. Who would have then, your company, for you appearing what?

Mr. GRUBMAN. Well, as I said earlier, those occasions where I did appear on the board, it was in connection with merger transactions that my firm was involved in. My role was to give, you know, the view of what the investor reaction would be. I was frozen on those occasions. And I was just one of the members of our firm, you know.

Mr. SHAYS. What was your role in those meetings?

Mr. GRUBMAN. My role in those meetings was to basically, you know, give my view on—usually this was only a day or so before, not always, but it was usually short duration before a transaction was announced. And I have done this with other companies, too. Where they have a deal, they're going to announce, and I'm the one who talks to investors. Bankers don't talk to investors. I talk to investors every day. So I give, at least my view, of what I thought the investor reaction would be the type of issues they would have to, you know, talk about.

Mr. SHAYS. In response to Mr. Kanjorski's question, I wasn't clear as to what your answer was. He asked you if Smith Barney provided any special IPO opportunities for any Board of Directors management family members of WorldCom. And what was your answer?

Mr. GRUBMAN. My answer is I don't know if that's true or not. That's not what I do. That's not my job, so I don't know.

Mr. SHAYS. Well, that's not your job. But I don't understand that's not your job. How does that relate to whether or not you knew? You seem to suggest that you might know. Are you saying, categorically under oath, that you are not aware of any sweetheart financial opportunities for anyone at WorldCom?

Mr. GRUBMAN. What I'm saying is I can't recall if anything like that happened because it's not something that I paid attention to. But I can't categorically say it didn't happen. At this—I just can't recall, I just can't recall.

Mr. SHAYS. How do you, in your business as a senior analyst, how do you make your money?

Mr. GRUBMAN. Well, my compensation is first and foremost, driven by what my perceived market value is by the senior management of the firm.

Mr. SHAYS. Does your company give you any IPO opportunities in any company, whether or not it's the company that you're analyzing?

Mr. GRUBMAN. No, I've never participated in any IPO opportunities in any company I followed.

Mr. SHAYS. Does your company give IPO opportunities for anyone else in—

Mr. GRUBMAN. I don't know that. I don't know.

Mr. SHAYS. Thank you.

The CHAIRMAN. The gentleman's time has expired. Mr. Ackerman.

Mr. ACKERMAN. Thank you very much, Mr. Chairman. Mr. Ebbers and Mr. Sullivan, you are evidently the chief executive officers and the chief financial officer, at least formerly, of a communications company. And yet you seem to have a great deal of difficulty today communicating. It seems to me that there are thousands of people in this country who believe that you have ruined their lives, and the lives of their children and their families. And it seems to me that there are probably millions of people in this country that are attributing to you a major role in undermining the public's faith in the free market system. What I would like to know is a simple question. Do you sleep well at night? Mr. Ebbers?

Mr. EBBERS. On the instruction of counsel, I respectfully decline to answer on the basis of my fifth amendment constitutional rights.

Mr. ACKERMAN. Mr. Sullivan.

Mr. SULLIVAN. Congressman, based on the advice of counsel, I respectfully decline to answer the question based upon my fifth amendment rights to the U.S. Constitution.

Mr. ACKERMAN. It was a pretty simple question. I guess that leaves Mr. Dick and Mr. Grubman. I don't care how you sleep at night. You've testified today that you've done a job based on information and communications that you have received from the two gentlemen sitting in between you, among others. Have they deceived you? Have they lied to you? Have they committed any crimes? Mr. Dick?

Mr. DICK. I don't know if they've committed any crimes. I can tell you that when we did our audits, we asked for the journal entries that have put—

Mr. ACKERMAN. Oh, stop giving us these happy horsefeathers. Do you still feel the need to cover up for these guys? I thought you were off the job. Would you certify their audits today?

Mr. DICK. Not based on the information I know today, no.

Mr. ACKERMAN. So the information they gave you before was incorrect, right?

Mr. DICK. I don't know if it was or it wasn't.

Mr. ACKERMAN. Then why wouldn't you certify it today. You know. You can say it.

Mr. DICK. Well, I've been provided—

Mr. ACKERMAN. Was the information they gave you previously the truth? Yes or no?

Mr. DICK. Based on what's been reported, no.

Mr. ACKERMAN. So would you certify it today?

Mr. DICK. No. We could not.

Mr. ACKERMAN. So did they lie to you?

Mr. DICK. I don't know if they did or they didn't.

Mr. ACKERMAN. Yeah, that's your problem. That's your problem. You're still on the job. The covering up you and your company have done for them has taken deep root in your soul and in your conscience and you can't even say it. Mr. Grubman. Did they lie to you? Did they deceive you? Did they commit any crimes?

Mr. GRUBMAN. I can't answer that.

Mr. ACKERMAN. Thank you.

Mr. GRUBMAN. No, I can't answer that last question about the crimes because I am not qualified. But if what was alleged was true, then I was deceived by the company reports.

Mr. ACKERMAN. So you believe they lied to you.

Mr. GRUBMAN. If what is alleged is true because I don't want to, you know, say anything that's not true, if what is alleged is true, then for at least the last five quarters of what we know, I and others were lied to.

Mr. ACKERMAN. You are an analyst, right?

Mr. GRUBMAN. Yes.

Mr. ACKERMAN. Did you analyze everything or did you just take their word for it and say if what they said is true, when you analyze something and put it out to the public and tout these stocks, do you say if what they said is true is true then it's a good company. Or do you just say it's a good company.

Mr. GRUBMAN. No. We analyze it. I don't know if you were here for my question to—my answer to the Congressman from Alabama, but in looking back at as to should we have caught this, should me and other analysts and the rating agencies should have caught this, the answer was based on the financial results, stress testing the results, the reasonableness of their capital spending trends, their margin trends, their financial performance relative to their competitors. There were no red flags. Even the—

Mr. ACKERMAN. So what you're saying is anybody who gives you a pro forma formula, that they went along within certain parameters and margins of the rest of the industry, then that doesn't raise any red flags to you? That's what you analyzed?

Mr. GRUBMAN. No. What I am saying is we are a user of the audited financial results. We don't get the opportunity to look inside the books. It's like buying a car. If the brakes don't work, you've got a problem. So if the numbers are—

Mr. ACKERMAN. So you relied on Andersen also?

Mr. GRUBMAN. I rely on whoever certifies whichever companies financial results I'm looking at.

The CHAIRMAN. That's the gentleman's last question. Your time has expired.

Mr. ACKERMAN. That was.

The CHAIRMAN. Mr. Royce.

Mr. ROYCE. Thank you, Mr. Chairman. I was going to ask Mr. Grubman a question. And what I was going to ask was whether the structure of the compensation package that you have at Salomon is related in any way to the amount of business that Salomon created by underwriting and selling this stock. I understand there's some 22 billion over a period of 5 years that you underwrote. Do you think—is there a relation there to your compensation package?

Mr. GRUBMAN. Okay. First of all, we actually never underwrote stock. It was all bonds, just to set the record straight. As far as the compensation, my compensation package as I alluded to earlier, has a lot of factors in it. How the firm does, which includes banking revenue, trading revenue, stock performance, how I rank with investors, like in the institutional investor poll. And so certainly, all of that is a factor in my compensation on top of what the senior management of the firm views as my value in the marketplace.

Mr. ROYCE. Well, let me ask you this. Do you think your optimistic advocacy of WorldCom's acquisition-based business model, do you think that had any effect on the underwriting fees that were generated by Salomon?

Mr. GRUBMAN. It goes without saying that when a company looks to do business with a Wall Street firm, they consider a lot of factors, the strength of that firm if—I've had situations where my research views, right or wrong, in terms of stocks, have been well known for a long time. They have helped us get banking business and they have hurt us in getting banking business.

Mr. ROYCE. Well, let me point out that this type of advocacy, by analysts that were presumed to be independent, helped push the market capitalization of this stock to $120 billion at its peak. You know, now I think it's at $355 million. Now it's not enough to pay the loan back that Mr. Bernie Ebbers, who's with us today and who doesn't want to answer any of the questions, it's not enough to cover that loan.

So, my question here on compensation is really one of how is that based and how is that bonus compensation compiled, because as I understand it, you're the best paid, if not one of the best paid on Wall Street, at least that's what's reported in the papers.

Mr. GRUBMAN. That the—first and foremost, your value and worth as an analyst to the firm you work for, and to banking clients, starts and stops with your credibility if the market plates with investors. And if you blow that then you have no value to anyone.

Mr. ROYCE. Okay. Let me be more specific. Maybe I am not being specific enough. Have you ever received compensation tied to a specific investment banking deal? Is that the way—

Mr. GRUBMAN. No, I never have.

Mr. ROYCE. You never have. And so your argument is that—and I assume your compensation it's been reported in the area of $20 million. Am I roughly in the ball park?

Mr. GRUBMAN. My compensation, if you start with the contract that I was offered in 1998, for Salomon Smith Barney, to retain me because there is a competitive offer in the market, over the course of the last 4 compensation years, I've probably averaged that amount. That's not just cash stock and other things in terms of my

cash comp, you know, salary and bonus, probably peaked maybe around $15 million in '99, and actually last year was substantially below that, well below half that.

What goes into all of those factors is a multitude of things, and there's no denying, you know, your contribution to banking revenues is part of it, just like your stock performance, just like how investors view you, internal polls, a whole multitude of factors. No one could sit here on Wall Street and deny to anybody in this committee that banking is not a consideration in the compensation of analysts and full service firms.

Mr. ROYCE. Do you think that the prospect of this large—you don't want to call it a bonus, but this large compensation package, this way of maintaining and attracting banking clients clouds in any way your judgment?

Mr. GRUBMAN. It doesn't cloud my judgment because I care first and foremost about my reputation with investors, which I know has been damaged because of the stock performance of the last 2 years.

Mr. ROYCE. Let me ask you another question, because you've reported a close personal relationship with Mr. Bernie Ebbers, and if you don't want to make evaluations about underwriting, let me just ask you, in terms of the decision-making process for the short-term gain of running up stock prices by those who are in corporate governance, and doing so by managing earnings, by adjusting the accounts, do you think—do you think that this is driven, part of this problem, by the desire to show stable earning growth?

Is that driven, this tendency to make journal entries and push 3.9 billion out of expenses and capitalize that so that that can be shown on the income statement? Is this being driven by management's desire to show these types of constant earning growths year to year, the very earnings growth that you tout when you're going to the public and urging them to buy these shares?

The CHAIRMAN. And that'll have to be the gentleman's last question. The gentleman's time has expired. But please respond. Please respond.

Mr. GRUBMAN. This brings up a very important topic and part of my answer, some people may not like because you have to look beyond the sell-side analyst and you have to go through the entire supply chain of who buys and sells stock.

I agree that over the past, certainly half a decade, that the entire market has become much more short-term oriented than long-term oriented. In fact, one of my major failings over the last 2 years in terms of our stock picking has been for 17 years, I have been very well known as one that has more long-term views than short-term views. Broadly speaking, the market which is not just Wall Street firms, it is the mutual funds and pension funds and money managers out there who increasingly, by their clients, are getting graded every quarter, Morningstar, and all these guys put all these stars against funds.

And so the pressure comes all the way up and down the supply chain, and I think that it probably—I mean, I can't say specifically what happened here because I don't know, or in other companies. But that pressure to perform quarter in and quarter out doesn't stop and start with Wall Street. It goes all the way through the

supply chain of who manages money, and each client at each turn of the corner puts increasing pressure to perform on a quarterly basis. So it is a big issue.

Mr. ROYCE. Well, apparently without anybody auditing to see whether any of it's true, at least those responsible.

The CHAIRMAN. The gentleman's time has expired. Mr. Bentsen.

Mr. BENTSEN. Thank you, Mr. Chairman. Mr. Grubman I guess this year won't be as good as the prior years for you, given how well or how poorly some of your stock picks have done. But I want to ask Mr. Dick, Mr. Dick, how long were you the lead auditor for the Andersen team on WorldCom and its predecessor?

Mr. DICK. I became the lead auditor in 2001.

Mr. BENTSEN. And how long were you on the team?

Mr. DICK. From 2001 until we were—

Mr. BENTSEN. But prior to that, did you—

Mr. DICK. Prior to that, I was not on the direct audit team. There would have been a transition process that took place during the latter half of 2000. But I would not have participated directly in connection with the audit of 2000.

Mr. BENTSEN. So prior to—prior to 2001, you did not review WorldCom's books at all?

Mr. DICK. That's correct.

Mr. BENTSEN. In—when you took over as part of the audit team and head of the audit team, and you prepared the 2001 books or prepared the 2001 audit, you looked at WorldCom in a consolidated fashion and then presumably you took it apart and the different parts, the MCI part, the WorldCom and the other components that make it up, did you back into those consolidated numbers or did you just take the numbers at face value front and back.

Mr. DICK. Our audit would have tested individual components, looked at individual components and then it would have been consolidated together into the consolidated financial statements.

Mr. BENTSEN. Now, line costs which are the issue here, with respect to whether they were adjusted from an operating expense to a capital expense, line cost in this type of corporation are fairly substantial items; is that correct?

Mr. DICK. That's correct.

Mr. BENTSEN. I mean, in fact these line costs are perhaps one of the most substantials items. If you read the 10K throughout the management's discussion, they talk about line cost as a percentage of revenue. I think you said it's approximately an annual $15 billion expense of the company. Presumably, the auditor would track those costs and how they were being dealt with as an expense, would you not?

Mr. BENTSEN. In connection with our audit, we would have had specific procedures that would have tested the systems that gave rise to those numbers of line costs, yes.

Mr. BENTSEN. But you wouldn't—but in doing so, you wouldn't look to see whether or not there were changes. I mean, you just took the numbers that came from management and said fair enough, those look good to us.

Mr. DICK. Well, we would have tested the under—you know, some of the underlying amounts, billings for line costs that gave rise to those numbers, and we also would have gone through an an-

alytical review process of comparing those costs to previous years, comparing those costs as a percentage of revenues for example, many of the line costs or a fair amount line cost is driven by the amount of traffic and the amount of revenues.

Mr. BENTSEN. Let me ask you this: Also, line costs or any expenditures, whether they are counted as an operating expense on an annual basis or capitalized over a period of time, would also have affected the tax work that Andersen would have done for WorldCom?

Mr. DICK. I don't believe so. We were not involved with in preparing their statutory tax returns.

Mr. BENTSEN. But you were compensated for tax work, I think you said, at the outset of your testimony.

Mr. DICK. Yes. We provided tax services related to tax planning, tax organization, et cetera.

Mr. BENTSEN. Did you also—last year WorldCom had an offering of about $11 billion in debt. Did you provide a comfort letter to the underwriters where you went back and reviewed both the first—I don't know if the second quarter was in, but the first quarter of 2001 financials or the 2000 financials. Doesn't that comfort letter give you an opportunity as the auditor to go back and take a second look at the books and provide the underwriters with some comfort that what they are getting from the company and from the auditors who have been compensated by the company are, in fact, what's there.

Mr. DICK. We would have provided a comfort letter, and the consent to our report. And would have done the appropriate procedures to insure that nothing—we weren't aware of or nothing came to our attention. On the financial statement—

Mr. BENTSEN. And so what you're telling us is the company handed you their financials. You ran some tests. You backed—you broke it apart, you backed it back together, backed it back into the numbers by breaking it apart, looked at it consolidated, looked at it separated. But in the midst of all that, apparently, the CFO, which you are now CFO of the company yourself. But the CFO switched $3.9 billion from an operating expense to a capitalized expense, and that because of the way you conduct your audit, there was no way you could have found that.

How is it that an internal auditor, who doesn't have the name of Arthur Andersen or any other firm, was able to find it and you all were not, given the fact that you did the financials, you came back, you did the quarterly financials? You do tax work for the company, or you did, and you gave a comfort letter where you supposedly went back and reviewed the financials again and reviewed the quarterly data.

Mr. DICK. As I said before, I have not seen the specific entries that have been purported to be made, nor am I aware of how an internal audit would have uncovered the issues that have been, so I can't—can I speak to the fact that we did our audit and I believe we did a good audit in accordance with generally accepted audit standards. I don't know what gave rise to the—

Mr. BENTSEN. Well, let me ask you this. How much—

The CHAIRMAN. The gentleman's time has expired.

Mr. BENTSEN. I would invoke the Watt rule on this if I might, Mr. Chairman.

The CHAIRMAN. The gentleman is correct.

Mr. BENTSEN. How much did 3.9 billion, or we'll say 3.2 billion, 3.1 billion in 2000, make up of the total capitalized expense of the company? I know you didn't do the 2000 audit. But presumably, doing the 2001 audit you would have some idea what the 2000 numbers would look like. I mean, that's a pretty significant number, is it not, of the firm?

Mr. DICK. Well, the total plant and services--.

Mr. BENTSEN. And it's a significant number of the line costs.

Mr. DICK. That's correct. It is a significant number of the line cost. The total property and service of the company, before depreciation in 2000 was approximately 45 billion on a consolidated basis. And in 2001, it was 49 billion.

The CHAIRMAN. The gentleman's time has expired. The gentleman from the first State, Mr. Castle.

Mr. CASTLE. Thank you very much. Over here. Thank you very much, Mr. Chairman. Let me go to you, Mr. Grubman, if I can, with respect to all this. On page 7 of the testimony I'm looking at, it says it is critical to understand that, but for WorldCom's fraud, I would have seen a more dire picture much earlier. You indicated earlier to Congressman Ackerman that you can't answer about crimes but you were lied to. I don't know if you used the words, if that was deleted later in your testimony or if you used it today. But are you referring to fraud as a crime, or fraud in a general sense, or how would you define fraud? Fraud typically is defined as a crime.

Mr. GRUBMAN. Yeah, I know. I am not a lawyer. So I know I'll have to be very careful, especially in this crowd. But the fact of the matter is, what I was referring to is all during 2001, there was roughly $3 billion and change of expenses that were reported as capital spending as the allegations charge. And had that been reported correctly, if, in fact, that ends up being true, we would have seen in the first quarter of 2001, you wouldn't have to wait all year, which—

Mr. CASTLE. You would have seen earlier that there was a problem. And therefore recommendations might have been different.

Mr. GRUBMAN. Well because the numbers would have been lower and it would have given a different view of what—

Mr. CASTLE. Right. But I assume you're not stating whether it was a crime or not.

Mr. GRUBMAN. No, I am not.

Mr. CASTLE. Just wanted to check on that. Maybe a more careful choice of language would be in order, if that's the case. Perhaps it was a crime too. You represent the best argument which I've seen. I've been looking for you as a matter of fact. Not you individually, but the person like you because you represent the best argument I've seen yet. When I came in here before I read this testimony, coming down here, I really wasn't sure whether we really should separate the research from banking. And I'm convinced now that we absolutely should separate it, and I'm not convinced by your argument otherwise. And you've made several points here today, indication in answers to various questions that your research was fair

and impartial, in spite of the fact that your firm also did banking, and in spite of the fact that your compensation may indeed have, in some ways, been tied to banking, indirectly, if not directly; is that correct?

Mr. GRUBMAN. Yes.

Mr. CASTLE. I mean, how can you—seriously, realistically argue that you can be put in that position that any good analyst could be put in the position of research making recommendations on stocks, bonds or other investments instruments in the same situation in which you're trying to encourage banking? And I realize you've already said that in certain circumstances, maybe because of your recommendations they didn't even come to you. But once they've come to you, isn't there an overwhelming amount of evidence that you're going to, in that case, always be more supportive of the companies than they should be?

Mr. GRUBMAN. You know, what you raise is, you know, an important point because there are a lot of, you know there's conflicts that you have to navigate through. You have to be cognizant that you're only as good as your reputation in the marketplace and clearly, those issues have gotten raised to greater heights over the last year or two. But having said that, now, I haven't done, you know, some huge statistical analysis of every stock in every industry. But let's talk about the company we're talking about today.

Mr. CASTLE. Don't do it in too much detail because I have other questions.

Mr. GRUBMAN. Okay. Sanders and Bernstein is a great research house.

Mr. CASTLE. But they do not have investment banking.

Mr. GRUBMAN. They do not have investment banking. And Fortune Magazine said that they are the last honest research house. You know what, they had a buy on WorldCom. They had a buy to the bitter end. There was no banking considerations. Why? Because the analysts there—

Mr. CASTLE. But that's one example. And there probably are a lot of examples either way.

Mr. GRUBMAN. That's what I'm saying.

Mr. CASTLE. Let me go onto my next question. You indicated to Congressman Shays that you talk to investors every day. I got a hunch you wouldn't talk to me. Actually since you're here you might talk to me now. But you wouldn't have talked to me before I started asking you questions. What investors do you talk to? You don't talk to the guy with the 401K, the average person on the street, the person with $50,000 to invest. Who do you talk to when you say investors, in a general sense? I assume you're talking to big corporate—

Mr. GRUBMAN. I talk to institutional investors, mutual funds, pension funds managers, all that who indirectly are representing a lot of individuals, obviously. And then, within our firm, and I think this is probably similar in other firms who have big retail systems, we talk to, you know, our larger—

Mr. CASTLE. Major larger people is who you're talking to?

Mr. GRUBMAN. Our retail brokers.

Mr. CASTLE. Did you ever recommend to investors that you talked to to sell WorldCom?

The CHAIRMAN. Gentleman's time has expired. The witness may respond.

Mr. GRUBMAN. I doubt it. No. I mean because we had a buy on it until April of this year. But we don't talk to individual investors.

Mr. CASTLE. I know my time is up, but it just stuns me that you could watch it go down 99 percent or something of that nature and nobody, you did not make a recommendation to sell. I yield back. Mr. Chairman.

The CHAIRMAN. Gentleman's time has expired. The gentleman from Connecticut, Mr. Maloney.

Mr. MALONEY OF CONNECTICUT. Thank you, Mr. Chairman. Mr. Dick, I would like to go back to the ground that my colleague, Congressman Bentsen, was inquiring about. But he was inquiring about it from sort of the bottom up dealing with the individual, the line expense accounts and the capital accounts and the aggregation of that into the overall picture. I'd like to turn it around and look at it from the other way. You said earlier that you had requested information from management about any top side journal entries, and that the management had said no, there were no such top side journal entries. First question, did I just characterize your testimony correctly?

Mr. DICK. We requested whether there were any top side journal entries as purported here, and we were not given any—that there wasn't any.

Mr. MALONEY OF CONNECTICUT. Okay. Fine. Then let me ask the next question. When you're told that, what do the generally accepted auditing standards say is the appropriate way to test the management's representation to that effect?

Mr. DICK. Well, we would get—in addition to requesting it, we got written confirmation that the financial statements were complete and they were in accordance with generally accepted accounting principles. But we would have taken all of the other work we had done and based on testing the systems as I've mentioned in the previous answers, analytically reviewing the financial statements and running our software related to the ratios on the financial statements, taking that all together and our understanding of the company, we would have reached a conclusion that we didn't need to do any further work.

Mr. MALONEY OF CONNECTICUT. I heard you say that, but that wasn't my question. My question was, what do the generally accepted auditing standards ask you or require you to do in regard to testing management's representations about top line journal entries? What is it you're supposed to do?

Mr. DICK. Well, they would—I think they would specifically—I mean, there wouldn't be anything that would probably be specific. It would be in context of all of our work that we've performed and our knowledge that we've gained from performing that work as to whether or not there would be or wouldn't be. But we do ask the question and we do get written representation from management to that effect.

Mr. MALONEY OF CONNECTICUT. All right. Well, I think we'll just leave it at that. What you have said today is that you asked the appropriate questions, and not only did you ask the appropriate questions, you then pursued those questions consistent with gen-

erally accepted auditing standards. That is what you said on many, many occasions, and that will obviously be reviewed on other circumstances.

And I thank you for your testimony today. Mr. Grubman, if I could just move to you quickly. You have referred twice today at least to your investment thesis in regard to this corporation.

Mr. GRUBMAN. Yes.

Mr. MALONEY OF CONNECTICUT. Could you give us a thumbnail sketch? And I emphasize thumbnail sketch as to that investment thesis.

Mr. GRUBMAN. Yes. This is something that really began in the mid '80s. First, we believed that as markets deregulated, first the long distance market with the AT&T divestiture, and then the Telecom Act that was passed in these Chambers in '96, the local markets, that the newer start up entrance would gain market share, innovate, create jobs, take market share. That worked perfectly in long distance.

Unfortunately, it did not end up working in local. WorldCom was an outgrowth as LVBS of that first thesis. In the mid '90s, I wrote a very big report called ″The Global Telecom Jigsaw Puzzle″ where I hypothesized there would be several spheres of influence among bigger companies. WorldCom evolved into one of those companies with their end-to-end array of assets that I thought would allow them to serve telecom intensive global customers around the world with a multitude of services.

Mr. MALONEY OF CONNECTICUT. Okay. Now let me follow that up with a question. Tell me what you think the relationship was between that investment thesis and what the investment banking side of the house was doing in regard to it's investment decisions. In other words, how did your thesis as an analyst inform and then change or motivate the investment side of the house in its decision making?

Mr. GRUBMAN. That's a good question because it aligns the cart and horse right. My research had a view, a view long before I worked for a firm with a big investment bank. I was at PaineWebber for, you know, 9 years prior to Salomon. That view, for better or worse, helped shape where the investment banking opportunities were for my firm. It helped us with, as you could imagine, one set of companies, it hurt us as you could imagine with another set of companies.

Mr. MALONEY OF CONNECTICUT. Thank you. My time—

The CHAIRMAN. The gentleman's time has expired. The gentleman from Michigan, Mr. Rogers.

Mr. EBBERS. Mr. Chairman, may I be excused to go to the restroom please?

The CHAIRMAN. Yes I was just commenting to staff, the gentleman may be excused. Let's—why don't we just take a 5-minute break here. The witnesses have been at the table for a long time.

[recess.]

The CHAIRMAN. The committee will reconvene. If Mr. Grubman and Mr. Sullivan could come forward. If we could find Mr. Grubman, and we can get started. The gentlelady from Illinois is recognized.

Mrs. BIGGERT. Thank you, Mr. Chairman. Mr. Dick, in your auditing career, is it normal practice for CEOs or members of the executive committees of companies to take large loans from their companies? Is this a policy that you have run into?

Mr. DICK. I haven't seen it in any—maybe occasionally I've seen it occasionally, where there would be loans to executives for companies.

Mrs. BIGGERT. Well, this was true in WorldCom, and did you see—how does that show up on the books?

Mr. DICK. It shows up as a receivable on the company's books on their balance sheet.

Mrs. BIGGERT. And is there usually a purpose? Do they state the purpose for the loans?

Mr. DICK. I believe there is appropriate disclosure in their financial statements regarding the loans with related parties.

Mrs. BIGGERT. Is it something that has to be approved by the executive committee of the company?

Mr. DICK. I don't know for what it would have specifically been. I imagine that could have been the case.

Mrs. BIGGERT. Did you work with Ms. Cooper, who is not here today because of the request of the Justice Department?

Mr. DICK. Did I work with her?

Mrs. BIGGERT. Yes.

Mr. DICK. We would have worked—our audit plan would have taken into consideration an understanding what the internal audit plan for WorldCom would have been. And we would have reviewed the outcome of their work, made inquiries as to the outcomes of their work, whether it should affect our plan as well.

Mrs. BIGGERT. But you would have gone over the audit with her?

Mr. DICK. We would have gone over the, you know, the result, I mean, she would have participated in, I believe, discussions with the audit committee on the results of audits.

Mrs. BIGGERT. Okay. Thank you. Mr. Grubman, just in time. I'm just curious about what convinced you to move your WorldCom recommendation from buy to neutral. I know you talked a little bit about that. But I am really—even, in fact, more curious about what finally led to you make the underperform recommendation, and I have read that you have been considered the number one investment analyst in the country. But the record shows that WorldCom share prices ranged from a high, you know, a $60 high in 1999 down to the 20s, and then the teens in 2001. And then it was only in April of 2002 that you moved from the buy to neutral at $4 a share and then on June 21 to—you changed your opinion to an underperform. What's the—the question is, what's the criteria that you use to make those recommendations or ratings?

Mr. GRUBMAN. In general, my recommendations tend to be more based on longer-term criteria than quarter in, quarter, out. This is as a broad—this is how I do my job. And as I outlined in earlier testimony, I just viewed WorldCom as the preeminent company in this industry, especially after the MCI merger, the assets, and the customers.

During the course of 2001, after WorldCom's stock had dropped quite a bit in 2000, WorldCom stock stayed pretty flat during the

course of the year in a market that went down. So it was actually, on a relative basis, not a bad performer.

During the course of 2002 what led me—and I think during this same day about 10 other firms—to downgrade the stock, there was a lowering of their financial guidance. It got to the point that it was difficult to continue to recommend the stock given where the evaluations were.

Mrs. BIGGERT. About how many stocks do you downgrade a year to sell or to underperform?

Mr. GRUBMAN. Well, the underperform downgrade June 21st, which was a one-notch versus two-notch, what we did in April, as I said, that was based on several very important factors. The rating agencies, 1 day and 3 days before what we did, downgrading to the equivalent of Single B which was a very harsh downgrade, it took the market by surprise.

My staff was reviewing the earnings models for all of our companies—

Mrs. BIGGERT. But how many other companies have you just done a sell and not jumped from neutral to downgrade, but from neutral to sell?

Mr. GRUBMAN. Well, we didn't have a sell. We went from a neutral—

Mrs. BIGGERT. Other companies, not WorldCom. What about McLeod or what about some of these others, or Global Crossing? Would you—did you go to a sell on those?

Mr. GRUBMAN. What happened with them where we had neutrals on—either they went bankrupt or we just suspended coverage.

This was a company that we did not think was going bankrupt, as we wrote. But we thought—a market underperformer was an appropriate rating, you know, until certain things were more visible, like their bank facility and what we thought was going to have to be a recapitalization to deleverage the balance sheet.

The CHAIRMAN. The gentlelady's time has expired. The gentlelady from Oregon, Ms. Hooley.

Ms. HOOLEY. Thank you, Mr. Chairman.

Mr. Dick, I think there are probably—I will move this way so I can see you. I think there lots—there are people watching today with their mouths hanging open, people that own companies, people that are in charge of organizations that thought that auditing companies would come in and find some of their problems.

I can remember sitting as a board of county commissioners, our auditing company, I expected that if there was any irregularities in any of the units, for them to let us know that. So we relied on them. Auditing firms probably had one of the best reputations in the country of any kind of business because people expected them to, if there were problems, to identify what those problems were. And yet here is a discrepancy of $3.8 billion that you don't find.

And I want to know, did you—have you sat down and said to your colleagues, how in the world did we miss a $3.8 billion discrepancy? Have you talked about that? Have you said, how did we miss it? And, what would we do in the future?

Mr. DICK. That is a good question. And again, let me just reemphasize, I have not seen the actual entries that have been purported to me, or do I know how it was uncovered by internal audit.

I have asked, since I became aware of this, other members of the audit team whether or not they had any knowledge of this, whether or not there was anything that we had done that was—should have revealed this to us. And I have concluded, based on the work that we did and my understanding of the work that other members of the team did, that we did our audit, and we did our audit in accordance with all of the things one would expect to do.

Ms. HOOLEY. You may have done that. But, I mean, you have got to be saying, what have we got to do different in the future? What do we need to do differently? I mean, if people are going to trust auditing companies, they have to have some faith that you are going to do things differently so this doesn't happen again. So what are you going to do differently?

I mean, you say you already did all of the things you are supposed to do. What are you going to do differently?

Mr. DICK. In this case, Congresswoman—and I am not trying to be evasive—I don't know the specifics, what gave rise to it, therefore I cannot—

Ms. HOOLEY. Is anybody sitting down and asking that question? Are you talking to one another?

Mr. DICK. As I said before, I have had some initial discussions with other members of the team.

Ms. HOOLEY. Do you think we should do something differently? Congress? What kind of—what do we need to do to help you?

Mr. DICK. Again, in this specific circumstances—

Ms. HOOLEY. Well, let's just talk in general. What do we need to do differently? We need to protect the investors out there. We need to protect the public. What do we need to do differently?

Mr. DICK. Well, as I mentioned before, I think there are a number of proposals, a number of things that are being considered by this committee and others. And again, the actions that may come out of those considerations may or may not necessarily produce any type of a fail-safe system that would prevent this kind of—purported kind of activity from having taken place.

Ms. HOOLEY. Okay. Mr. Grubman, a couple of questions.

Mr. GRUBMAN. Yes.

Ms. HOOLEY. Do you consider yourself an independent analyst?

Mr. GRUBMAN. Yes.

Ms. HOOLEY. Then why were you a participant in the WorldCom board meetings?

Mr. GRUBMAN. As I said earlier, I don't know if you were here—

Ms. HOOLEY. I was here.

Mr. GRUBMAN. On only a few occasions when I was brought over the wall and thus frozen from doing my job with investors, did I participate in WorldCom board meetings on very specific items.

Ms. HOOLEY. But with your compensation, do you think it is possible to be objective when WorldCom is essentially paying your salary?

Mr. GRUBMAN. WorldCom is not paying my salary. Salomon Smith Barney is paying my salary.

Ms. HOOLEY. But then they underwrite WorldCom. Is that right?

Mr. GRUBMAN. WorldCom is one of the investment banking clients of the firm. At our firm, investors are extremely important. The retail system and the capital markets bring revenue into

Salomon Smith Barney that is at or above what investment banking revenues are. So all constituents are very important. An analyst who ends up losing all credibility with investors will have a very short-lived value to the firm.

Ms. HOOLEY. Do you think it is a good analogy between, for example, pharmaceutical companies, if they want to do—if somebody wants to do research, medical research, usually they can't do any independent study because you can't get anyone to pay for it; so then they go to the pharmaceutical companies and they help pay for the research. And that is why, for example, people pay, you know, $200 a month for Celebrex, when they probably could be using aspirin that is only slightly more effective.

I mean—and we ask our researchers to be independent. It is hard to do that. I mean, do you think analysts can be objective?

The CHAIRMAN. The gentlelady's time has expired. The witness may answer.

Mr. GRUBMAN. Yes, I think that we can. And in our case, we adopted, we at Salomon Smith Barney adopted the Merrill-Lynch proposals. And therefore on a going-forward basis, there will be no direct input at all from the investment banking department into the compensation of analysts. And I like to think that my behavior and the rest of the staff at Salomon Smith Barney won't change as a result of that.

The CHAIRMAN. The gentleman from Pennsylvania, Mr. Toomey.

Mr. TOOMEY. Thank you. My first question is for Mr. Dick. I take it from your repeated responses to other questions that you would not agree with my assessment that the audit that your former employer did for WorldCom was a total disaster? You seem to believe that you performed the function properly.

The problem I have with that, is that in your own testimony, on page 2, one of the things you stated is that the role of an outside auditor is to review the financial statements to determine if they are prepared in accordance with the generally accepted accounting principles. Well, these weren't, unless you are suggesting that this shift from—of line items, the line charges to a capital cost was—is consistent with GAPP accounting. But I don't think you are suggesting that.

Mr. DICK. I am not suggesting that.

Mr. TOOMEY. So clearly it fails that test of what the proper role of an auditor is. And the Andersen audit failed that test. Then it goes on to say, ″and to conduct its audits in accordance with the generally accepted auditing standards, which require that auditors plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.″ .

Well, of course they weren't free of those misstatements. They had gross misstatements.

I guess I am trying to understand how this cannot be perceived by yourself as a huge failure. For instance, what is that plan to obtain that reasonable assurance? Do you, for example look at sample transactions that go into a given line item? Is that a test?

Mr. DICK. Yes, we did.

Mr. TOOMEY. Are they intended to be representative samplings; are they random; are they intended to get to the gist of whether these accounts are likely to be accurate?

Mr. DICK. They would be intended to be representatives.

Mr. TOOMEY. The line charges, as they seem to be described, that were misplaced or misrepresented, they were like 20 percent, roughly, of the total line charges that were reported. Is that about right, according to the numbers that I have?

Mr. DICK. The numbers I reported, 3.8 billion versus roughly 15 billion.

Mr. TOOMEY. So, thereabouts. That is a pretty substantial percentage that is missing from what ought to be there, right? And then an equal amount that shows up somewhere where it doesn't belong?

Mr. DICK. Of that line item, yes. I agree.

Mr. TOOMEY. I am not sure which of the accounts, I have got a consolidated financial statement here, and I am not sure which exactly of these capital accounts those line charges got buried in, whether it is in plant and equipment or good will or otherwise. But if you look at the change in these capital accounts from one year to the next, a $3 billion change is pretty substantial. It is a very large percentage with respect to the change.

And I would think that any reasonable representative sampling of how did this capital account change so much would gave rise to perhaps discovering that there are some things in there that didn't belong in there.

Should not a system intended to give you the reasonable assurance that you are supposed to obtain, should not it help you discover that?

Mr. DICK. Well, in our audit—we did the appropriate audit, in my opinion, in accordance with our standards that we followed. And we tested the transactions, we analyzed it —

Mr. TOOMEY. Do you think you tested enough transactions?

Mr. DICK. Based on our audit work we did, yes.

Mr. TOOMEY. Even though you didn't discover this massive problem?

Mr. DICK. Well, we tested sufficient transactions to rely on the system of controls in place for those transactions. But what has been reported here is that the company made journal entries outside of the normal transaction systems. I have not seen those journal entries. But in fact if they have been made, and we did in fact ask and make inquiries of those, you know, we would have been misled.

But in addition to those testing of those transactions that we did, we looked at the financial ratios of the company. And the—

Mr. TOOMEY. Because I am short on time here—so you did look at sample transactions from the very capital accounts which were inflated?

Mr. DICK. We looked at sample transactions from various capital accounts. I don't know if it is from the specific capital accounts that were inflated, because I haven't seen them.

Mr. TOOMEY. What you are implying, then, is that there may be very large capital accounts for which you did not look at any sample transactions then.

Mr. DICK. We probably would have looked at sample transactions from most significant—

Mr. TOOMEY. It seems to me that the system, the plan designed for this purpose, clearly seemed inadequate. I am surprised that there is no acknowledgment of that.

Let me ask a separate question. Throughout the course of the audits that you were involved in, was there any time in which anybody at WorldCom in any way, in your opinion, attempted to obstruct your investigation; actively, for instance, prevent you from looking at documents you wanted to look at or forbid you from looking at transactions?

Mr. DICK. Not that I am aware of.

The CHAIRMAN. The gentleman's time has expired. The gentleman from Texas, Mr. Sandlin.

Mr. SANDLIN. Thank you, Mr. Chairman.

Mr. Ebbers, you are the former CEO of WorldCom; is that correct?

Mr. EBBERS. On the instruction of counsel, I respectfully decline to answer on the basis of my fifth amendment constitutional rights.

Mr. SANDLIN. Yet in your sworn testimony earlier today, you said, ″I served as CEO of WorldCom for 17 years.″ now, did you think you did an appropriate job in approving the handling of expense for WorldCom?

Mr. EBBERS. Is that a question?

Mr. SANDLIN. Yes, sir.

Mr. EBBERS. On the instruction of counsel, I respectfully decline to answer on the basis of my fifth amendment constitutional rights.

Mr. SANDLIN. And yet in your testimony today, you said, ″I am proud of the work that I did.″ Do you know the value of WorldCom stock today?

Mr. EBBERS. On the instruction of counsel, I respectfully decline to answer on the basis of my fifth amendment constitutional rights.

Mr. SANDLIN. In your sworn testimony today, you said, ″WorldCom continues to be a valuable company.″ now, you know that there are certain civil and criminal penalties for filing false statements and false affidavits, don't you?

Mr. EBBERS. On the instruction of counsel, I respectfully decline to answer on the basis of my fifth amendment constitutional rights.

Mr. SANDLIN. Yet in your sworn testimony already before us today, you said, ″I believe no one will conclude that I engaged in any criminal or fraudulent conduct during my tenure at WorldCom.″ .

Now, you also indicated you didn't believe you had anything to hide. That is what you said in your previous testimony today, isn't it?

Mr. EBBERS. On the instruction of counsel, I respectfully decline to answer on the basis of my constitutional rights.

Mr. SANDLIN. Now you are trying to take some selective sort of fifth amendment privilege, I see.

Now, let me ask you this. Are you a citizen of the United States of America?

Mr. EBBERS. On the instruction of counsel, I respectfully decline to answer on the basis of my constitutional rights.

Mr. SANDLIN. You won't even tell this committee if you are a citizen of the United States. That is a question.

Mr. EBBERS. On the instruction of counsel, I respectfully decline to answer on the basis of my constitutional rights.

Mr. SANDLIN. So if we put off this hearing today and we have this subpoena out, and you go away to come back for a contempt, we have no guarantee that you are coming back. You have access to tremendous amounts of money since—although the stock is now at 6 cents a share today, you sold yours for 35 million at its peak in June of 2000. Since we don't know you are a citizen, we don't know if we can require you to get back or not, do we?

Mr. EBBERS. On the instructions of counsel, I respectfully decline to answer on the basis of my constitutional rights.

Mr. SANDLIN. Mr. Chairman, I am going to renew my motion for contempt and ask that the witness be held in contempt. He has waived his fifth amendment rights. I asked him questions off his own sworn testimony, which I would like to deliver to the Chair. He is now refusing to answer those questions. I don't believe he is a citizen of the United States of America.

I don't believe that we have a way to guarantee his reappearance before this committee for the contempt hearing. I would like a motion for show case to issue setting a date certain. I would like some security that he will return, that after the hearing he be held in contempt of the committee, that this be taken to the House floor and he be held in contempt of the United States Congress until such time as he answers the questions before this committee.

It is not that difficult. He is trying to invoke the protections of the United States Constitution for himself, but he will not cooperate with the United States Congress. He is attempting to invoke the protections of our Constitution at the same time that he won't even say whether or not he is a citizen of the United States. And I don't think he is. We will find out if he will answer it.

So I am reviewing that motion for contempt. I am going to deliver his transcript to the Chair and ask that you look at that and hold him in contempt.

The CHAIRMAN. The Chair has indicated before, it will take that under advisement and take a look at the testimony.

Mr. SANDLIN. Mr. Chairman, what kind of—I don't think it is improper to inquire as to the citizenship status. And I don't think that is deserving of a fifth amendment protection. He is either a citizen or he is not.

The CHAIRMAN. The Chair would ask counsel's opinion first before we proceed further.

The gentlelady from Pennsylvania.

Ms. HART. Thank you, Mr. Chairman.

Mr. Grubman, Pennsylvania's Teachers' Pension Fund has lost 69 million on a sale of WorldCom stock already, and bonds as well, for the fiscal year that ended June 30th. They are carrying 17 million in unrealized losses on WorldCom bonds that they still own. That is the Teachers' Pension Fund in Pennsylvania. I know the California fund has lost a lot. And a number of those funds that invested based on analysts recommendations in WorldCom have lost extremely large sums of money.

In the year 2000, WorldCom just met its operating earning target two quarters in a row by tiny fractions of a cent. Aren't the odds of that happening two quarters in a row extremely rare, and shouldn't that have been some kind of red flag to analysts and the directors of the company?

Mr. GRUBMAN. First—and this is sincere. I mean, let me say that as I said in my opening remarks, it is tragic what has happened to investors and employees with WorldCom, in general with the telecom space.

As far as just meeting by fractions of a penny, well, you certainly take that into consideration in terms of looking at just how they did it. Now, I don't recall specifically quite how they got to those numbers. But from the best of my recollection, it wasn't necessarily because of, you know, low tax rates, anything on a book basis, not a cash basis.

WorldCom was actually a quite high-tax payer if you go back and look at their statements. So the first thing you look at is do they make the number kind of below the line, below the dollar line or below the operating income line? In the case of WorldCom, that wasn't true.

And as you point out, while that was true for the first couple of quarters, in the second half of the year, you know, in fact that started missing. You may also recall at the end of 2000, they took a—they did a big change to their going-forward guidance. So probably had that lingered for 5, 6, 7 quarters, maybe you look at it, you look at what the source of it is. If it is all of a sudden a 20 percent tax rate, that throws up more of a red flag. That wasn't the case.

Ms. HART. So you would wait a number of quarters?

Mr. GRUBMAN. You look at quarter in, quarter out. As I said to the earlier question, when it comes to the topic of this discussion, the capital spending trends were completely in line with guidance. And don't forget, no one was hiding cash out of the door. Cap X is still cash outlays, it is just spread out over the income statement as opposed to expensed in periods.

Ms. HART. In a typical situation when they are that close to meeting expectations, though, do you normally take an extra look at the company?

Mr. GRUBMAN. Well, you do that anyway. I mean, in fact sometimes you take a harder look when they blow away expectations. Because telecom is an industry, it is not like, you know, biotech or whatever. And a telecom company the size and stature of a WorldCom, you would probably be more suspicions if they blew away the estimate.

Ms. HART. Thank you, Mr. Grubman.

Mr. Sullivan, reflecting on that fact, that two quarters in a row WorldCom met its operating—the target the analysts had placed there for it by tiny fractions of a cent, does that—sounds to me, anyway, like the analyst's recommendations were looked at first, and then perhaps the accounting was done so that you did meet the expectations. Is that the case with WorldCom?

Mr. SULLIVAN. Congresswoman Hart, I have asserted my right to—my fifth amendment right to the Constitution today for all questions. I had no prepared statement on the advice of counsel.

Ms. HART. You decline to answer that again. Thank you, Mr. Sullivan.

Mr. Dick, in your testimony, it was referred to earlier, I think Ms. Hooley actually asked you regarding the responsibility of the company, some of the other—my colleagues have asked you about who is responsible for the audit. It is mostly—you state it is something like, it is mostly the responsibility of the management of the company, not the outside auditors, to present the financial statements.

Mr. DICK. I think I stated it is the responsibility of the management to prepare the financial statements. The auditors would be responsible for auditing the financial statements.

Ms. HART. To audit. In your testimony, you stated that you relied on the integrity and competence of management. To what degree do you do that? When do you start to question management? You mentioned that there is some kind of test done. I would like you to go into that and explain what kind of test you do. Could do you that for me briefly?

Mr. DICK. Well, the type of tests we do relate, again, to the transaction systems. For example, we might select a particular billing or an invoice that had been paid. And we will look at it for proper approval and that it flowed through the company's systems, then ultimately got into the company's financial statements.

In terms of reliance on integrity of management, that is a much more subjective evaluation. It would be—the kind of things one would consider would be, have we ever had significant issues or concerns with representations from management? Have we had concerns about the management's attitude?

Ms. HART. Would those concerns have generated from you, the auditor, or would they have generated from somewhere else?

Mr. DICK. They would have been from the auditor's perspective.

The CHAIRMAN. The gentlelady's time has expired. The gentleman from New York, Mr. Meeks.

Mr. MEEKS. Thank you, Mr. Chairman.

Mr. Sullivan, when you came up with this practice of taking money out of the operating fund and putting it into the capital fund, had you done that previously? Was it many times you had done it, or was this the first time that you engaged in such a practice?

Mr. SULLIVAN. Congressman, based on the advice of counsel, I assert my fifth amendment right to the U.S. Constitution.

Mr. MEEKS. What about with the reserve funding? Did you do anything with the reserve funding that kind of changed the books or something, or how we can find all of the money that was in the reserves? Is there anything that we should know about now that you would like to talk about?

Mr. SULLIVAN. I assert my fifth amendment rights.

Mr. MEEKS. Mr. Dick, you are with Andersen, and you do the accounting. You said you looked at some of the documents, et cetera, and you, based upon the information you was given, there is nothing that you could come up with to show that there was anything wrong or any money that was from one account put to another; is that correct?

Mr. DICK. Yes. I just—I am no longer with Andersen.

Mr. MEEKS. But when you were there.

Mr. DICK. When I was there, we would have performed our audit.

Mr. MEEKS. Would you say also, based upon your examination in regard to the reserve fund, did you find or detect anything that could show that maybe there was some additional money, maybe more than 3.8 billion, there is some money that might have been accounted for in the reserve funding that now was shifted? Is there any evidence of that in your audit?

Mr. DICK. In your audit of 2001 we looked at the company's reserves and whether there had been any shifting out of those reserves and didn't find anything inappropriate.

Mr. MEEKS. Do you have the ability to detect whether or not, now thinking back, based upon the principles that you utilized, knowing what has taken place with the operating funds going into capital funds, would you think that there is anything that you could have possibly done or would you look at now to detect whether or not any of the reserve funds were transferred?

Mr. DICK. Well, when we performed our audit for 2001, we looked at—when I refer to reserve funds—or you are referring to reserve funds, I am not certain—but reserves are generally considered allowances for bad debts, for example. We would have looked at the appropriateness of that allowance, whether that allowance was building up based on the aging of their accounts receivable, whether they would have reduced that allowance based on better collection experience, these type of things when we look at the reserves.

Mr. MEEKS. Could there have been any cooking of the books with respect to the money that was put aside for reserves for bad debts, et cetera?

Mr. DICK. I am not aware of any.

Mr. MEEKS. Let me ask this question, and maybe we are missing it. I don't know whether the role of auditor—in your years as being an auditor, have you ever in your—you know, auditing books, et cetera, uncovered any fraud or ever been lied to by any client?

Mr. DICK. In terms of uncovering fraud, I haven't—in our auditing—in my experience as an auditor, there might be minor instances of fraud or illegal acts that might take place at a company. I have never been associated with or never personally been involved with any significant fraud that has been uncovered at a company.

Mr. MEEKS. So my question is, if you found, whether it is minor fraud or major fraud, et cetera, what did you do in that instance?

Mr. DICK. Well, in cases where an auditor has become aware of fraud or illegal acts, their responsibility is to notify management.

Mr. MEEKS. You said there has been one case, or a case.

Mr. DICK. If I would have personally become aware of it in connection with the audit, we would have notified management and the board, the company's board, of that act.

Mr. MEEKS. Have you done that in the past?

Mr. DICK. I can't think of any specific instance right now.

Mr. MEEKS. So most of the time, what you just try to do is to make sure that you make a presumption, I guess, that the figures that you are given by management are correct. And you then just try to make sure that as you add them up, that those numbers are

correct. So there is nothing probing that you would try to do, other than whatever you have in your computer?

Mr. DICK. No. In connection with our work, and in fact in connection with our work for WorldCom, we have a responsibility to make sure that the financial statements are not materially misstated, as I mentioned in my testimony.

We would, in fact—that would be from—

Mr. MEEKS. But you didn't do anything probing?

Mr. DICK. If I could finish, please.

We would have done probing. We would have asked the questions. We would the asked management and got representations, and we would have evaluated whether or not we thought there was an opportunity.

Mr. MEEKS. My last question is, in response to a couple of my colleagues, you know, you have indicated that there are a couple of proposals that may be coming out of this body, whether from the Senate side or from the House side, that might be useful for us in the future. I was wondering, since you know that there are proposals coming out, which specific ones that you reviewed would you recommend that we strongly consider that will help prevent this from happening again in the future? Since I know you know of—everyone knows, that is public knowledge, that is something that is public knowledge, what we are considering.

Is there any specific one or two or three of them that you would strongly recommend? I know that there is nothing that is going to be fail-safe, but you would strongly recommend to us as a body to consider?

Mr. DICK. As I said before, there are a number of proposals outstanding. I guess in thinking about those proposals, there has been a lot of discussion and maybe now a rule—I am not certain if it has formally passed—of executives, CEOs, and CFOs of companies having to certify that their financial statements are correct.

I guess as a CFO, I believe that is a very significant change or proposed change that—I am not sure I understand exactly where that is, but I have heard about that proposal.

The CHAIRMAN. The gentleman from Ohio, Mr. Tiberi.

Mr. TIBERI. Thank you, Mr. Chairman.

Mr. Dick, following up on a question by Mr. Bentsen, you stated that you were not aware of how the internal audit discovered the financial fraud accounting practices at WorldCom. Is that correct?

Mr. DICK. That is correct.

Mr. TIBERI. Can you detail to us what your relationship or your committee's relationship was and your interaction was with the internal auditors at WorldCom?

Mr. DICK. As we would have done our audit work, we would have interacted with internal audit to understand what audits they were doing. We would have—for example, internal audit gave a readout at the audit committee. And we would have understood that readout. We would have participated in that.

We would have reviewed selected—and I don't know if it would have been all—but we would have reviewed selected internal audit reports that were issued by internal audit, as necessary. We would have followed up with questions, if appropriate, as to the type of

points or observations that internal audit had, to see if that should impact or would impact our audit plan that we were executing on.

Mr. TIBERI. Do you believe that we would be here today, that the public and the investor community would know what we know about WorldCom and its fraudulent accounting practices, if it hadn't been for Ms. Cooper?

Mr. DICK. Again, I am not sure—in fact, I do not know what internal audit did to uncover this. So I don't know if I can answer whether we would be here today or not.

Mr. TIBERI. I hate to beat a dead horse, but you have heard over and over again today, I guess the assumption was prior to the last year, that auditing firms could uncover fraudulent behavior by companies and executives in those companies. Is that statement not true?

Mr. DICK. Well, I think there is a belief that auditors can uncover all fraud; and auditors have a responsibility, as I said in my written testimony, to make sure there aren't material misstatements, and to plan and design our audit in that approach.

There will be instances, I believe, and have been instances, where external audits will not uncover fraud of any nature. If there is going to be a concentrated effort—and I don't know—I mean, it has been reported—there is going to be a concentrated effort, that is going to be very difficult under any circumstance to potentially uncover.

Mr. TIBERI. Thank you. Mr. Grubman.

Mr. GRUBMAN. Yes.

Mr. TIBERI. You mentioned earlier that the institutional investor is the primary person that you deal with on a daily basis; is that correct?

Mr. GRUBMAN. That is the investor that I talk to day in and day out.

Mr. TIBERI. When you talk to that investor day and in and day out, do you disclose your relationship or Salomon's relationship with a potential client, like in this particular case, WorldCom?

Mr. GRUBMAN. In all written material that Salomon Smith Brothers—Salomon Smith Barney puts out, that goes to everybody, retail investors as well as institutional investors, and on the Internet, all banking—we disclose that we have a banking relationship, if we do, with the particular company that is in question, yes.

Mr. TIBERI. How many companies which you have recommended have filed for bankruptcy Chapter 11 in the last 2 years?

Mr. GRUBMAN. I don't recall the exact number. But it is—it has been quite a few, unfortunately.

Mr. TIBERI. On March 21st of 2001, a year after, I think everybody would argue, most telecom companies began to sink, you issued a 28-page research report titled "Grubman's State of the Union: Does He Ever Stop Talking?".

In that report, you urged investors to purchase your top 10 picks. Do you remember which ones those were?

Mr. GRUBMAN. Yes, it was a—what we called an eclectic basket of names that ranged from Verizon, which is a regional Bell operating company, to, unfortunately, several small emerging names, some of whom have gone bankrupt.

Mr. TIBERI. Right. Let me give you those 10. Broadwing, down 83 percent since your report. WorldCom, down 99.9 percent since the report. Qwest Communications, down 94.7 percent. Allegiance Telecom, down 90.7 percent. Global Crossing, down 99.9 percent. Metro Media Fiber Network, down 99.9 percent. McLeod, down 99.9 percent. Windstar Communications, down 99.9 percent. And XO Communications, down 99.9 percent.

In November of 1999, you reversed your long course on AT&T by issuing a buy recommendation. And, in fact, Smith Barney, at the same time, was jockeying for a $10.6 billion AT&T Wireless IPO. Did the prospect of getting the investment banking fee from AT&T influence the sudden shift?

Mr. GRUBMAN. No. Our work on the AT&T research started in August of 1999. AT&T, who I was cautious on to say the least, from about 1995 onward, was undergoing a huge transformation. They had bought two cable companies. They were the largest cable company in the United States. They were a large company in my group. And it is my obligation, when a company like that goes through a massive transformation, to take a second look, which we did.

Secondly, we have had a long-held view that the regional Bell operating companies were particularly vulnerable on all sorts of fronts, most notably on the residential side from cable companies, and a view we reiterated just a few months ago in a big report.

So on AT&T, this was a company we had not liked very much, undergoing a massive transformation in terms of its asset base. We owed it to ourselves and our investors to take a fresh look, which we did, and we wrote a very large report. The investment thesis there was AT&T, by virtue of being the biggest cable company in the United States, we thought over a 3- to 5-year period would develop what we call the triple play of voice, video, and data to a large swath of customers. A collateral benefit of that was going to be that it would be able to protect a big chunk of its consumer long distance base as a result of that.

Mr. TIBERI. Just one last question, Mr. Chairman.

Mr. Grubman, correct me if I'm wrong, but the nine companies that I mentioned that tanked, whose stocks have since tanked, didn't they have a relationship, a financial relationship, an underwriting relationship, with your firm?

Mr. GRUBMAN. The stocks that you cited were all stocks that I believed in, and as a result of our research and other considerations in the firm, yeah, we did banking business with them; just like stocks that I chose not to cover or did not believe in, you know, had negative consequences to the firm.

Mr. TIBERI. Thank you.

The CHAIRMAN. The gentlelady from California, Ms. Lee.

Ms. LEE. Thank you, Mr. Chairman. Let me just say that this world, the world of WorldCom, is really a world that very few of us would ever get a glimpse of until now, unfortunately. And I must say that it is very disturbing and almost unbelievable, and really appears to be criminal for what has happened to thousands and thousands of men and women.

I would like to know just a little bit more about your world. Are there any conflict-of-interest rules, any ethical guidelines that govern your work and your behavior, your industry?

Now, you indicated to Congresswoman Maloney—and, Mr. Grubman I am asking you specifically, since I can't ask the other two gentlemen for an answer to these questions—but you indicated that you had never owned any stock of your clients. But let me ask you about what we here call gifts, perhaps you may call it business entertainment, amenities, such as were you a passenger on a WorldCom aircraft, those kind of goodies that come with some industries.

What type of firewalls do you have in your business that we can understand a little bit more about?

Mr. GRUBMAN. Well, obviously, there are formal firewalls between banking and research. And you only get taken over on special occasions for short periods of time. As I said earlier, you are frozen and can't do your job at that point. So that is why you don't like to do that. As far as conduct is concerned, which I think—

Ms. LEE. I will ask you about being frozen. Keep going. I am sorry.

Mr. GRUBMAN. I and every other analyst on Wall Street try to get to know management, because it is a way for us to determine if we think a management team has the ability to execute its stated business plan. There is no apologies for that. Every analyst on Wall Street tries to do that. There are occasions where there are social events involved that happen.

In the case of WorldCom, over the course of a dozen years that I think I have known Mr. Ebbers, I think anyone in this room would describe it as a sort of handful of occasions where you would suggest that I was in any kind of quasi-social atmosphere.

Ms. LEE. You said, and you said in your statement, and also you responded to I think Mr. Sanders by saying that your relationship was a good working relationship. But there have been reports—others have couched it by saying that it is a personal relationship.

Could you make that distinction and clarify for us what that relationship is? Is it personal, or was it a working relationship?

Mr. GRUBMAN. Well I—my view of my relationship with Mr. Ebbers is that it was a very good working relationship. If you actually added up the number of times over a dozen years that we actually saw each other and spoke to each other, it would be surprisingly low, given what the press accounts seem to think.

Ms. LEE. So you don't consider it a personal relationship?

Mr. GRUBMAN. I consider Mr. Ebbers someone I like, someone, you know, I liked to be around when I was around. But it was—it was clearly based on work. There was almost never an occasion, or very rare, where we were together that work wasn't a dominant topic. So it was a relationship that I liked. And I not going to sit here and deny that I didn't like Mr. Ebbers, clearly. But it was born out of our working relationship and that is what it was.

Ms. LEE. So it was not a personal relationship?

Mr. GRUBMAN. Well, I don't know. I view—as having a personal relationship with people who I see every day, I talk to every day, I do things with every day, that was not the case here.

Ms. LEE. Let me ask you about being frozen. What does that mean, and could you explain a little bit more about that, and when does the freeze end? Do you ever get to thaw out after being frozen? I mean, I am not clear on how that works.

Mr. GRUBMAN. It is very straightforward. And as I said, you hate being in that position as an analyst. I am supposed to talk to investors every day. I am supposed to talk to our retail sales force, our institutional sales force. When, as an analyst, for whatever reason, you are quote/unquote "frozen," sort of my term—I am not sure that is the official term, that is my term, because that is what it feels like—you are prohibited from talking to your clientele of the particular company on which you are frozen. Because it is so severe, it tends to be very infrequent and on short duration.

Ms. LEE. For how long? Can you ever come back after this and conduct more evaluations of the same company?

Mr. GRUBMAN. Yeah, you do that all of the time, when you get unfrozen or thawed out. Then the only reason that happens is because whatever you are frozen about has now become publicly disseminated.

Ms. LEE. Thank you.

The CHAIRMAN. The gentleman from New Jersey, Mr. Ferguson.

Mr. FERGUSON. Mr. Ebbers, as recently as last February you were quoted as saying that, quote, "WorldCom has a solid balance sheet, manageable leverage, and nearing $10 billion in available liquidity. Bankruptcy or credit default is not a concern,".

In light of that statement, what credibility do you feel like you have today with your former employees and with investors in America?

Mr. EBBERS. On the instruction of counsel, I respectfully decline to answer on the basis of my constitutional right.

Mr. FERGUSON. Well, I am terribly disappointed that Mr. Ebbers and Mr. Sullivan have chosen not to testify here today. Your silence may have saved you today, but we can promise you this: We are going to get answers to the questions that need to be asked. Eventually we are going to get to the bottom of this situation, and there will be consequences.

While it is your constitutional right to maintain your silence, note that it speaks volumes that there is no dispute that you have caused employees to lose their jobs and countless other hard-working Americans to lose their savings, and in some cases their life savings.

Since it seems that there are some individuals who insist on illegally or unethically manipulating the system, let me be very direct and succinct. To the corporate CEOs and the accounting firms that audit their companies, let me be very clear. If you violate the public's trust, if you flush down the drain the retirement security of millions of Americans, you will go-and you deserve to-go to jail.

And to company executives, you will not be able to walk away with millions of dollars after bringing a company into bankruptcy without there being consequences.

Mr. Grubman.

Mr. GRUBMAN. Yes.

Mr. FERGUSON. I want to pick up on a couple of the points that Mr. Tiberi was making a moment ago. He went through a list of

companies that you had recommended who are either in bankruptcy or have seen their stocks down anywhere from 83 to 99.9 percent.

On April 25th—I am certain you are aware of this. On April 25th, 2002, Money magazine published a story entitled, "Is Jack Grubman the Worst Analyst Ever?" what is your response to that? What is the answer to that question?

Mr. GRUBMAN. Well, I would obviously disagree with the premise. But, look, I am not happy with what happened to my sector over the last 2 years. It is an embarrassment and a humiliation. I am not happy that people lost money. I am not happy that people lost jobs. I am not happy that the Telecom Act of 1996 ended up not materializing the way that a lot of people, probably in this room, thought that it would.

So that doesn't make me feel particularly good.

Mr. FERGUSON. Let me get back to the AT&T issue. Mr. Tiberi before was asking you about the AT&T, about some perceived conflict. During a CNBC interview on October 6th, Erik Gustafson—I don't know Erick Gustafson, but apparently he is a respected mutual fund manager—commented on the reversal of your recommendation.

And his quote was, quote, "There is no coincidence in the financial markets. There is no coincidence in the financial business at all, Darby. Clearly, Jack upgraded the stock because he wanted a part of the deal. Lo and behold, his firm, Salomon Smith Barney, was one of the three in the underwriting consortium,".

My question, following up on Mr. Tiberi's question, was are there companies, and can you think of any examples to give us, that your firm has a banking relationship with, which you have given a negative recommendation for?

Mr. GRUBMAN. Well, first let me respond to that, I would argue, allegation. We took our buy off AT&T in October of 2000 for a very simple reason: They said never mind. We spent a lot of time and wrote a big report that was very detailed, because we bought into the notion that we still do today with the cable companies, you can have this triple play, as I mentioned.

And with AT&T—

Mr. FERGUSON. There is nothing to Erik Gustafson's allegation? He is completely off the mark?

Mr. GRUBMAN. That is my view. AT&T, 10 months after we upgraded for the reasons I outlined, said never mind, we are going to break the company apart. That completely undermined my entire reason for upgrading the—

Mr. FERGUSON. Can you give me an example? My time is short. Can you give me examples of companies that your firm has banking relationships with that you said, this one is a dog, get far away from it, it is the worst thing you have ever seen? Can you give us some examples of when that has happened?

Mr. GRUBMAN. Sprint. The Bells. Sprint, who we have been cautious on for 2 to 3 years.

Mr. FERGUSON. You are going to give me one stock, comparing with all of these others which you said, this is where—this is going to take you to the top. And they are down 83 to 99.9 percent.

Mr. GRUBMAN. As I said, Sprint is an example. The Baby Bells, who our firm does various banking relationships with, we have not been bullish on. And we never follow about half of the new companies that came public, all of which were brought public by major firms like ourselves.

The CHAIRMAN. The gentleman's time has expired. The gentleman from Washington State, Mr. Inslee.

Mr. INSLEE. Thank you, Mr. Chairman.

Mr. Grubman, I am pleased that you are here today, because I think you are a walking, talking exhibit about why the Republican Party has been wrong in the U.S. House of Representatives, refusing to adopt meaningful reforms of your industry that have the capacity of preventing enormous loss of retirement income that you have been associated with. So I am glad you are here.

And, Mr. Dick, I think you are a walking, talking epitome and example of why the Republican Party has been wrong in standing between the American people and meaningful reform of the accounting industry so that we can avoid these horrendous, repeated, multiple disasters.

So I appreciate your testimony, because any Congressman, Republican or Democrat, who doesn't understand the need for an aggressive, assertive reform effort now, after listening to you, just is asleep at the switch. I am hoping that some more of my Republican colleagues have the epiphany that Mr. Castle has had; that we will now be able to revisit this and in fact have a meaningful bill, when we had a weak-kneed, totally ineffectual bill go out of here before because of their resistance.

Now, Mr. Grubman, I want to ask you a question. You referred to fraud, I believe, in your testimony. I wanted to let you know if you sell crack, 50 grams of crack in the United States, you go to jail for a mandatory 10 years. The judge can't reduce it. Mandatory 10 years.

Now, there is some suggestion that some folks at WorldCom were selling a fiscal crack. I want to ask you: Do you think people who are intentionally responsible for selling that type of misinformation ought to spend a mandatory 10 years, just like those who sell crack in this society?

Mr. GRUBMAN. I don't know about what the right mandatory sentencing requirement is. But I would say that, directionally, if people committed widespread fraud, they should pay for it.

Mr. INSLEE. Don't you think they ought to pay the same amount as somebody in the inner city selling 50 grams of crack? Shouldn't we make that the statute? Don't you agree with that? After you have seen the devastation that has happened to people who followed your advice that you say is a result of defrauding you, don't you think that ought to be the law in this country?

Mr. GRUBMAN. Well, again, with all due respect to the folks who are more qualified than me in terms of sentencing mandates, all I would say is, is taking a life away with a drug and taking one's, you know, life away maybe another way, because of fraudulent financials, both should be dealt with severely.

Mr. INSLEE. Well, I certainly am heartened by your comment. You have been involved, you have told us, supposedly as an independent analyst. An independent analyst. You have told us today

that this independent analyst, following the existing rules of law, apparently, was sitting in board of directors meetings when there are mergers, on just a small number of occasions you told us. I think you said three.

Mr. GRUBMAN. A few.

Mr. INSLEE. You have told us that no one in your industry can deny that, quote, "independent analysts are in fact receiving income associated with the investment banking side of their business."

Mr. GRUBMAN. Indirectly, through the comp process.

Mr. INSLEE. That no one can come to the public and say that they are independent in the sense that they are free of influence from the investment banking side.

Well, would you, based on what you have told us and based on your experience, would you encourage some of my Republican friends to revisit their reluctance to join us in building a firewall between those segments of the industry?

Mr. GRUBMAN. Okay. As I said, by the way, we at Salomon Smith Barney adopted the Merrill Lynch proposal, which will now have no investment banking revenues coming into the comp pool for research. So we have done at least that so far.

I still think, and I know there is a lot of people trying to figure this out, that you can be an independent analyst and part of a full service firm. But having said that, clearly if for no other reason than public perception, if not reality—and as we speak today, public perception is as important I think as reality—we probably need to figure out. And people a lot smarter than me will figure this out.

Mr. INSLEE. Thank you.

Just one more comment to Mr. Ebbers. Mr. Ebbers, you have invoked your fifth amendment. You have a constitutional right to do so. I think that all constitutional rights are important in that regard. But the trouble is, you have come to us in what I think is a bit of an arrogant position and testified about these factual issues, including how you are proud of your work, the company is valuable, it provides important services, no one can conclude that you have been involved in criminal or fraudulent conduct. And then you expect not to answer questions about that.

I want to give you a chance to make sure you make a decision, a rational decision, which horse you are going to ride: testifying or invoking the fifth amendment.

So I would ask you, sir, do you withdraw your original comments that you gave to this committee before you invoked the fifth amendment? Do you want to withdraw these comments and ask this committee to disregard them and strike them from the record?

Mr. EBBERS. On the instructions of counsel, I respectfully decline to answer on the basis of my constitutional rights.

The CHAIRMAN. The gentleman's time has expired. The gentlelady from West Virginia, Ms. Capito.

Mrs. CAPITO. Thank you.

I have a question for Mr. Dick. In the March 21st testimony of Michael Salisbury before our Subcommittee on Oversight, he stated that WorldCom had entered into two IRU transactions with Global Crossing, swap transactions. I am wondering, did WorldCom restate its revenue or earnings figures downward to remove these

transactions with Global Crossing? And do you have any knowledge of this?

Mr. DICK. I don't have any knowledge whether they restated their revenue figures downwards or would have needed to.

Mrs. CAPITO. Do you have any information that—as to whether the SEC has been questioning these swap transactions with Global Crossing?

Mr. DICK. I don't know specifically if the SEC is questioning those specific transactions.

Mrs. CAPITO. Okay. Thank you.

An additional question. In its July 1st statement to the SEC, WorldCom said it is reviewing its accounting for reserves for 2000 and 1999. Can you describe for the record what does that exactly mean; and do you have any knowledge, based on your experience, of the amount involved?

Mr. DICK. I don't know specifically what that might mean. I believe that it would relate to reserves that WorldCom has recorded on its books or had recorded on its books during these years.

Okay. I do not know what amounts that would be that they are reviewing or looking at. I just don't have any knowledge. I haven't been party to any of that.

Mrs. CAPITO. Okay, thank you. I have no further questions, Mr. Chairman.

The CHAIRMAN. The gentleman from Kansas, Mr. Moore.

Mr. MOORE. Thank you, Mr. Chairman.

Mr. Ebbers, you did read a statement when you started here this afternoon. I am just going to read one part of a sentence. ″I am proud of the work that I did at WorldCom. I believe that in spite of its recent problems, WorldCom continues to be a valuable company.″ did you say that, sir?

Mr. EBBERS. On the instruction of counsel, I respectfully decline to answer on the basis of my constitutional rights.

Mr. MOORE. Mr. Grubman, did you hear—were you here when Mr. Ebbers testified earlier?

Mr. GRUBMAN. Yes, I was.

Mr. MOORE. Did you hear him say that?

Mr. GRUBMAN. Yes, I did.

Mr. MOORE. He said WorldCom continues to be a valuable company. You heard him say that?

Mr. GRUBMAN. Yes, I did.

Mr. MOORE. Do you know what the price of WorldCom stock was on July 1st, just 7 days ago? Does 6 cents ring a bell?

Mr. GRUBMAN. I was going to say under 10 cents.

Mr. MOORE. About 6. Does that suggest great value to you of a company?

Mr. GRUBMAN. No, it doesn't.

Mr. MOORE. In fact the stock, you said earlier, had—the trading had been suspended; is that correct?

Mr. GRUBMAN. After the announcement came out it had been suspended, it started trading again. There was a question of delisting. So I am not sure.

Mr. MOORE. So it is trading now?

Mr. GRUBMAN. I don't know.

Mr. MOORE. It is a buy or sell?

Mr. GRUBMAN. I don't think there is an analyst on Wall Street that would put a rating on it right now.

Mr. MOORE. There is no real value right now, is there?

Mr. GRUBMAN. There is no way to analyze it.

Mr. MOORE. All right. You heard the discussion earlier about a proposal that CFOs and CEOs be required to swear to the truthfulness of financial statements. Do you personally think that is a good idea?

Mr. GRUBMAN. I personally think, as a user of financial statements, anything is a good idea to further ensure that they are truthful. Now, if we all think having CEOs sign financial statements will ensure that, or if it is just cosmetic, if it is just cosmetic, who cares.

Mr. MOORE. I am talking about a financial statement, if it is not true, they can be prosecuted in Federal court and go to prison. Does that sound like a good idea to you?

Mr. GRUBMAN. If, in fact, it is enforced, then that is a good idea.

Mr. MOORE. Well, that is what the Justice Department is for, is to enforce those and prosecute people who make false financial statements. Do you understand that?

Mr. GRUBMAN. I am a user of financial statements.

Mr. MOORE. So can I conclude that it is a good idea, then?

Mr. GRUBMAN. I think—yes. My personal opinion.

Mr. MOORE. Thank you. That is what I asked for.

Did you, during the three board meetings or any other time, have personal or telephone conversations with Mr. Sullivan, Scott Sullivan, sitting right next to you, about the accounting methods that he was using? I am talking about line expenses were booked as capital expenses. Let me back up. Strike that for just a minute.

Have you read at least allegations that Mr. Sullivan instructed that?

Mr. GRUBMAN. Yes, I have.

Mr. MOORE. Did you ever have any conversations with him, either by telephone or in person, about that accounting method?

Mr. GRUBMAN. No.

Mr. MOORE. Okay. Did you hear that was being done prior to disclosures in the press?

Mr. GRUBMAN. I had no knowledge at all of any rumors or anything about that.

Mr. MOORE. Okay. You a moment ago said that Sprint was a dog.

Mr. GRUBMAN. No, I didn't say that. He asked me if there was an example of a firm, of a company where we didn't have a buy that our firm does banking business, and Sprint was one.

Mr. MOORE. Okay. Sprint is in my district.

Mr. GRUBMAN. I actually—I actually probably made my reputation on the street early on by recommending the old United Telecom when Sprint was bleeding.

Mr. MOORE. Do you recall a Washington Post article dated July 6, 2000, in which the statement was made—I am going to read this for the record—that the most consistent and strident voice forecasting approval of the WorldCom/Sprint deal was the analyst who worked for the company that helped put it together, Jack Grubman of Salomon Smith Barney, Inc.?

As WorldCom's investment banker, Salomon stood to pocket billions of dollars if the deal closed. Do you recall that?

Mr. GRUBMAN. I don't recall that quote.

Mr. MOORE. Would you like to see it?

Mr. GRUBMAN. No.

Mr. MOORE. Is that true?

Mr. GRUBMAN. Again, I thought that the merger made sense for pure fundamental reasons. There is no denying Salomon Smith Barney was advisor on that.

But, if Sprint and WorldCom had come together, put aside, you know, what we know today—because Bill Esrey, who you obviously know quite well, sure thought the numbers he was seeing with WorldCom were right, or else he wouldn't have agreed to take their stock—you would have had, you know, quite an incredible set of assets with Sprint PCS, plus their Global assets.

Mr. MOORE. Does that suggest—I am looking for answers here—not just WorldCom—looking for answers of what Congress can or should do. You heard my questions, I think, in the form of my opening statement.

Does that suggest any kind of conflict to you? Being an advisor there and also standing to pocket billions of dollars if the deal closed?

Mr. GRUBMAN. Don't forget, while Salomon Smith Barney might have been the advisor to WorldCom, it is the investment bankers who, you know, do that work. My role is an analyst.

Mr. MOORE. Could that in any way color the analysis that you do, billions of dollars?

The CHAIRMAN. The gentleman's time has expired. The witness may respond.

Mr. GRUBMAN. I do my best every time to filter out things that I think are inappropriate that would color my analysis.

The CHAIRMAN. The gentleman from New York, Mr. Grucci.

Mr. GRUCCI. Thank you, Mr. Chairman.

Mr. Grubman, could you take me through the process that you go through when you analyze a company to make a recommendation? What is the procedure that you go through? And obviously don't be too long because I need some time to ask a few other questions.

Mr. GRUBMAN. Well, you look at a variety of factors. You look at—you know, you build a financial model. Either—you talk to the company. You get their views on what you think their growth rates will be in terms of demand and revenue. You stress test their assumptions about things like pricing. In my industry, you have to factor in the regulatory environment, as you know. There have been a multitude of court cases up and down the various circuits to the Supreme Court, so we have to factor in that type of thing.

So, you know, you try to build a quantitative model; and then you try to factor in qualitative variables, the business environment, regulation, demand outlook, such.

Mr. GRUCCI. When you talk to the company, what are some of the questions that you would ask them?

Mr. GRUBMAN. Well, if it's a start-up company where really a lot of the value is going to be predicated upon them executing over a long period of time—

Mr. GRUCCI. This is not a start-up company. What kind of questions would you ask a company of this size?

Mr. GRUBMAN. What you would ask—let's take the case of WorldCom. They had three or four broad areas of business, voice long distance, data, Internet and international operations. So you try to drill down in each of those categories what's going in those businesses, what's going on in the competitive landscape, what's going on in pricing.

Mr. GRUCCI. Do you test any of these things to make sure what you're being told is accurate?

Mr. GRUBMAN. Again, this is where you are talking about the qualitative stuff. So this is why it's important to try to talk to as many companies as possible. If WorldCom says we think we are seeing stability in pricing, you go to Mr. Moore's district and ask SPRINT or you go to New Jersey and ask AT&T and you try to triangulate what the major competitors within a given industry's segment are saying. A lot of it is anecdotal and a lot of it is qualitative, as opposed to hard quantitative fact.

Mr. GRUCCI. Would you define for me the term ″independent analysis″? What defines you as being independent? I heard during the course of this afternoon that you can sit in on corporate board meetings. You can be part of discussions that were taking place with mergers. How do you become independent if you're so interwoven with the activities of the company?

Mr. GRUBMAN. Well, you're not really interwoven. On a select few occasions you are brought into that realm.

Mr. GRUCCI. If you were brought in on one occasion, even just one occasion, an occasion of a magnitude of a company like WorldCom or any other of that caliber, you sat in on those types of discussions, how could you then be independent?

Mr. GRUBMAN. I'm not saying it's not hard, but I mean that is—that's what I and other analysts do for a living. And you come back to one thing. You have to have—

You know, when people ask me, you know, why all these stocks went down and why are we stuck with it for a long time, it would be easy for me to just blame the banker and say, no, they made me do it. No, I believe it is I made a mistake on the research side; and I am not blaming anyone else. You try to stay independent. You have your own views of the industry, but there is a—there is a connection between your views of an industry and what the bankers in your given firm are then likely—I think a previous questioner had brought that up—are then likely to do with that.

Mr. GRUCCI. My time is starting to run short, and I wanted to ask Mr. Dick a question, and it is more of an inquisitive type of a question. What do you think ought to be done to be able to prevent these types of accounting errors or misinformation from coming to the accounting firms then going forward? What kind of steps ought Congress be taking to be able to ensure that people who, when I go home and talk to my constituents and they tell me how much money they've lost, whether it was in WorldCom or some other corporate failure because the market right now is just not—it is not keeping pace with the consumer confidence that exists out there.

The economy appears to be gaining strength, but there is absolutely zero confidence in the corporate governances of our largest corporations. We hold ourselves out as this great place, to come to America where your dreams can come true for those who work hard. Those who are working hard, their dreams are evaporating; and I truly believe it won't stop until someone is dragged off and sent to jail. I would like you to hear from you what you think ought to be done in order for Congress to take the type of action it needs to take to help your industry prevent these things in the future.

Mr. BAKER. [Presiding.] The gentleman's time has expired, but please respond.

Mr. DICK. I think there are a number of proposals, as I understand it, that are under consideration; and this committee and others are in a far better position than I am, quite frankly, to address those and to do those particular things. My only comment is that no matter what type of safeguards, measures, processes, whatever's put in place, there can be—you cannot define or design an entirely fail-safe system where, you know, these types of things that are reported to have happened will not happen in the future or where people may make investments and those investments may not turn out. And I am not trying to be coy or anything.

Mr. GRUCCI. That's not an encouraging statement.

Thank you, Mr. Chairman.

Mr. BAKER. Thank you, Mr. Grucci.

Mr. Sherman.

Mr. SHERMAN. Just a couple of preliminary comments.

First, Mr. Chairman, I want to take this opportunity to commend the Financial Accounting Standards Board whose slow and ineffectual response to Enron has made this Congress look speedy and decisive.

I also note, Mr. Chairman, we have gone directly from Enron to WorldCom. We have skipped over Global Crossing, Xerox, et cetera, et cetera; and I can understand that because these hearings are going to take awhile. Perhaps you and Mr. Oxley want to consider the creation of several subcommittees to hold simultaneous hearings so all the pillars of the corporate community who wish to do so will have an opportunity to assert their fifth amendment rights.

Mr. BAKER. We will take your advice under advisement, but I can't imagine why anybody would not participate in all of these meetings.

Mr. SHERMAN. Speaking about fifth amendment rights when they are asserted, I expect that folks will get better legal advice than Mr. Ebbers. Mr. Ebbers, did you help a small company rise to one of America's largest corporations?

Mr. EBBERS. On the instruction of counsel, I respectfully decline to answer on the basis of my constitutional rights.

Mr. SHERMAN. Thank you. I would note that I took those words directly out of the statement that you presented to the committee, so you're refusing to testify that what you said under oath is true. But I think any further questioning would be fruitless.

I want to go onto the fact that WorldCom is another client of Arthur Andersen, that, as Chairman Tauzin of a committee that once had jurisdiction in this area noted on the Sunday talk shows, Arthur Andersen was the one firm that had the engagement partner

in total control of the audit with what was called the quality review or technical review department operating on a don't-ask, don't-tell basis. It's my understanding, Mr. Dick, that you were able to make the decision and if somebody in the quality review department or back in Chicago, if you didn't want to consult them, you didn't have to.

Now my colleagues will remember that, pretty much on a party-line vote, we rejected the idea of solving what I call the Arthur Andersen problem and requiring that all accounting firms have the quality review department sign off on publicly traded corporations audits. But I'd like to ask you, Mr. Dick, what was—did the quality review department, or whatever you happen to term it at Arthur Andersen, were they involved in this audit or did you pretty well make the decisions in your own office.

Mr. DICK. We had an extensive—what I would call quality control process that took place on this audit. In addition to myself as the lead engagement partner, there was another audit partner involved in the account. There was also an advisory partner who had no involvement with any of the audit work. There was a concurring partner who we discussed all significant transactions, activities, our audit approach, our audit scope, et cetera. Furthermore, if we had any—

Mr. SHERMAN. Were there folks involved back in Chicago?

Mr. DICK. Yes. Furthermore, if we had any questions relating to accounting for various transactions—for example, during 2001, WorldCom no longer had control of the subsidiary in South America—that accounting was cleared and reviewed with our people in Chicago.

Mr. SHERMAN. I thank you for your answer, and I want to go on to another question. Because this was not a question of a tough accounting issue as far as I can tell but just the field work not discovering 3 billion plus dollars. Am I correct in estimating that you have had at least 20,000, maybe 30 or 40,000 hours of field work involved in this audit?

Mr. DICK. I don't recall the specific number. It was probably between 10 and, say, 15 or 15 and 20,000 hours.

Mr. SHERMAN. So roughly 15,000?

Mr. DICK. Roughly.

Mr. SHERMAN. Now back when I was involved in audits, one of the first things you did was made sure debits to asset accounts were not overstated. You in your opening statement indicated, well, this is a company with $100 billion in assets. But a key thing to check is not the whole $100 billion but the additions to the asset accounts. This $3 billion that was misclassified and missed. In making sure that the debits to asset accounts were not overstated, what percentage of that was that $3 billion, what percentage of it was the—all the additions to asset accounts? How much did the assets grow on the financial statements from fiscal 2000 to fiscal 2001?

Mr. DICK. Well, I think there was—as previously mentioned, the capital expenditures of the company were approximately 7 to $8 billion.

Mr. SHERMAN. So a key part of the audit is to make sure that when the company says we've added $7 billion to our assets that

they've actually added $7 billion to their assets and three out of the seven wasn't added to their assets. And you've got people under your supervision spending 10, 15, 20,000 hours, how did they miss this?

Mr. BAKER. That is the gentleman's last question, but please respond.

Mr. DICK. Those hours were being spent on all our areas. We did in our auditing—as I mentioned before, we did test specific additions and looked for the appropriateness of those additions being either capital or whether they were line costs. I mean, whether they should have been expensed on the income statement.

Mr. BAKER. Gentleman's time has expired.

Mr. Barr, did you have questions?

Mr. BARR. None at this time.

Mr. BAKER. Mr. Gonzalez.

Mr. GONZALEZ. Thank you Mr. Chairman.

Members of the committee have been provided the most recent revised statement by WorldCom that was filed today with the SEC, and it is affirmed as accurate and signed by Michael H. Salisbury, General Counsel. As indicated earlier by my colleague on the other side, this is the same Michael Salisbury who appeared before the Subcommittee on Oversight and Investigations on March 21, 2002. Mr. Chairman and members of the committee, I would like to read a couple portions of his testimony that day:

"The competitive sectors of the telecommunications industry have experienced difficult times recently, primarily as the result of the failure of the Federal Communication Commission and the Department of Justice to engage in timely and effective enforcement actions. Accounting issues also have contributed to the problems experienced by some companies. The subcommittee's correct in considering both Federal policies and accounting issues at this hearing."

He goes on: "Under factors contributing to the industry's problems, quote, the subcommittee also asked to what extent the following factors served as a trigger for industry problems: use of unique accounting standards and the issue of pro forma revenue projections." WorldCom does not use unique accounting standards and does not issue pro forma revenue projections."

His last statement, closing statement, was as follows:

"Conclusion: The current problems in the competitive sectors of the telecommunications industry were not caused primarily or even significantly by accounting issues or assumptions about capacity utilization. Rather, those problems resulted directly from unrelenting efforts of the Bell Companies to retain their monopoly power and the fundamental failure of the SEC and Department of Justice to properly and effectively implement and enforce the law. In WorldCom's view, those failures have destroyed far more market capitalization and robbed far more value from shareholders' investments than any accounting issues."

Can you believe we are here 3 months later, which really leads me to believe I am not real sure that Mr. Salisbury should be affirming as accurate these reports filed with the SEC.

In this revised statement, Mr. Dick, discovery of line cost transfers during May, 2002, Cynthia Cooper, Vice President and internal

auditor, began an investigation of certain of the company's expenditures and capital accounts. This audit had been scheduled for third quarter 2002, but Ms. Cooper advanced it. Ms. Cooper determined that a number of questionable transfers had been made into the company's capital accounts during 2001 and the first quarter of 2002 and then goes on, Mr. Sullivan indicated the line cost transfers began in the third quarter of 2001 and that previously these costs had been expensed. Now the question or the period in question, wasn't this during your watch, Mr. Dick?

Mr. DICK. I was the engagement partner during 2001.

Mr. GONZALEZ. Why would Ms. Cooper be privy to certain information that put her on alert as to what was transpiring as either inappropriate or illegal and you were not?

Mr. DICK. I can't answer that, because I don't know what procedures or what she had done or what caused her to do the audit she did and I don't know what the specific findings were.

Mr. GONZALEZ. The frustration members of the committee and I share, Ms. Hooley and Mel Watt and others, is that we turn to you as members of your profession for guidance and don't want to act independently. We want to know what is best for the profession in serving a, well, important need. Yet you come to us, and you really don't say that much. The problem is, how do you confirm and verify the information on which you base your decisions and your judgment and your reports? Then, in turn, Mr. Grubman looks at your work and makes his decisions.

It's the old thing with accountants, garbage in, garbage out. How do you determine it's not garbage in? You're telling me you can't ask any questions and, if you do, if a CEO or CFO simply gives you a response, that you are going to believe it at face value.

Mr. DICK. I mentioned before that we performed our tests; and we did those tests based on our understanding of the company's processes, procedures, their system of internal controls that they had to process.

Mr. GONZALEZ. But you would agree it's totally inadequate; and it didn't work in this case, did it?

Mr. DICK. I can't say whether it worked or not because I honestly—and I am not trying to avoid your question.

Mr. GONZALEZ. But you failed to detect these transfers which clearly do not appear to be appropriate.

Mr. DICK. I am not aware of the specifics behind those transactions—those transfers.

Mr. GONZALEZ. Quickly, Mr. Chairman, I would like to ask one last question of both Mr. Ebbers and Mr. Sullivan. It's a two-part question, and let's see if I can kind of frame it here. Who in WorldCom made the decision to transfer the costs associated with charges paid to local telephone companies for the use of their networks and categorized those costs as capital costs after each business segment reported their results? Who made that decision and when was the decision made, Mr. Ebbers?

Mr. EBBERS. On the instruction of counsel, I respectfully decline to answer on the basis of my constitutional rights.

Mr. SULLIVAN. Based upon the advice of counsel I respectfully decline to answer the question based on my fifth amendment to the U.S. Constitution.

Mr. GONZALEZ. Thank you very much.

Mr. BAKER. Ms. Tubbs Jones?

Mrs. JONES OF OHIO. Thank you, Mr. Chairman.

Mr. Ebbers, can you tell me who your counsel is, please?

Mr. EBBERS. Mr. Reid Weingarten.

Mrs. JONES OF OHIO. Do you want to spell that for the record?

Mr. EBBERS. I don't know how.

Mr. WEINGARTEN. R-e-i-d W-e-i-n-g-a-r-t-e-n.

Mrs. JONES OF OHIO. Mr. Sullivan, who is your counsel, sir?

Mr. SULLIVAN. Irv Nathan, N-a-t-h-a-n, with the firm of Arnold & Porter.

Mrs. JONES OF OHIO. Thank you.

Mr. Ebbers, I know the answer I am going to get. You're not going to answer because of your fifth amendment right against self-incrimination.

I come to the committee as a prior judge and a prior prosecutor, and I recognize that your fifth amendment right is not absolute. At some point, even when you choose to take the fifth amendment, you will be required to respond to some of the questions that are being put to you. I trust that your counsel has given you good advice, but I would also suggest to you—both you Mr. Ebbers and Mr. Sullivan—the fact that you appear here just to say that you're exercising your fifth amendment right doesn't make you look any better in the eyes of the public who have been damaged by the activities of your company and your corporation.

I won't ask you any more questions since I know what the answer is going to be, and I move on to Mr. Grubman. How long have you been in the business as an analyst, sir?

Mr. GRUBMAN. I started in 1985.

Mrs. JONES OF OHIO. How long have you been with Salomon Smith Barney.

Mr. GRUBMAN. Salomon Brothers in March of 1994.

Mrs. JONES OF OHIO. During some of the questioning by my colleague, Congresswoman Barbara Lee, you struggled with what a personal relationship is, trying to distinguish and scoot away of what was personal and not personal. You would suggest, however, you probably had a drink with Mr. Ebbers on occasion.

Mr. GRUBMAN. I was struggling, I guess, with semantics. I have known Mr. Ebbers probably for about a dozen years. We have on occasion, you know, seen each other. Yes, I have had an occasional drink or whatever.

Mrs. JONES OF OHIO. Let's not get hung up on the personal relationship. The fact is, you knew him and did business with him and you knew about his business and you made recommendations to people about investing or not investing in his company.

Mr. GRUBMAN. Right.

Mrs. JONES OF OHIO. Based on that relationship and what we know now about what you said about WorldCom and what is happening, what would you suggest we as Members of Congress do to regulate that relationship, sir? And I need a short answer.

Mr. GRUBMAN. Analysts are always going to try to get to know management, and I think if you attempt to somehow forbid that from happening, that will—despite why we're here today, I think will damage investors.

Mrs. JONES OF OHIO. Let me stop you right there for a moment, please. You think it would damage investors. We are attempting to regulate the accountants from being auditors and consultants. That has been a problem for all of us, has it not?

Mr. GRUBMAN. Yes.

Mrs. JONES OF OHIO. Would there not be a similar dilemma between the relationship you have with WorldCom as an analyst and you have as part of Salomon Smith Barney?

Mr. GRUBMAN. I understand what you're saying.

Mrs. JONES OF OHIO. You understand what I'm saying.

Mr. GRUBMAN. You're saying separating banking from research?

Mrs. JONES OF OHIO. Yes.

Mr. GRUBMAN. I wanted to make it clear.

Again, there are a lot of people that are looking at this, all the various self-regulatory bodies so forth and so on. I guess my view—and, again, this is my view—is I think—I think and I believe that an analyst could be objective and still be part of a full service.

Mrs. JONES OF OHIO. Can you tell me how much—how you have financially benefitted from that relationship as well as Salomon Smith Barney even though you think it's okay?

Mr. GRUBMAN. Salomon Smith Barney, obviously, did banking transactions with WorldCom.

Mrs. JONES OF OHIO. The question is not whether they did or did not do. I want to know to what tune and how have you financially benefitted in dollar amounts?

Mr. GRUBMAN. I do not have a direct tie to any one company or any one banking fee. As I stated earlier in these testimonies, I have been highly compensated for quite some time, particularly the last 3, 4, 5 years. Part of that is due to my perceived market value by the firm.

Mrs. JONES OF OHIO. We think you're a great guy and made a lot of money. The point I'd like to get an answer, Mr. Chairman, in writing is how much financially you have benefitted from working with Salomon Smith Barney as a result of your analysis of WorldCom. And whatever it is, it is. I mean, because the guy from Global Crossing told me he made $3.5 million, got a $10 million dollar loan forgiveness, and he doesn't give a darn about anybody else. He thinks Arthur Andersen's relationship is great. I want to know what it is.

Mr. GRUBMAN. My compensation is not tied to WorldCom. I—my compensation is not tied to any one company. So that has to be clear.

I have been compensated over the past 4 years roughly $20 million per year on average, about half that amount last year on some of the cumulative basis, including loans, including stocks, options, cash, whatever. But that is not tied to any one company.

Mrs. JONES OF OHIO. But it's tied to the work you do for Salomon Smith Barney, which in fact has some dealing with WorldCom. Is that a fact?

Mr. GRUBMAN. It's tied to my work with Salomon Smith Barney which has dealings with lots of firms including WorldCom.

Mr. BAKER. The gentlelady's time has expired.

I would like to make an announcement for the benefit of the members about how we should continue to proceed.

I would like to go ahead with Mr. Capuano, Mr. Lucas and Mr. Shows, if possible, in the time remaining until we have to go to the floor for votes. I would like for the committee to recess to give our witnesses and others who are affected here this evening while we conclude the votes—I understand we have one 15-minute and two fives. That always translates to 30 minutes anyway—if we can get people to reconvene at 7:15, that will give people opportunity to attend to personal business and then pick up with remaining members who were not addressed on Panel I. If we finish Panel I, we will dismiss these witnesses and proceed to Panel II when we return.

Mr. Capuano, you're recognized.

Mr. CAPUANO. I don't intend to ask any questions of this panel. Because, frankly, I have been sitting here all afternoon and heard every word you have said, and I have not learned anything new that I didn't read in the papers, and I honestly, frankly, don't believe much of what you said to me. So, therefore, asking questions is really a waste of time.

If this wasn't real, I really think this is great for Monday afternoon TV. This is the worst soap opera I have ever heard. The only unfortunate part is it's real.

We have 17,000 laid-off employees, probably 100,000 people in the pension systems who are now losing their money, not to mention the millions of other people who have invested in this company.

We've got a CFO who, according to all reports, again has cooked the books to the tune of $4 billion in a lie that anyone who is taking introduction to Accounting 101 knows how to avoid.

We have a CEO who made hundreds of millions who apparently didn't have any idea what was going on in the financial world of his own multi-billion-dollar corporation. I guess all he did know was how to borrow $400 million from the corporation.

We have an auditor who apparently can't audit, somehow missed that simple $4 billion lie.

And we have an independent analyst who is neither independent nor a very good analyst. Apparently, you don't analyze anything. You take what the auditors say, and they take what the CFO says.

I don't know what you're doing here except for the fact that, between the four of you, my quick calculations have come up with about $2 billion in salaries, fees and compensation over the last 4- to 5-year period just in the four of you and the companies you two work for. $2 billion.

I don't expect—now again that's an unaudited number, and I'm not so sure it would change if it were audited. I don't expect that those employees, those laid-off employees, those pensioners or those investors will see a penny of the $2 billion you four people took out of this company. I don't think any of you are going to stand up and say, I was wrong, sorry; I donate back 1 year's salary. You think you could live on $80 million. I think maybe you wouldn't have to suffer. I don't expect that to happen.

I sit here today and listen to—well, the only company I only saw that was bad was SPRINT, but yet I advised my clients who for 2 years pursued buying that very company. Who are you lying to, your investors or your clients or us? Somehow, if it was a dog, why

did you pursue it for 2 years? Why did you only get stopped because the European Union and the Department of Justice said, no, sorry, can't do it?

My big fear here today is we are not going to uncover anything new. My big fear today is that you will get away with it. That's the fear that I hear from every one of my constituents. They expect you to get away with it just like some of your predecessors have over the years. Just like they fear Enron will, Global Crossing will, Tyco will, K-Mart will, Adelphia will.

You will possibly get away with it. What kind of a message is that to the rest of America? How do you think that's going to impact the stock market? You know better than I do. Get away with it, great. Enjoy your hundreds of millions of dollars. Enjoy the home that we can't touch for $18 million. You have done the American dream. You've taken every penny you can take, and you are going to keep it. God bless you, because I sure as hell won't and my constituents won't. They will go to sleep at night with your names on their lips and the names of your companies on your lips cursing you for what they have lost for their children. But I hope you're happy.

But beware, because all it takes is one of the four of you to turn, one of the four of you. I am reading some of these reports and I got to tell you, you guys better be watching each other. We were just given the revised statement of WorldCom, not the original one but the revised one that was done from the restatement of earnings. Just a few sentences.

"Mr. Sullivan reported to Bernie Ebbers, Chief Executive Officer of the company, until April 29, 2002." Mr. Ebbers, that sounds like a toilet flushing around your head. Be careful.

Also says, "in February 6, 2002, the audit committee met with Andersen, and it was Andersen's assessment that the company's processes for line cost accruals and for the capitalization of assets in the plant and property equipment were effective."

Mr. BAKER. Gentleman's time has expired. Can you summarize?

Mr. CAPUANO. I certainly will.

I think you better watch what's flushing around your head.

Mr. Sullivan, you know you're the number one target. Ms. Cooper says she discussed her investigation with Mr. Sullivan on June 11, 2002. Mr. Sullivan asked her to delay her review until the third quarter of 2002.

Gentlemen, I think you better watch your backs, and it's not us to fear. I think it's the other members sitting at the table and people who are not here today that you need to fear. Your future's in jeopardy, but, rest assured, you'll get to keep most of the millions that you, in my opinion, have stolen.

Mr. BAKER. Gentleman's time has expired.

Mr. Ford?

Mr. FORD. In light of what Mr. Capuano said I want to make my remarks brief.

I'm slightly surprised. I know Mr. Ebbers. He may not remember me, but my district is across the way from Mississippi. I represent Memphis, and about a thousand of the employees at WorldCom have lost their jobs in the Memphis area, and we certainly hope the best for them. We'll do all that we can here to try to not only make

life easy as we possibly can for them but for the remaining 16,000 employees who have been hurt by this, not to mention all the investors.

You know, the President will speak tomorrow, as most of you know—and I'll get to the point I was trying to make. I know Mr. Ebbers to be someone who has been a risk taker over the years and has been very successful, and I'm slightly surprised. I know you are here at the advice of your counsel not to make statements and so forth, but that's not the Bernie Ebbers that we have come to know in our area of the country.

That being said, the President will speak tomorrow, and I think all of us expect him to express continued outrage of what has happened. All of us expect him to talk hopefully strongly in terms of punishing wrongdoers, evildoers as he likes to call them. Many of us hope he will lay out a road map of how he can restore investor and consumer confidence. I know I am a believer, although I voted for the House version of a corporate governance reform that's—what's right now percolating through the Senate from Mr. Sarbanes committee is probably a better bill in light of recent revelations and will probably find quick passage in the Senate; and I do hope tomorrow the President will express strong, strong support for that bill.

All that being said, Mr. Grubman and Mr. Dick, $3.8 billion is a lot of money; and Mr. Capuano has expressed it very well. I think his point is well taken. Having been to law school—I'm not as a good a lawyer as he is or an accountant, for that matter, but I've got a feeling he's on to something.

All that being said, I'd ask Mr. Grubman, and you've heard the questions along these lines—and I was not here earlier in the day and I apologize—what can we do and what would you recommend—as you can tell, there is a lot of passion, heat and spirit around this issue; and one of the things that Congress is sometimes accused of doing is overdoing things or doing things excessively. But you all have laid out a pretty bad case of facts, however you look at it. You have damaged a lot of people—not you, not to indict you or anyone.

But I am perplexed and puzzled by Mr. Dick's comments about what my colleague, Mr. Sherman, was trying to get at about quality process controls. How do you miss something like this? And for the both of you, if indeed that was missed, what would you suggest we do or not do? I mean—

I want to enter into the record—I have John McCain's op ed piece from the New York Times I want to put in.

[The following information can be found on page 237 in the appendix.]

Mr. FORD. I also want to enter into the record the Business Roundtable's recommendations from many of the large CEOs or big companies' CEOs across the country.

[The following information can be found on page 235 in the appendix.]

Mr. FORD. But what would you suggest we do? We have seen the Business Roundtable suggest transparency and independent auditors and fairness, even those who took a lot of money from the company based on fraudulent accounting to return that money. Are

these things you would find agreeable and, if not, what would you recommend?

Because I have heard some of the things you said and the money you made, and it's staggering amounts of money for anyone, maybe not where you work but for the rest of us it's a lot of cash, $20 million. And what you do in investment banking and those who want to put up firewalls, but what you would recommend, quickly. Give you a lot of chance to respond. But I don't want—you have taken a lot of hits today, maybe rightly so, maybe some not so. But there are a lot of people who are hurting. So what you would recommend?

Mr. GRUBMAN. Okay. This is my personal view, not necessarily—I am not sure the firm would agree or disagree.

Someone in here said garbage in, garbage out; and that's the first thing you have to start with. Who is the originator of the data? It's the company, internal auditors, internal financial people. Who then is the next line of defense? And I'm not slinging arrows. I am just saying, who certifies that stuff? It is the audit profession.

So the first thing you start with is how to make sure that the originators of the information will not misbehave, and I will leave it to you folks to figure out how to do it.

Then, when it gets to us, Wall Street, Moody's or S&P and the rating agencies, certainly we need more transparency so all investors understand, you know, what firms do, even though we all put our disclosures, what are our reports, perhaps there needs to be more transparencies. We adopted the Merrill Lynch plan on having no banking fees directly coming into the research pool. It never came in individual by individual.

So I think you start with the origination of the information and then, when it gets to Wall Street, the rating agencies and mutual funds and pension funds. I think there has to be, I believe, more transparency of whatever potential conflicts there may or may not be or at least people understand what full disclosure—

Mr. BAKER. Mr. Grubman, let me suggest, if further explanation is warranted, would request on the gentleman's request you respond in writing.

Mr. Shows has indicated a desire to be heard before we recess the committee. If we conclude with Mr. Shows in a timely manner, my intention would be to dismiss this panel.

Mr. Shows?

Mr. SHOWS. Thank you, Mr. Chairman.

It is more a statement than a question. I do have a question.

According to the revised statement pursuant to section—and, of course, as Mr. Sullivan—I know he's not going to answer, so I will ask the other two gentleman—according to a memorandum by Ms. Cooper, she discussed her investigation with Mr. Sullivan on June 11, 2002. Mr. Sullivan asked her to delay her review until the third quarter of 2002 and to audit the second quarter of 2002 numbers. Now I know that he had a severance package of $10 million, Mr. Dick. Was that severance package supposed to come out before this time or after this time?

Mr. DICK. I'm not familiar with that. I have read that Mr. Sullivan had a severance package, but I'm not familiar with the de-

tails, nor am I familiar with anything subsequent to when Andersen was involved as the auditors, which was May 16 of 2002.

Mr. SHOWS. I think my point is pretty obvious, that sometimes people are motivated by money to get that big severance package; and I hope we look at this in this deliberation.

But also I would like for the committee to look into the fact about CEOs and CFOs getting these huge loans. Not only WorldCom but Enron and other executives had this done. Because, right now, we need to put that money in the fund for these unemployed and these investors.

Thank you, Mr. Chairman.

Mr. BAKER. Thank you, Mr. Shows.

Mr. Kanjorski.

Mr. KANJORSKI. I have a request and ask unanimous consent. I have just prepared a letter to Mr. Grubman dated July 8, 2002, for the purposes of inquiring on his part of his firm Salomon Smith Barney as to what IPOs were offered or sold or provided to any executives, directors or officers of WorldCom; and I ask that that information be accumulated by Mr. Grubman within the next 72 hours and provided to this committee.

Mr. BAKER. Without objection.

Mr. KANJORSKI. May a copy of this be entered into the record and that the committee forward this letter to Mr. Grubman.

Mr. BAKER. Without objection, it's made part of the official record; and the committee will forward the letter.

[The following information can be found on page 243 in the appendix.]

Mr. BAKER. I would further state that it's been a long afternoon, and we will recess at this point until 7:15. But pursuant to my earlier announcement, this panel is excused. Thank you.

[Recess.]

The CHAIRMAN. The Committee will reconvene, and the Chair will now introduce our second panel of witnesses. They are Mr. John Sidgmore, President and Chief Executive Officer of WorldCom, and Mr. Bert Roberts, Chairman of the Board of WorldCom.

Gentlemen, you are aware that this committee is holding an investigative hearing. When doing so, the Chair may decide to take testimony under oath. Do either of you have any objection to testifying under oath?

The Chair then advises each of you that under the Rules of the House and the Rules of the Committee, you are entitled to be advised by counsel at the table. Do either of you desire to be advised by counsel during your testimony today? Mr. Sidgmore?

Mr. SIDGMORE. I do not.

Mr. ROBERTS. I do not.

The CHAIRMAN. In that case, if you please rise and raise your right hand I will swear you in.

[witnesses sworn.]

The CHAIRMAN. Gentlemen, you are under oath. And we will proceed with the testimony. Mr. Sidgmore, welcome to the committee. This is a long day, and we appreciate your steadfastness and patience as we work through this difficult process. Mr. Sidgmore.

TESTIMONY OF JOHN SIDGMORE, PRESIDENT AND CHIEF EXECUTIVE OFFICER, WORLDCOM

Mr. SIDGMORE. Well, thank you, Mr. Chairman, and good evening.

My name is John Sidgmore, and I am the President and Chief Executive Officer of WorldCom, Inc. About 2 months ago when I agreed to take over as CEO, it was clear that the company faced a lot of hurdles and challenges, but I never really imagined what was going to wind up in store for us.

Since WorldCom's recent announcement regarding misstated earnings for 2001 and the first quarter of 2002, there has been an understandable outpouring of public anger and rage. While the misdeeds we uncovered occurred before I became CEO, I want to right here apologize on behalf of everyone at WorldCom.

I can assure you that WorldCom's new management team and employees share the public's outrage over these events. I cannot change the past, but I am responsible for what we do now and in the future. My actions will be guided by my commitment to restore public confidence in this great company and to operate WorldCom according to the highest standards of ethics and integrity.

I want to outline for the committee a number of important steps that we have already taken and that we will take in the coming months. I would like to remind everyone at the outset, however, that WorldCom uncovered this problem internally. In fact, we audited our external auditors. We found what they missed and promptly brought this matter to the attention of the SEC and the public.

This kind of initiative that was demonstrated by our internal audit team is to be applauded and will continue to be encouraged. From the time that I first heard about the possibility of inappropriate line cost transfers and a potentially major accounting problem on the morning of Thursday, June 20th, WorldCom's management and board investigated this matter and acted as swiftly as possible.

The actions taken by the board's Audit Committee and full board between Thursday, June 20th, and Tuesday, June 25th, when we took this matter to the SEC and made our public announcement, are documented in a Section 21(a) statement that WorldCom filed with the SEC, originally on Monday, July 1st, and we clarified that SEC statement earlier today.

I know there is some conjecture in the media that Mr. Sullivan may have raised these issues regarding line cost transfers at meetings at the board in May or June.

However, I do recall that during a June 13th conversation regarding SG&A and capital expenditure reduction measures Mr. Sullivan indicated that the desired savings might not be achieved fully due to write-downs that were planned for the second quarter. In addition, at the June 14th board meeting Mr. Sullivan gave a presentation on second quarter 2002 results, including certain write-downs, and indicated that he would continue to examine WorldCom's line cost commitments.

As you probably know, companies the size and complexity of WorldCom frequently take write-downs to adjust for changes in its business or in the accounting rules. I have to say I am extremely

puzzled that the wrongdoing was not uncovered or discovered by Arthur Andersen, our external auditor at the time, and they have not provided us with any real explanation. What is even more remarkable is that Andersen's February 6th, 2002 report to our Audit Committee indicates that it was Andersen's assessment that the WorldCom accounting processes for line cost accruals and capitalization of assets were effective, the very processes that later turned out to be ineffective.

Beyond Andersen, many other questions remain. We won't know all of the answers until the conclusion of the pending investigations. But one of the most important steps we can take is to make sure that our past transgressions are fully investigated and that the wrongdoers are punished. We are therefore cooperating fully with the various official investigations, and there are many by the SEC, the DOJ and Congress, to ensure that those responsible will be brought to justice.

WorldCom is being proactive here. At management's instigation, the Audit Committee, on June 24th, hired William McLucas, former Chief of the Enforcement Division of the SEC to perform an independent investigation of the facts and circumstances surrounding this issue. He will not only investigate our past and current management team, but also our board members, regarding any individual involvement.

We know if we are to be a model for corporate behavior going forward, we must be transparent and above reproach. Therefore, in our July 1st SEC statement we clearly stated that we were examining what additional earnings restatements might be required for periods going back to 1999 with respect to accounting for reserves established by the company.

We are committed to completing this analysis with the assistance of our new external auditors, KPMG. Through these and other steps, we plan to restore public trust in WorldCom. And while our reputation has suffered a tremendous blow, we think this is a great company and that the new management team will do everything in our power to save it.

Millions of people have a real stake in this company's survival, our customers, our employees, our lenders and our shareholders. WorldCom has always been a competitive force in the telecommunications marketplace and is a key component of the Nation's economy and communications infrastructure.

Before concluding, I would just like to say a very small number of words about the 60,000-plus employees we have at WorldCom. Every member of this committee has our employees living in their district. They are decent, hard working and highly talented men and women. Many have spent an entire career building a company that has changed the face of our industry, a company they have every right to be proud of, and they don't deserve to be tainted by the wrongdoing of a few.

Mr. Chairman, and members of the Committee, I reiterate my apology on behalf of WorldCom. We will work hard to regain your trust and that of the American people as well as rebuild the value of this company. We will return your faith in us by making a significant difference in the marketplace.

Thank you, Mr. Chairman, and I would be pleased to answer any questions that you may have.

[The prepared statement of John Sidgmore can be found on page 199 in the appendix.]

The CHAIRMAN. Thank you, Mr. Sidgmore.

Mr. Roberts.

TESTIMONY OF BERT ROBERTS, CHAIRMAN OF THE BOARD, WORLDCOM

Mr. ROBERTS. Good evening, Mr. Chairman. My name is Bert Roberts. I am the Chairman of WorldCom's Board of Directors. Over the years, I have been privileged to have numerous opportunities to testify before Congressional committees. Usually the subject matter pertained to some issue of telecommunications policy, and ordinarily I would begin noting how pleased I was to be here.

Today, however, given the circumstances, I must confess that I am not at all pleased to be here. The accounting improprieties that are the subject of today's hearing are an outrage. However, I am here to testify voluntarily. I want to work with the committee to restore the confidence in our company going forward.

So let me begin where I think most appropriate, by echoing John's sentiments and extending to this committee, to the Congress, to the President, and to the American people my most sincere apology. You have my commitment, our commitment to do what we can to accomplish four critical objectives: To get to the bottom of this, to bring wrongdoers to justice, to develop safeguards for the future, and to save this great company.

When I first learned of a potential accounting problem on June 20th, I was stunned. My emotions ran the gamut from disbelief to concern to anger. When the problem was confirmed and brought to the board's attention, the action was swift and decisive. The actions taken by the board, after being apprised of the situation, are summarized in statements we filed with the SEC.

To my mind, the failure of our outside auditors to uncover these accounting issues is inconceivable. That said, it is important to emphasize that our company's internal controls brought the problem to light. I commend our internal auditing group not only for their discovery of the problem, but also for having the fortitude to bring this matter forward to the board's Audit Committee.

Mr. Chairman, I have been privileged to hold a senior management position with MCI and now WorldCom for the better part of 30 years. I have not only served on this company's board for most of that time, but have also served on a number of corporate, university, and charity boards.

My experience has been that in approving the company's financial statements and records, the board is entirely dependent upon the competence and veracity of the CFO and his external auditor. The board's Audit Committee reviews matters with the CFO and the outside auditor before making its recommendations to the full board. But if financial documents have been prepared and okayed by the CFO and further sanctioned by the external auditor, neither the Audit Committee nor the full board has the independent capability to look beyond these approvals.

Indeed, we have never before had cause to question them. I am shocked that our outside auditors failed to detect the accounting issues that totaled nearly $4 billion. At this point we have more questions than we have answers, but we are absolutely determined to get those answers. We must. Restoring public trust in our company and in the marketplace demands it.

I would like to amplify something else John mentioned. WorldCom is a great company. I spent nearly 30 years trying to open the telecom markets to competition, originally at MCI and for the last few years at WorldCom. No other company in the world has a legacy that rivals ours in terms of promoting competition and advancing the Internet.

Unlike many of our competitors, we were never a monopoly. Our company has had to compete for every one of our 20 million plus customers. Today, we are the second largest long distance company in the United States, the largest competitive provider of local telephone service, the largest carrier of international voice traffic in the world, and the world's biggest Internet backbone provider.

We have world class employees whose great ideas and marketing savvy have produced, year in and year out, innovative services and customer savings. Savings may be the ultimate measure of our success and our continuing value to the marketplace. Since MCI introduced competition to the old Bell system, residential consumers and business users have saved many tens of billions of dollars.

The last 30 years in the telecom business have been tumultuous. I have had to manage through many ups and downs. Never before, though, has this company faced a greater challenge. But never before has our resolve been greater.

In summary, we will meet this challenge. We will deal with this matter openly, expeditiously and responsibly to help restore trust in our corporate and financial institutions, and we will rebuild the value of this great company and ensure its long term viability.

Thank you, Mr. Chairman. I would be pleased to answer questions that you and the committee may have.

[The prepared statement of Bert Roberts can be found on page 195 in the appendix.]

The CHAIRMAN. Thank you, Mr. Roberts. Let me begin by actually commending you for appointing Bill McLucas to head up the internal investigation. Obviously he had a major role in the Enron debacle. And with his experience at the SEC in the Enforcement Division, I think I speak for all of the members of the committee saying that he has great credibility.

Mr. Sidgmore, when can we expect the report, the McLucas report, to be available?

Mr. SIDGMORE. Well, this is going to sound evasive but it is not. We have given Bill complete freedom to take the investigation wherever it goes. So at this point in time I think he is trying to get his arms around it. It will take some period of time for him to go do all of the interviews and get all of the information, because we want all of the facts.

I would guess, and Bill may not like this, but I would guess probably 2 months, maybe 3 months.

The CHAIRMAN. Okay. Mr. Roberts, do you have a comment?

Mr. ROBERTS. No, I agree. He has full freedom as far as the board goes. I would hope he would do it expeditiously, but more importantly it has got to be thorough and get to the bottom of the matter.

The CHAIRMAN. Mr. Sidgmore, Mr. Roberts stated in his sworn statement that he first learned of the fraud on June 20. But nowhere in your sworn statement today or in WorldCom's sworn statement to the SEC on July 1, or in the unofficial transcript of your comments on July 2nd at the National Press Club, or in the company's press release on June 25 did you state when you first learned of the transfers of expenses by Scott Sullivan, or that you never knew or approved of Mr. Sullivan's accounting transfers. So please state, if you will, for the record, under oath, the date on which you gained any knowledge of the nature and amount of transfer of line costs to capital expenditure accounts during 2001 and the first quarter of 2002 by Scott Sullivan, and that includes knowledge from any source about any of the transactions which were improperly recorded by Scott Sullivan as capital expenditures during the period in question.

Mr. SIDGMORE. Okay. Well, let me give you the time line. Basically the first time I heard that there was any kind of significant problem was on the 20th of June.

I had breakfast with one of our board members, Judy Areen. She is the head of the Georgetown Law School. She mentioned to me that she had a meeting with the Audit Committee or with some members of the Audit Committee the night before. They had some serious accounting concerns. She asked if I was aware. I said absolutely not.

The CHAIRMAN. Is she a member of the Audit Committee?

Mr. SIDGMORE. Yes. So I went back to my office. She told me that Max Bobbitt, the head of the Audit Committee, would be calling. He called me at about—I am going say 10:00 or 10:30—and said, you know, we think have got a really serious problem here. We are not sure, but we think there is a significant problem. We are going to have an Audit Committee meeting tonight at KPMG. We are going to invite Scott Sullivan. We really think you should come, and we briefed Bert, talked to Mike Salsbury about it, and Mike went over with me—

The CHAIRMAN. Mike Salsbury being?

Mr. SIDGMORE. He is our general counsel. So we had a fairly large Audit Committee meeting, which included Scott Sullivan, Mike Salsbury and myself, the Audit Committee, and Cynthia Cooper, the internal auditor, and KPMG.

And so at that meeting, KPMG and the Audit Committee went through their concerns about this line cost-capitalization and—which really was the first time I had heard what the details were of this. And basically they went through, I am going to say, about an hour explanation of what their concerns were. And then we asked Scott Sullivan to give his explanation, and his explanation was reasonably lengthy.

But the long and the short of it was that the KPMG auditors did not buy his explanation, at least at that point. We went through a lot of discussion on it. We specifically asked KPMG if they were ready to tell us that this was a problem or that there was a re-

statement required or even a write-down. And they said, no, they had not concluded that. They wanted to go through the documentation with Scott. They wanted to see Scott's explanation fleshed out. And they gave him basically the weekend to do it.

So we set up an Audit Committee meeting for the 24th, later in the evening, actually it was 5:00 I think. And at that meeting, we got together with the Audit Committee and a couple of additional board members, and then KPMG and Scott. At that meeting, we heard sort of the full explanation from KPMG, also from Arthur Andersen, about why both of these accounting firms disagreed with the accounting. And they had concluded at that point that the statements were not valid, we probably had to restate.

The CHAIRMAN. So your testimony is, basically, not until June 20th did you have a conversation with Mr. Sullivan or anyone else in regard to that particular issue?

Mr. SIDGMORE. Yes. There is only one other thing which I was going to clarify. It is not necessarily directly related. But on June 13th, I had a conversation with Scott Sullivan in the context—in the context of cost savings that we were trying to get out of our P&L. And you have to remember, until the 24th—or I am sorry, until the 20th, our major problem was trying to get our financing situation straight and our P&L straight because the company had lots of financial problems even then.

And so what I wanted to do was take out about $2 billion worth of costs from the business. And, you know, Ron Beaumont, our Chief Operating Officer, had identified several buckets of cost that we could look at. And on the 13th, it was the day before our board meeting, we were pulling together the package to show the board relative to these costs. And Scott mentioned to me, you know, we may not be able to get all of those costs out because there are going to be some significant write-downs this quarter. We didn't get into line costs or any of that. We have write-downs, we make adjustments to accounts. That is not untypical in a company of this size.

So I didn't pay that much attention to it. That just went away. On the morning of the 20th, after I heard from Max Bobbitt, there was a voice mail from Scott telling me that this had become problematic. But those were the only conversations I had. So really the first time I knew there was any problem, I mean serious problems with accounting was July 20th. I had heard from Scott a little nervousness about some write-offs on the 13th.

The CHAIRMAN. You meant June 20th?

Mr. SIDGMORE. Yes.

The CHAIRMAN. Let me yield to the gentleman from Massachusetts.

Mr. FRANK. Thank you. The 3.8 billion was discovered a few weeks ago. But for instance, Mr. Grubman noted that he had begun to do some downgrading some time before. It is clear that the 3.8 billion was hardly the sole cause here. It is important for this reason. That is, obviously, it is outrageous that there was fraud. But I don't want to lend support to the theory that we are here with a who-done-it with one culprit and one crime. We are talking about some systemwide problems, it seems to me.

Even the motivation that led Mr. Sullivan to do this, no one is alleging that this is an embezzlement. In the typical cases that we

call fraud, the employee is finagling the books to get some money into his or her own pocket. Here Mr. Sullivan is accused of doing this to get money into the corporation's pocket. Now that doesn't make it any less a violation of the law. But it does mean that the motivations are different. It is not simply finding one, two or three crooks.

What troubles me is this. We have a system in which we have been told increasingly that forms of compensation, incentivized compensation are very important for top executives. I must tell you, that whole concept troubles me. I would have thought that if someone was being paid like a million and a half dollars to run a corporation that he would not need an extra incentive to have that corporation's interest at heart. Ordinarily in our economy people who work for a particular entity are not considered to be in need of a little extra, so they will really do the job well.

But at any rate, we have developed this system in which we have this extra incentive often tied to the stock price, and tied to the stock price in a way if the stock price hits a certain point the compensation can come, even if it later goes down. Some of it may be tied to a certain number of years. So what happens is we have given a number of people at the highest reaches of the corporation incentives to play with the stock price.

Again I want to stress, what Mr. Sullivan is accused of is not putting money in his pocket, but violating accounting rules, violating maybe the law to pump up the stock price of the corporation.

So what we have then is that option system that gives that incentive. Then we have the people who are supposed to check it. I got to say with regard to boards of directors in general it has been my impression—I was asked before in an interview whether I thought that the board of directors was providing checks and balances, and it seems to me that they were cashing the checks and ignoring the balances. They weren't doing anything.

The accounting does not seem to have been a strong eye, partly because some of the accountants are told by some companies, by the way if you don't go along with this I will replace you. There are competitive pressures on the accountants. There are pressures on the analysts. Mr. Grubman acknowledged that, yes, there is some connection between the report you give on a company and whether or not you get the investment business.

So here is the problem, as I said, it is systemwide. Now, I think that is why we have to not simply go after individuals, but to deal with it—what we are dealing with here are the kind of financial systems equivalent to steroids. We have banned steroids, because if you want to run the race without steroids you are disadvantaged by the guy who gets them.

Now, if you are trying to sell your stock and run your company and you don't play these games, you may be disadvantaged in the short run by the people who are playing those games. Now, people may say that is only the short run. Actually this whole business with the stock focus on the short run may be giving a new and literal meaning for the corporations to John Maynard Keynes' quote, "In the long run we shall all be dead, because some of you are going to be because you got too short run intensive."

But that is why I think we should be focusing not on this or that wrongdoer, which I don't think is our job, but on what systematically we can do to diminish, A, the incentive to play with the stock price, and, B, to increase the safeguards against that.

Now, I would ask you both to comment on that in your experience. But let me throw in one other thing. This is something that troubles me, the loans to Mr. Ebbers. I don't want to ask Mr. Ebbers, because I think the fifth amendment is an important part of the Constitution. I must say the test of whether or not you really believe in constitutional principles is whether you are prepared to apply them to people you are not that crazy about. It is easy to be for the constitutional rights of your friends. People you do not admire, when you stand up for their constitutional rights, then you are serious. Most free speech cases consist of the right of really obnoxious people to say vicious things. But the loans to Mr. Ebbers, they seem to have become a serious problem.

Let me ask you this. We have heard about hundreds of millions of dollars. How much did Mr. Ebbers owe the company? Is it secured? Are you at risk? How much of it is likely to be at risk? And why did you have to do that in the first place? Mr. Sidgmore.

Mr. SIDGMORE. Well, first of all, I was not CEO then so I don't want to make an excuse. But let me just describe what I know about it, and then Bert can jump in.

Mr. FRANK. You were both working for the company.

Mr. SIDGMORE. We were both board members.

Mr. FRANK. You weren't bystanders?

Mr. SIDGMORE. He was the CEO.

The loans amount to a little over $400 million at this point in time. At the time the loan was made there was an enormous amount of perceived collateral, because first of all the stock was at $24.

Mr. FRANK. Perceived collateral?

Mr. SIDGMORE. I tell you why I say that. The stock was at $24 a share. So the stock alone provided a huge amount of collateral against the loan. That is point one. Point two, he had several other pieces of property that in total added up to—the loan appeared to be well over—

Mr. FRANK. Were they formally pledged? The property?

Mr. SIDGMORE. I believe that they are.

Mr. FRANK. They were collateral?

Mr. SIDGMORE. At that time they were not fully pledged but I think they are now.

Mr. FRANK. Were they pledged at all?

Mr. SIDGMORE. Yes, sir.

Mr. FRANK. How much of the loan was secured other than by the stock itself?

Mr. SIDGMORE. I want to say that the stock was—I don't know the answer to that question.

Mr. FRANK. The point is this: What was your job at the time, Mr. Sidgmore?

Mr. SIDGMORE. We will get it for the record.

Mr. FRANK. Nobody knew and nobody much cared is my point.

Mr. SIDGMORE. We did. I don't remember the exact split at this point. So anyway the point was that at the time it didn't seem

that—as outrageous—in retrospect it seems outrageous. But at the time the theory was, the company, you know, didn't want him to be out in the market selling all of his stock. The theory of the case was it was over-collateralized. I am not defending it. I am just saying that was the theory.

Mr. FRANK. Isn't it a little contradictory—

The CHAIRMAN. The gentleman's time has expired. Let him finish.

Mr. FRANK. Can I ask him one quick question?

The CHAIRMAN. You already have two questions on the table.

Mr. FRANK. I will withdraw that one and ask this one, which is can you tell me, it seems to me it is contradictory when you say it was substantially collateralized by the stock. But you were worried that he would sell the stock and bring the price of the stock down. I mean it seems on the one hand the stock is pretty firm, but on the other hand it is pretty shaky.

Mr. SIDGMORE. My point is he didn't have enough stock to pay for the loan. Okay. Completely. So we had to have additional collateral. We added to it.

Mr. FRANK. But the reason you made the loan, the corporation made the loans, was not as an incentive to him or because he was the CEO, but because you were afraid that he would otherwise sell the stock in a way that would depress the value of the stock?

Mr. SIDGMORE. Yeah. I want to be careful.

Mr. FRANK. The CEO of the company. You have to bribe him not to undercut the stock of his company.

Mr. SIDGMORE. The Compensation Committee evaluated the situation and recommended that we take this loan, because it would ultimately be better for the company.

Mr. FRANK. The Compensation Committee of the Board of Directors? One more wonderful example of the firmness of the Board of Directors.

The CHAIRMAN. The gentleman's time has expired. The gentleman from Iowa, Mr. Leach.

Mr. LEACH. Well, it is interesting as we think through the day that there have been some winners and losers. Mr. Grubman made $20 million a year for 4 years. The calculation that I have, and it is off by up to 100 percent, is that the clients that he advised and your company and seven or eight other companies lost several hundred billion dollars.

That is a real distinction in winners and losers. Your board took $400 million and lent it to your President, and you both voted for that, I assume. I consider that a dereliction of duty. Nothing else—it has nothing to do with whether that $24 a share was adequate. It is an improper act of a board of a public company in the United States of America.

And I want to ask both of you, do you think it was right, morally right, to do that? Mr. Sidgmore?

Mr. SIDGMORE. I would say this. If I had to vote for it again, I would not vote for it.

Mr. LEACH. Mr. Roberts?

Mr. ROBERTS. I would say the same thing. Looking in hindsight—

Mr. LEACH. I agree looking in hindsight. But I will tell you that is an easy one. Looking in foresight at the time, it is inconceivable to me that a board would take $400 million of the capital of the company and lend it to its President. I want to come back to your situations.

Mr. Sidgmore, according to some paper I have been given, I don't know if it is right, it indicates that you made about $87 million in insider sales, and because you are an insider they have been called insider sales.

Mr. SIDGMORE. That was in the Wall Street Journal this morning.

Mr. LEACH. And Mr. Roberts $22 million; is that correct? And so the two of you sold, and then in order to possibly maintain the value of the stock you lent your President money so he could keep his stock?

I come from a small rural state. I have got a—I don't know who produced this, but a chart here that says my State public employee fund lost, $30 or so million in your company.

I have an insurance company in the largest city in my State that lost over $100 million in corporate bonds in your company. Those are huge losses.

Now, the irony is that we have looked basically at three companies on the committee. We have looked at the Enron Corporation. We have looked at the Arthur Andersen Company. We have looked at your company.

Enron, frankly it is really sad for its employees but, when it leaves the corporate landscape, is not going to be much missed.

Arthur Andersen as it existed a decade ago was one of the truly, truly great American companies. It somehow got transferred in the decade of the 1990s and took on a different ethic. And so it is hard judge whether it is bad or good that it is being held accountable. I think to get down to only four major public accounting firms is really unfortunate, but that is what is happening.

Your company, on the other hand, is really vital to our country. It is vital to an incredible industry. It is vital to the competitiveness of American communications companies worldwide. It is really important that your company be transformed, reformed, reorganized, and maintained in one form or another, whether it be under your management or some other companies or some other individuals.

But this country is really in a pickle, because clearly inappropriate decisions have been made, and yet just as clearly this is a company with employees in my district, as you say, every district in the country, that are really dedicated. They look upward, and I will tell you they are just appalled by what they have seen happen.

Now, I will also tell you, Mr. Sidgmore, my employees tell me that they really have hope in you. They really like you. They really hope it works. On the other hand, where do we go as a country? What advice do you give to corporate boards? What advice—what kinds of compensation are you now taking?

Mr. SIDGMORE. Well, we will start with the last one if that is okay. My current salary is a million dollars a year. When I joined, I came back into operations 2 months ago, that was what the Compensation Committee granted me. They also granted for, voted for

a large bonus package which we have chosen not to implement at this time given where we are. So that is where it is. It is about a million dollars a year.

I just want to address the stock option question also. This is not a sympathy vote here. But with the 86 million or whatever the number actually is, I want to say is in large measure, a great majority of that is made up of original UUNet stock that I earned while building UUNet from 1994 through 1996. And actually, when it converted to WorldCom, I still have almost half of those shares in the form of WorldCom stock, and most of those sales were made from 1987 through—1997 through 1999, I mean well before the loans were given.

So I can't really honestly see any tie whatsoever to the loans. I do think that there can be changes made to the way boards operate to prevent some of these things, and I also think personally that probably—I mean, I think I would say more than probably, I think it is likely that the options situation has gotten out of control over the last few years. And the option situation was terrific for the guys at the high end while the companies were all growing. Now, it doesn't seem to have that much impact anyway because the economy has changed.

So, I mean I have all kinds of other situations on board governance and so forth, but I don't want to take too much time now.

The CHAIRMAN. The gentleman's time has expired. The gentlelady from California, Ms. Waters.

Ms. WATERS. Thank you very much.

Mr. Roberts, it is rumored that Mr. Sullivan told you and perhaps the entire board about his accounting practices. He told you how he reported the operating expenses that had put it over in the capital outlay future columns.

Now, I don't know whether he told you directly or if it was in a report or if it was in something that the board gets routinely. But is it true that you were told at some point about Mr. Sullivan's accounting practices what he had done?

Mr. ROBERTS. The answer is yes. John went through the sequence. There was a board—after we found out on the 20th there was the Audit Committee that John referred to that was attended by a few. There was an update call on the Friday at 3 o'clock where the entire board was advised as to what was going on.

Scott worked on his white paper across the weekend. On Monday there was another Audit Committee meeting where Scott basically presented several of us that attended that Audit Committee—

Ms. WATERS. If I may interrupt, did you know about it prior to, what day did you just give me, June 20?

Mr. ROBERTS. No.

Ms. WATERS. Did the board receive any kind of report from Mr. Sullivan relative to the way that the accounting was taking place prior to June 20th?

Mr. ROBERTS. Not that I recall. Scott Sullivan did make presentations at each of the board meetings and presumably made more—

Ms. WATERS. We will be able to look back at these board meetings and determine whether or not it was revealed in any of his reports that maybe you didn't pick up. Have you looked at that in retrospect?

Mr. ROBERTS. Yes, we have.

Ms. WATERS. What did you discover?

Mr. ROBERTS. We discovered that there was nothing said at those meetings with respect to the problem at hand.

Ms. WATERS. Was there anything submitted in writing to the board prior to June 20th?

Mr. ROBERTS. Was there?

Ms. WATERS. Anything in writing. Anything written?

Mr. ROBERTS. No.

Ms. WATERS. So no—

Mr. ROBERTS. Not that I know of. We have looked at the board minutes. We have tested our memories on what was done at the various board meetings. Although the Audit Committee was not here, John and I have examined some of the Audit Committee minutes, and there appears to be nothing that identified that was a problem before we learned about it through our internal auditor, who brought it for forward to the Audit Committee.

Ms. WATERS. I would like to ask Mr. Sidgmore, what is going to happen to this company? Are you going to file bankruptcy? Are you negotiating with the banks to restructure the loans? How do you plan on retaining your executives? Do you plan on giving them retention bonuses to the tune of $2 to $3 million? If so, where are you going to get the money from? And what do you think your customers ought to do right now? A lot of questions, but see if you can answer them.

Mr. SIDGMORE. Well, first of all, we are fighting for our life. I mean, I think that should be clear to everybody if you read the newspaper. This is a tough time for the communications industry and for WorldCom in particular.

Ms. WATERS. What is the bank saying about the loans?

Mr. SIDGMORE. We have got a number of proposals coming together. Some potentially would include a Chapter 11 filing, and some don't. Okay? And so we are not 100 percent sure where that is going to wind up.

I can tell you this, I am confident, not positive, but I am confident that we will pull this company together and turn it around one way or the other, and I am quite confident that the great majority of the customers and a great majority of the employees will wind up with this company for a long time.

Ms. WATERS. Do you anticipate coming to the government asking to be bailed out in way, shape, form or fashion?

Mr. SIDGMORE. That is not in our current plan, no bailout or borrowing from the government. That's not in the plan. We will ask for help from some agencies to help potentially calm some agencies down where we have had some contract questions. I think you have read about those in the papers; in other words, people that are worried about giving us new business. But that would be the extent of the favors we would ask at this point.

Ms. WATERS. What about the retention bonuses? Do you plan on giving out retention bonuses?

Mr. SIDGMORE. We had a retention bonus plan in the company for many years.

Ms. WATERS. But you don't have money now. I'm asking you do you plan on doing it now?

Mr. SIDGMORE. Well, we're not going to certainly do it now unless we wind up refinancing the company so that the company is financially healthy. We certainly wouldn't do it now. But there may be a rationale for putting a compensation plan together for critical employees that we need to make sure we keep with us as we go through this process.

The CHAIRMAN. The gentlelady's time has expired.

Ms. WATERS. So you're going to try to do retention bonuses.

Mr. SIDGMORE. We're going to try to do bonuses. I didn't say retention bonuses.

The CHAIRMAN. Gentleman from Louisiana Mr. Baker.

Mr. BAKER. Thank the Chairman for yielding.

Mr. Sidgmore, I've got several questions, and I will try to be as brief as I can in asking them. When Mr. Ebbers departed, you were brought on board as the new president and CEO. What were you told as to the reasons for Mr. Ebbers' departure and any problems you needed to rectify in your new capacity?

Mr. SIDGMORE. I think it's fair to say that the board had become, or at least some members of the board had become, frustrated with the company's performance, stock's performance and sort of the general direction of the company over the last couple of years.

Mr. BAKER. So there was no specific event or circumstance of Mr. Ebbers' conduct in the preceding 6 or 8 months that caused the board to have concerns, but rather a gradual deterioration of business performance?

Mr. SIDGMORE. I don't know if that's gradual, but there was a deterioration of business performance, and there were some concerns about the final negotiations surrounding his loans. And so I guess the independent directors basically got together and concluded that this situation was getting critical, and they had a conversation with Mr. Ebbers about it, and he wound up terminated.

Mr. BAKER. I note in the explanation of the restatement previously given to the SEC and the explanation of the restatement made available to us today, in the last—on the last page, paragraph 21, there is an explanation with regard to Mr. Sullivan's disposition that the board acted on June 25 to dismiss him without severance. When did you remove Mr. Sullivan from his capacity as a board member?

Mr. SIDGMORE. We have not—we have asked for his resignation as a board member, but legally right now, without getting in too many details, without entering some kind of formal procedure, it's not easy to remove a board member without a shareholder vote.

Mr. BAKER. So your bylaws don't have a provision for removal for cause if an individual is serving as a board member and convicted of a felony relating to securities fraud?

Mr. SIDGMORE. Like I said, we are looking at that. It may require a formal procedure, but we have asked for his resignation.

Mr. BAKER. And I would point out that prior to your capacity as being the new CEO, you were a board member for some period of time, so appear to have some prior knowledge as to the deterioration of company conditions coming into this new responsibility.

Mr. SIDGMORE. Yes. That's true.

Mr. BAKER. On page 24 of the explanation of the restatement, it said, we expect potential and certain material reversals of reserve

accounts for '99 and 2000. Can you identify the nature of those reserve accounts and to what extent the reversals are we talking about, or are we in hundreds of millions?

Mr. SIDGMORE. I will just tell you what we know, and we don't know as much as you want us to know right now. The way this situation came up was the day of our announcement about the misstatements, an employee faxed to us a series of transactions that they didn't recognize, that they were concerned about, given the fact that this was just announced and it was so explosive. So the list came out. There were about seven or eight transactions that I recall on these pages. So we actually turned that over to the SEC. We showed it to McLucas. And we asked, you know, McLucas to go investigate it.

Mr. BAKER. Was this as a result of your internal audit work or Andersen's work?

Mr. SIDGMORE. Actually this was a result of—I believe—I think this was a result of an employee finding this, sent the information to our comptroller, and our comptroller faxed it to us.

Mr. BAKER. So what was the capacity in which the employee was engaged? Who discovered it?

Mr. SIDGMORE. The person who sent it to me was Stephanie Scott, who is now acting as comptroller of the company.

Mr. BAKER. And at the time she made the discovery, she just worked in the comptroller's office; is that right?

Mr. SIDGMORE. That's right. Well, she didn't work in the comptroller's office. She was actually the head of SEC reporting, and she had some other financial responsibilities as well.

Mr. BAKER. Well, I want to join with Mr. Leach in expressing my concern about this matter. Although you have a narrow window of opportunity in which you appear to have a favorable reception by the employees of the company, this is a very horrendous set of circumstances, from my outside view looking in, from the time of your arrival on April 30 until now, as a former board member, with an inability to remove a board member who was terminated by the company for apparent misconduct, to—I am sure the board expressed significant concerns to you at the time of your employment about company performance and what they expected you to do in order to turn it around, with the potential restatements coming with regard to reserve accounts, with the difficulty that this might present in future financial arrangements to turn the company around.

This is very disturbing news, and I don't know what, if anything, this Congress can do in light of the condition of the corporation. But certainly knowing that the former CEO is now retiring on $150 million a year and maintaining other assets that can't be secured, this is not a proud day in a free enterprise system, and I deeply hope that you have the will and ability to turn this around and save the few dollars left in investors' accounts who have faithfully contributed their resources to you and your company and who are now planning to have to work many more years into their retirement while the former CEO lives in the south of France. This is really not good.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from Pennsylvania Mr. Kanjorski.

Mr. KANJORSKI. Thank you very much, Mr. Chairman.

Mr. Roberts and Mr. Sidgmore, were either of you in the hearing room when we had the panel of four before us?

Mr. SIDGMORE. Yes. Both of us were.

Mr. KANJORSKI. Did you find anything in response from any of the four witnesses that made you proud of WorldCom or of the free enterprise system?

Mr. SIDGMORE. I didn't find anything.

Mr. ROBERTS. I didn't find anything.

Mr. KANJORSKI. It is not the role of the government or the Congress to impose itself in private—even for public companies. And there's been an effort over the years to try and cut loose entrepreneurial spirit in this country, and to a large extent the telecommunications field represents in some peoples' eyes a shining example of turning loose that free enterprise spirit. But what I heard from your auditor today, what I heard from the impartial, independent analyst, and what I didn't hear from the former chief executive officer and chief financial officer makes me wonder whether or not WorldCom is of itself enough to shake the very confidence of the investing public in large corporations that should know better, do know better, but apparently have lost their confidence.

I am disturbed about the fact that Mr. Sullivan is still on the board. What does a member of the board of directors get paid by WorldCom?

Mr. SIDGMORE. He gets paid nothing. He was fired as CFO and an employee and has been severed. As a legal matter which we are looking at, we have no easy mechanism to force him off of the board, but I am hoping we will be able to accomplish that in the near future, hopefully by resignation.

Mr. KANJORSKI. Is he still sitting in on confidential meetings?

Mr. SIDGMORE. No. He has not been invited to any board meetings since he was escorted out.

Mr. KANJORSKI. Mr. Roberts, you have been chairman of this corporation for a fairly decent period of time, haven't you?

Mr. ROBERTS. [Nods affirmatively.]

Mr. KANJORSKI. And I have no reason to assume that you have any evil intent or had any evil intent, but could you explain to me how all of this could have happened, and you're chairman of the board of directors, and you obviously don't know about it?

Mr. ROBERTS. I think you should understand the way the board works. This is not untypical of many companies, but you're dependent as a board member to the numbers that the CFO puts forward as he has been audited by the outside auditors and reviewed by the audit committee. And I think we're in a situation where, in fact, numbers were put forward. The accounts of MCI/WorldCom were what they were. They were audited by the external auditors, reviewed by the audit committee, and then presented to the board on each of the occasions throughout the year of the quarters that we're looking at, and also at the end of the year. And every indication and every presentation that was given to the board showed no indication of a problem with either our accounting or our books. I am appalled that this happened.

Mr. KANJORSKI. And I think you probably genuinely are, but I have a big question in my mind. Wasn't there a lawsuit, stockholder lawsuit, filed in 2000 against WorldCom?

Mr. ROBERTS. We have a number of suits filed against us.

Mr. KANJORSKI. But the one that was dismissed under the Reform Act of '65. And didn't that talk about improper activities on the part of officers of the corporation?

Mr. ROBERTS. I believe that lawsuit, from what I know about it, was specifically focused on a write-down that the company had at the end of 2000, the year 2000. It was dismissed by the court.

Mr. KANJORSKI. It was dismissed because the court said under the act that our friends on the other side passed, took the court's jurisdiction away. But, in fact, the court passed on the clearness of wrongdoing, but it said the court no longer had jurisdiction under the law to deal with it. Isn't that substantially the dismissal? The dismissal wasn't the fact that it was a clean bill of health, nothing happened. It was saying that the court just lacked the jurisdiction under statutory law to do anything about it.

Mr. ROBERTS. But nevertheless, the suit was dismissed, but it's also the subject of what the SEC was investigating.

Mr. KANJORSKI. When these suits are filed, and these facts are alleged in the suit, and the SEC is doing some investigation, would you all sit there and say, well, we are just innocent lambs, and proceed along, or do you think as a member of the board responsible for governance of a huge corporation that a bell shouldn't go off or a tilt and say, we better find out what this auditing committee is doing, and find whether we should enlarge it or change it, or find out what the CEO and CFO is doing, or change them? It just seems to me it was like going around the maypole on May Day.

The CHAIRMAN. Gentleman's time has expired.

The gentlelady from New York is recognized.

Mrs. KELLY. Thank you, Mr. Chairman.

Mr. Roberts, we are all sitting with this chart about the fact that you own stock, and you sold it. Can you tell me the date that you sold the bulk of that stock?

Mr. ROBERTS. I think the stock that was referred to in the Wall Street Journal this morning I believe was sold in the 1999 time frame, maybe as early as the first quarter of 2000. It was, I think, mostly associated with exercise of stock options that were a result of my efforts at MCI before the merger.

Mrs. KELLY. Okay. Thank you.

Mr. Sidgmore, you sold the bulk of your stock in May 2001?

Mr. SIDGMORE. No. No. I sold a very small amount in May 2001, about $400,000 worth. And I believe, let me see where that is—$440,000, these were sales from trusts that I had set up for my niece and nephew's education. And basically we had contributed the stock in December of 2000. This was just the sale of it into their trust. Normally you wouldn't want to keep stock in a college fund, or at least I wouldn't.

Mrs. KELLY. I am just wondering what occasioned your selling of the stock, because obviously Mr. Ebbers wanted to sell his stock, too, at one point. It's clear from the way this graph shows us how it folds, how the fall or the crumbling of WorldCom, that probably all wanted to sell your stock. And it's interesting to me, and the

reason I'm asking is that you have been talking, Mr. Sidgmore, about a new management team, and I am at a loss to understand where the new management team is coming from. You were vice chairman. You were on the board. Mr. Roberts was on the board. Who's new on this board, and why should anyone in the public believe that WorldCom is getting a new look?

Mr. SIDGMORE. Well, if I could just respond. I was the chief operations officer at WorldCom from January '97 till September of '98. In September of '98, I moved out of my operating role and had no operating responsibility whatsoever.

Mrs. KELLY. Excuse me, sir. Were you still on the board?

Mr. SIDGMORE. I was a vice chairman and a board member. In '99, I took the role basically as strategic development officer, and basically what I did was look for acquisitions; work on acquisitions, mergers, new technologies, new ideas and that sort of thing. In the year 2000, I played almost no role whatsoever, and in the year 2001, my entire role literally was making speeches and to come up with an occasional idea on Internet technology.

So everyone in the company knows and everyone on Wall Street will tell you I haven't been involved at WorldCom in a long time. I worked maybe 1 day a month. I reduced my salary by 20 to 1. Most of my stock was sold in '97 and '98, and then some more in '99. But the stock you're referring to in '01 was simply the transfer—a result of me transferring a bunch of stock into the kids' trust fund in December of 2000, and I sold it a few months later. And the reason I sold it is very simple. I did the same thing a year before. The stock went down, and the kids' trust fund went in half. So what I said was if the stock goes back up, we're going to sell it this time so that the kids can get back to even.

Mrs. KELLY. I don't have much time, but I am glad you saved your kids' college fund. But my question is—and you are perfectly within your rights to sell your stock even if it's in the corporation where you're the vice chairman of the board. My concern and my question that I ask you is who's new on that board? You, Mr. Sidgmore, created two very, very important companies. UUNET is something I am quite concerned about as a part of WorldCom, and it was a strong corporation. I am asking you what's going to guarantee me as a stockholder—I don't own WorldCom stock, but if I were, what's going to guarantee me that there's going to be a new administration at the top?

Mr. Roberts, you were there on the board. Where were the questions that the two of you, having been involved with major corporations prior to this time of being on the board, should have been asking?

My final question to you, and you can answer that, but my final question because I'm running out of time is do you believe that Mr. Ebbers was so joined at the hip to Mr. Sullivan that it prevented either one of you from asking the appropriate questions?

Mr. SIDGMORE. I guess the only thing I would say is we have not been involved in operations. We operated as board members, notwithstanding my ceremonial title and Bert's title as well.

Again, to repeat what Bert said before, we have to depend on the CFO and the outside auditors to a great extent. Number two, if you looked at the financials from last year and the ratios to revenue

from a line across to revenue and capital expense, all of those things, as Mr. Grubman said, seem to be in line. We didn't know that the transfers were happening, and it was very, very difficult from our position to see that. So, I think from our standpoint as board members, it would have been very difficult to find something that Arthur Andersen couldn't find in an audit and our original audit team didn't find either.

The CHAIRMAN. The gentlelady from New York Mrs. Maloney.

Mrs. MALONEY OF NEW YORK. Thank you, Mr. Chairman.

I would like to ask Mr. Sidgmore, I would like to ask about an item that I raised earlier that was reported in the paper that WorldCom reported 16 billion in earnings to shareholders between '96 and 2000, yet it reported less than a billion of taxable income to the IRS during that same period. So obviously WorldCom had two sets of books, one for the shareholders with earnings and another set of books with losses or very little earnings. So my question to you is do you think that it would be a good idea for WorldCom to give the same information to the shareholders that they give to the IRS?

Mr. SIDGMORE. Yeah. And we can give you a reconciliation of that if that would be useful to you.

Mrs. MALONEY OF NEW YORK. I would like to look at that.

Mr. SIDGMORE. I want to say in most corporations, especially ones that are this complex with 65 acquisitions and all that, there is definitely going to be a difference between tax accounts and book accounts, and that's not abnormal.

Mrs. MALONEY OF NEW YORK. Do you think it would be a good idea for public companies to reveal their taxes? We heard earlier from analysts and from auditors who said they just rely on the information that's given to them. I think investors would find it very interesting that what's being reported to shareholders are great earnings, but to the IRS and other companies it's a loss—very little earnings. That might help an analyst have a little more information. I know if I was an analyst, I'd start looking a little deeper if I saw that difference. Do you think that be would a good idea to put that out to the public?

Mr. SIDGMORE. I am in favor of transparency generally, which is why we're going along with all the investigators' requests from all agencies, why we are making our information available to anyone who asks. So I generally would favor that kind of transparency.

Mrs. MALONEY OF NEW YORK. There has been some criticism of the accounting form that you use, the EBITDA. I would like to put in the record an article on this by Christine Nuzum, and in it she says that there are a lot of people—or WorldCom, because of your fraud, that it has hurt a lot of industries that are associated with this type of accounting, EBITDA, or earnings before interest taxes, depreciation and amortization, to assess stocks. And many leaders in finance, Warren Buffett and others, have been very critical of this form and said we should probably go back to general accounting principles, GAAP. And do you think that would be a good idea, or are you going to continue to use this controversial form?

[The following information can be found on page 244 in the appendix.]

Mr. SIDGMORE. EBITDA has been the standard in the telecommunications industry for a long time.

Mrs. MALONEY OF NEW YORK. Given the fact that so many have gone bankrupt recently, do you think maybe it would be good to rethink this?

Mr. SIDGMORE. No. The biggest issue with EBITDA is you don't count the cost of capital against yourself. In many of these cases of the bankruptcies and even WorldCom, which is struggling with our debt, huge interest payments don't show up in the EBITDA calculation. So the EBITDA calculation masks the cost of capital, and that's what happened to a lot of the problematic telephone companies, including WorldCom and Global Crossing.

Mrs. MALONEY OF NEW YORK. Don't you think it might be better to just to go back to GAAP then?

Mr. SIDGMORE. They're all under GAAP. GAAP is sort of the general accounting rule. But the question of how you report it—

Mrs. MALONEY OF NEW YORK. I mean, just don't go into EBITDA. Just use GAAP instead of the other one.

Mr. SIDGMORE. EBITDA is according to GAAP. The EBITDA measure, when you highlight that, it doesn't show you what the real cash flow of the business is, which today is the most important measure, in my mind.

Mrs. MALONEY OF NEW YORK. Maybe we shouldn't use it. Maybe we should go back to cash flow. Maybe then our auditors and analysts might get a better understanding of what's taking place in corporate America.

I want to go back to a question that was asked many, many times with the prior panel. And how is your internal auditor able to find this when Andersen, which was your tax auditor and your tax adviser, your consultant and your auditor that was involved in all these areas, they couldn't find it? And then I want to ask, why are you continuing with this investigation despite the fact that the Department of Justice has requested you to discontinue the investigation immediately?

Mr. SIDGMORE. First of all, we are not doing the investigation. Bill McLucas is doing the investigation.

Mrs. MALONEY OF NEW YORK. Why is he doing it when the Department of Justice has asked him to stop?

Mr. SIDGMORE. They haven't asked him to stop. He's actually working with the Department of Justice and the SEC on this. They made certain requests to see certain witnesses before he does, and we are complying with all that. But Bill is the one that is actually doing the investigation. It's not us, the company.

Mrs. MALONEY OF NEW YORK. Why was he able to find it?

The CHAIRMAN. The gentlelady's time has expired.

Mrs. MALONEY OF NEW YORK. Why was he able to find it when the others could not find it?

Mr. SIDGMORE. I don't know the answer to that question. He did a terrific job and a terrific service for the company, and I have no idea why Arthur Andersen didn't find it. I think I made that clear in my opening comment.

The CHAIRMAN. The gentleman from Alabama.

Mr. BACHUS. Thank you Mr. Chairman. Mr. Sidgmore, when you operated an Internet backbone company, did you ever expense capital expenditures?

Mr. SIDGMORE. Did we ever capitalize expenses you mean?

Mr. BACHUS. Yes.

Mr. SIDGMORE. Some expenses, but not like this. There are certain things that you can capitalize, but not operating expenses traditionally.

Mr. BACHUS. Not operating. How about telecom access charges or transport charges?

Mr. SIDGMORE. No, we did not. At UUNET we pretty much had an annuity stream of revenue, and we were profitable from January of '95 on.

Mr. BACHUS. But you followed generally accepted accounting practices.

Mr. SIDGMORE. I certainly believe so.

Mr. BACHUS. You have testified today that the accounting irregularities, the dubious accounting that you first became aware of on June 13 and then—

Mr. SIDGMORE. No. On June 20, I became aware that there were accounting irregularities. On June 13, which I really didn't pay attention to except on the 20th, Scott Sullivan said we may not be able to get all these savings.

Mr. BACHUS. You're saying June 20.

Mr. SIDGMORE. That's right.

Mr. BACHUS. June 13, you had a little remote suspicion there were some accounting irregularities.

Mr. SIDGMORE. Not accounting irregularities, just that we were going to have to take a write-off for something. But that's not atypical in our business really.

Mr. BACHUS. Now, you're quoted in early May as saying that investor concerns over aggressive accounting to artificially inflate revenues were red herrings. Would you reconsider what you said then today?

Mr. SIDGMORE. Well, I think—I didn't remember that exact quote, but I think there were some concerns about our increasing or inflating revenue through some billing irregularities, and we felt at that time, and still feel, that that was basically a red herring.

Mr. BACHUS. The quote is, quote, "that investor concerns over aggressive accounting to artificially inflate revenue." Now, that's what they did here.

Mr. SIDGMORE. They didn't inflate revenues, not in this last scenario. What they did was that they took traditional operating expenses and moved it into the capital account.

Mr. BACHUS. By amortizing, it does increase profits.

Mr. SIDGMORE. Increases profit, not revenue.

Mr. BACHUS. What about artificially inflating revenues; that would be wrong, too.

Mr. SIDGMORE. That would be really bad.

Mr. BACHUS. Do you believe that that has gone on now?

Mr. SIDGMORE. We haven't heard of anything in that light, but this is one of the reasons it's hard for us to be positive of anything right now, to be honest with you, and that's why we asked KPMG

to go back and audit the books and really scrub them for 3 years, and go back to '99 to make sure everything is pretty clean.

Mr. BACHUS. Was it Mr. Ebbers who was escorted out, and he looked up—Sullivan was escorted out, not Ebbers.

Mr. SIDGMORE. I don't know about Ebbers.

Mr. BACHUS. Seventeen thousand employees lost their jobs last week. Now, they weren't given—they are not being extended on their health care or their life insurance, or they're not going to be paid an annual pension, are they?

Mr. SIDGMORE. No. They did get severance, and I would like to say on this point, because I heard that several times today, the reduction in force that caused 17,000 people to lose their jobs has nothing to do with this accounting issue. We actually had planned this about a month ago, and this is about our cost-saving effort. This issue with the accounting problem exacerbates our general financial condition.

Mr. BACHUS. Let me ask you this last question. We've heard reports that Max Bobbitt, who is chairman of the audit committee—he's part of your senior management team now, I guess?

Mr. SIDGMORE. He's part of the board.

Mr. BACHUS. That he's allowed a $1-a-month lease on a WorldCom corporate jet?

Mr. SIDGMORE. First of all, it's not Max Bobbitt. It's another board member, Stiles Kellet. He's actually the head of the audit committee—I'm sorry, compensation committee. There was apparently some kind of deal made for Stiles to rent and use the corporate jet—that we had an extra corporate jet at one time—and he houses it in his facility in Atlanta. This was a deal that was made between he and Mr. Ebbers, and we are investigating that right now.

Mr. BACHUS. By extra, if you are laying people off, it might be prudent to sell an extra jet.

Mr. SIDGMORE. We agree with you.

The CHAIRMAN. The gentleman's time has expired. The.

Gentleman from North Carolina Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman.

Could I ask a couple of quick questions and maybe get some quick answers? Mr. Sidgmore—Chairman can't find me most of the time either—at some point you testified on June 20 or thereabouts, 21st, that KPMG and Andersen both agreed that there was a problem; is that right?

Mr. SIDGMORE. No—well, almost. The 20th, we heard from KPMG. On the 24th, Andersen—

Mr. WATT. They both agreed to that. Was that Mr. Dick who was in that meeting or—I mean, the same guy that testified earlier?

Mr. WATT. I'm not positive about that. I'm not positive it was Mr. Dick. He was on the conference call.

Mr. WATT. Could you give us information about who that was?

The second question I have is just a great big why? I mean, I think I could understand this whole Enron thing because people were profiting personally, and I guess the question I am—the thing that's just not adding up to me here is I don't understand why two people—either one or two people in a multibillion-dollar corporation would have the motivation to do this. Either of the two of you care

to comment on what the motivation, Sullivan's motivation or Ebbers' motivation or the combination of them? I mean, what was driving this?

Mr. ROBERTS. Well, I don't know that we can speak for those two individuals that were not speaking earlier.

Mr. WATT. Your own interpretation. I mean, you obviously got—you got some clue about what was driving this.

Mr. ROBERTS. Based on the information that was disclosed to us during those days after the 20th, Scott Sullivan presented a case that he believed that he was doing the right accounting treatment. As a company, we listened to KPMG and other experts, determined that it wasn't the right treatment, and that's why we took the action that we took. But Scott put together the white paper and made a case that he believed he was doing the right thing.

Mr. WATT. So you escorted him out the door not because he thought he did anything wrong or you thought he did, this was an honest misunderstanding about what was generally accepted accounting principles? Are you telling me that he still believes that he was doing the right thing, and Andersen never detected it, and KPMG thinks that he was doing the wrong thing?

Mr. ROBERTS. I am only speaking for what happened that weekend that he presented the case that—

Mr. WATT. That wasn't my question. My question is why have you concluded that this was done? I mean, an honest mistake?

Mr. ROBERTS. I can't answer that. I think we as a company, John, myself and other members of the board, have determined talking to KPMG and others that it was the wrong application of accounting principles, and that's why we took the action that we did.

Mr. SIDGMORE. Could I just add that a lot of us are totally mystified about this.

Mr. WATT. All of this is backward-looking, you know. My policy in these hearings is try to look forward. And you said, Mr. Sidgmore, that you had a whole list of things that you would suggest going forward about corporate responsibility. Can you just give us your top three?

Mr. SIDGMORE. I think—I mean, first of all, I think in terms of the audits, okay, I think there should be a main auditor and an auditor to audit the auditor. Unfortunately there are only four accounting firms left, but it seems to me we need more scrutiny over the audit, particularly in light of the coming potential regulations on, you know, CEOs signing forms and that sort of thing. So from that standpoint, having an audit and having the audit audited is probably a good thing.

In a strange way this is how we uncovered. We had our internal audit group audit the audit. It turned out to be the right thing, but it was too late. But I think that's one scenario.

You talked this morning about the investment banks and the conflicts of interest and everything. I agree that research should be separated from banking. And on the board itself, I think that the—I think over the next year or 2, the board committees have to become a more important and more integral part of the company's operations.

The CHAIRMAN. Gentleman's time has expired.

The gentleman from Illinois Mr. Manzullo.

Mr. MANZULLO. Thank you, Mr. Chairman, and just a couple of thoughts. On the first panel, Mr. Dick, the former partner at Arthur Andersen and the head of the audit committee, stated that the $3.96 billion misstatement of WorldCom represented roughly 20 percent of the line items in terms of dollars on the WorldCom balance sheet. The way I interpret it is that one out of five line items examined by Arthur Andersen was incorrect; that these statements should have raised a red flag with the auditors. So if any auditing tests occurred, the auditors should have more or less an 80 percent chance of testing a correct line item and a 20 percent chance of finding an incorrect line item.

Dick testified that Arthur Andersen billed 15,000 hours among 8 auditors at WorldCom over a period of 1 year. These numbers are extraordinary because if the auditors spent just 1 percent of their time during the year in reviewing WorldCom line items, which is pretty conservative, this would equate to 150 hours or 19 days. If the auditors conducted 1 accounting line item test each 8-hour day—I think that is also conservative—and 20 percent of the line item costs should have raised a red flag, the simple probability that the auditors could have missed these incorrect line items is about 1 percent. In other words, the likelihood that the auditor should have seen a cost which raised a red flag is about 99 percent. And so much for the auditing committee.

But what I really wanted to demonstrate to you today is the reason I have been here all day and got up at 4 o'clock in the morning is because of the 1,000 MCI employees that are in my congressional district. And I met with them on a couple of occasions, and I said, what is it that—what questions could I ask on behalf of you, my constituents; what words could I give before this congressional committee? And they said two things: Congressman, first of all, jail the wrongdoers. Put them in prison for a long, long period of time. But at the same time, the government, the SEC and Department of Justice and whatever we do around here should remember that there are thousands of innocent people out there, including these in Rockford, Illinois.

I had visited several hundred business establishments and factories since I was elected to Congress several years ago. I have never seen employees with such a spirit of productivity and ingenuity as those at MCI in Rockford. And Mr. Leach had the same experience with his 3,000 employees.

Let me give you more particulars. MCI in Rockford is the largest minority employer in that area. This is the city that led the Nation in unemployment in 1981 at almost 26 percent. We are 8 percent unemployment now. The steel tariffs could endanger thousands of jobs in a city that is heavily manufacturing. And what we are seeing there is something extraordinary. We have lots of government programs for lifting people up by their boots, but there at MCI, people have an opportunity to become involved in the entrepreneurial spirit, to make as much money as they want to, and they are making a tremendous amount of money in telemarketing without having to invest any capital. It is an extraordinary opportunity. And these are 1,000 families desperately wanting to hold on to their jobs. They have confidence in the two of you, and because

they know your backgrounds at MCI and UUNET. And my question to you is their question: What can you tell the American people that can give assurance to these 1,000 people that they have a good probability of maintaining their livelihood?

Mr. SIDGMORE. Well, like I said before, before the restatement we had been working on a new strategic plan for the company which included refinancing, selling some of the businesses that are not central to the core strategy of the company, reducing costs, both line costs and SGNA, and retooling the company around a central piece that we think will grow over the next few years. And you know, had the restatement not occurred, I am highly confident we would have implemented all those pieces already.

I do think if we can find a solution to our financial issues in the short term, and I do think we will be able to, I think we will go forward and implement that strategy, and I think the lion's share of the company will wind up pretty much intact, and we may eventually have a growing healthy thriving business again.

You have to remember one thing here. The issues at WorldCom, I mean, that existed before the restatement are not unique to WorldCom. Most large telecoms today have the problem that there's too much capacity out there at the same time that the demand is not growing for the first time in a long time. Everyone has been slow to get to this. But the real issue is we have to restructure these businesses so that they are more focused and that they're smaller and we find some new products that people will buy. And I do think that can happen as long as the debt load on all these companies gets reduced, and that's really our fundamental problem right now. But I am confident.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from Texas Mr. Bentsen.

Mr. BENTSEN. I want to follow up on Mr. Watt's line of questioning because I was thinking the same thing. According to the document you all filed today with the SEC, the amendment, how is it that the chief financial officer or member of the board came up with this idea in the last several months, this revolutionary theory that no one else had come up with in accounting that somehow you could treat line costs, which are a principal cost factor in the business that you all are in—that you could treat that as a capital expense and not an operating expense and just independently make that adjustment in a fairly significant amount, about 10 percent of the capital cost on an annual basis, and nobody knew about it?

I mean, that is what I think Mr. Watt is trying to get at, and what I don't understand is where was his motivation to not go and check with his auditor, to not talk to the members or other officers or directors of the company? He just all by himself, sitting in the CFO suite, and said, here's an idea, we can start doing this now. And ironically it appears to match very close to what earnings targets were for the company based upon guidances that were given both by the company itself in its discussions it would have with analysts as well as what the analysts, including Mr. Grubman and others who followed the company.

Now, perhaps it's all a coincidence, and perhaps he one weekend came up with this idea, but how is it that no one else knew? And

were there ever any discussions within the board on the questions—on the question of meeting those targets? Was there pressure from the board on meeting earnings targets?

Mr. SIDGMORE. See, that to me is one of the strange things. The motivation really isn't there. Scott didn't sell any stock. And we do review at board meetings the projections and the quarterly targets and where we are year to date and all those things, just like all boards do. But the thing that is—first of all, we didn't make our targets for a couple of quarters last year, so you think if we are going to go through all that—

Mr. BENTSEN. And your stock was in a dramatic decline.

Mr. SIDGMORE. If you could hear me for 1 minute here, which is very difficult for people to understand, but if you look at line cost as a percentage of revenue, which is what we review at every board meeting, we review line costs as a percentage of revenue, we review people costs as a percentage of revenue, those ratios were very strikingly similar to our historical pattern, and they were right according to plan. And there was nothing to make us believe that there was a problem there. What we didn't know was—and the capital expense was going up exactly according to plan. But what we didn't know was the capital expense was going up, but we weren't actually buying anything. We were using it to cover the operating expenses.

Mr. BENTSEN. Again while he did not sell any stock, many of you all still held stock, and the stock had dropped dramatically in value, so there was an incentive in some period of time to see the stock recover.

Let me ask this: On the meeting on June 24—you were at that meeting, both of you were at that meeting, I believe—what did Andersen say? Did you ask Andersen, why did you not catch this, and what did your current auditor, KPMG, say? Is it something they felt they would have caught?

We heard from Mr. Dick today, and he said he—they blessed the documents that they were given by the—

Mr. SIDGMORE. That's bothersome. But the question before about having—

Mr. BENTSEN. Bothersome is an understatement.

Mr. SIDGMORE. One-fourth or one-third of the transactions were bad. Well, it wasn't actually the one-third of the transactions were bad, it was one-third of the amount was bad. The whole thing was done with a small number of transactions, I mean, four, five transactions out of tens of thousands. So, you know, it would be more difficult to find than you might think.

Still in all, our view, with an audit you should be able to catch something that large.

Mr. BENTSEN. You said one thing, I think, is very important on the question of attesting—of the CEO and CFO attesting to the veracity of the financials of a company, something that's been debated in this committee and will be debated later on. But I think it's very interesting and telling that you tie that to the need for more aggressive auditing, and basically it's the cause and effect that once you put somebody's backside on the line, then they are going to want a lot more questions than have been asked.

It has been reported that the corporate board rules, the governance rules, while there is a chairman, Mr. Roberts is the chairman, that the real power under the rules vest in the CEO. Has that rule been changed, or do you still have that sort of introverted or contorted board, because it strikes me that this board was never set up as—to have truly independent directors minding the store.

Mr. SIDGMORE. We have changed it to this extent. We haven't officially changed it, but maybe we should look at that. Under Bernie's reign, the president and the CEO, first of all, was—according to the charter, ran the board meetings. So in a more traditional company the chairman of the board sets the agenda and runs the board meetings. And when Bert and I first talked about this when I came in, we agreed quickly he'll run the board meetings and do all the things that a chairman of the board is supposed to do, and I'll run the company. And I am—actually haven't thought about changing the official rule, but we might.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from Connecticut Mr. Shays.

Mr. SHAYS. Thank you, Mr. Chairman.

One of the most boring books I have ever read, but one of the more interesting in one way, was a book—it was like the 500 men and women who control America. It was about the boards of directors who were CEOs in other companies, and then they worked for some nonprofit organization, and they were all intertwined. And as the CEO salaries just ballooned, I began to think of this: You scratch my back, I'll scratch yours. And when I was about to leave and I heard the question about this $400 plus million loan, which I should have picked up in the wonderful notes our staff provided, and both of your responses—and your responses were if you had to do it today, you wouldn't have done it. Why was it such a good idea, you know, 6 months ago or a year ago?

Mr. ROBERTS. If I could maybe just comment on that, the loan wasn't $400 million day 1. What specifically happened was the stock started to drop. It was either 27 or 24, something in that range. And Bernie Ebbers wanted to sell stock to cover his margin calls that he was getting from, I guess, brokerage houses. The compensation committee of the board met with Bernie and decided that it would be harmful to shareholders to have the CEO of the company selling large blocks of stock.

Mr. SHAYS. Like WorldCom, highly leveraged—he was highly leveraged in his own personal finances. Bottom line, he was buying marginal stock, and unfortunately WorldCom is highly leveraged. It's a company highly leveraged. It seems to reflect the management. But you all are the directors, and I guess what I am trying to understand is why I should have any faith in this economic system where I wanted to privatize Social Security or at least a part of it and thinking, my God, it's a crooked system right now and doesn't work right, and even the both of you, people I thought were kind of heroes in this hearing agree to this. I need to know why.

Mr. ROBERTS. It was a judgment made at the time. We all wish now that it would have been better off for the company if Bernie just sold stock to cover his margin calls.

Mr. SHAYS. What kind of leverage did he have to have? What kind of collateral?

Mr. SIDGMORE. What kind of collateral did he put up? All his WorldCom stock. He put up—he's got farms and large pieces of real estate.

Mr. SHAYS. Basically you felt you had to do it, otherwise he was going to sell the stock, and the stock would tumble.

Mr. SIDGMORE. We did get appraisals on the collateral that proved at the time that the collateral was worth well more than the amount of the loan.

Mr. SHAYS. Not now.

Mr. SIDGMORE. When was the last—

Mr. SHAYS. The collateral isn't close to being the 400 million.

Mr. ROBERTS. The collateral was only put up as the stock continued to fall and he needed to put up more.

Mr. SHAYS. I want to know the collateral. But let me ask you this. There wasn't much collateral. What was the interest rate?

Mr. ROBERTS. I don't believe that is quite correct. I am not suggesting that collateral is sufficient today or not, but what the collateral is, it's a timber farm which was appraised at $685 million that has a $400 million lien against it. It's a ranch in Vancouver that is appraised at 56 -, $58 million, and it's a boatyard that has a value of 30- or $40 million dollars, plus the stock.

Mr. SHAYS. What was the interest he was charged, 2 to 3 percent or higher?

Mr. SIDGMORE. Between 2 and 3 percent.

Mr. SHAYS. It's a pretty low interest rate, isn't it?

Mr. SIDGMORE. It was our incremental cost of capital at the time the loan went out.

Mr. SHAYS. Tell me a good decision the board of directors made in any of the last 3 years. I am not trying to be funny, but tell me something positive so I can feel better about some part of my economic capitalist system which I have grown up to revere.

Mr. ROBERTS. I mean, I think you have to look at the company and decide. The company obviously had a substantial capital improvement during the first part of that time before the telecom industry started to move down. Depending on how far you go back, there was within that time period, 1998, when WorldCom acquired MCI, which from a WorldCom investor point of view turned out to be a good decision. And I think if you look at it from a company point of view, we have offered tremendous services to customers, government and been a large employer base.

Mr. SHAYS. I am one of your customers, and I do like your service.

The CHAIRMAN. Gentleman's time from Connecticut has expired.

The gentleman from California.

Mr. SHERMAN. Thank you, Mr. Chairman.

I left the room earlier, and I apologize for that, but I wanted to see the President's press conference, and I need to report to this committee that the President showed a profound and unfortunate misunderstanding of what the SEC does. He was questioned about his own investment in Harken, and he stated that the SEC makes sure that complex accounting rules are applied correctly. And the President painted a picture, perhaps out of his own experience, that the SEC is looking over the shoulder of those preparing the financial statements, or of the outside auditor, in making sure that

these complex accounting rules are applied in a reasonable manner.

While the President had that image of the SEC, we in this House of Representatives passed a bill that said it was the sense of Congress that at least the SEC would read the financial statements of the thousand largest corporations, come up with questions, post those questions on its Web site, demand a written answer, and post those answers on its Web site. And I wish to put in the record at this point the response of that sense of Congress—or actually the response to the hearings of Harvey Pitt. The Chairman stated that he didn't think it was a good idea for his people to read any of the financial statements, and he refused to provide this committee with even a cost estimate as to what it would cost to do the very things that this House of Representatives has declared ought to be done. And now the President is 1,000 percent behind a SEC Chair who refuses to even consider doing the work that the President thinks is already being done.

I am not inspired by confidence, Mr. Shays. I would hope that eventually this committee will demand that the SEC goes through a review process and an inquiry process at least with the thousand largest corporations.

Now, the Arthur Andersen spin, roughly 15,000 field hours auditing WorldCom didn't find $3 billion of asset additions that were phony because they were hidden among a total of $7 billion of assets and therefore constituted only three-sevenths of this very significant account. You have a great internal auditor on your staff, Ms. Cynthia Cooper, who was able to find this just during the month of May of this year. Can you describe how many staff she deployed to find that which Arthur Andersen could not discover in 15,000 hours that they billed you for?

Mr. SIDGMORE. I am not positive of that answer, but I think she's got four people, herself—in total, which probably includes some other projects.

Mr. SHERMAN. She was doing a number of things with four people, and it took her a month with her staff of four while doing other things to discover something about the size of Mount Rushmore which in 15,000 hours Arthur Andersen could not discover. I am going to stop telling people I'm a CPA.

Now, you say that this was harder to find because it was four or five transactions. I assume you mean about four or five transactions per quarter were reclassified by Mr. Sullivan. Do I have that right, Mr. Sidgmore, when you say four or five transactions?

Mr. SIDGMORE. The only caveat I'm going to put on that is that was the initial take on it, and we won't know the exact count until KPMG completes its audit from last year. But I believe it was a handful of transactions for the whole year. But—

Mr. SHERMAN. But this handful would be a handful of mountains, a hard to miss. If it's a handful, then each one is hundreds of millions of dollars in size. And my limited experience in auditing is if a company engages in 100,000 transactions, you can't just look at their orders of paper clips. You also have to look at the $100 million transactions even if there are only a few of them. I can't imagine how you can miss a $100 million or $400 million transaction

on the theory there are hundreds of thousands of transactions and you looked at the others.

Can—the one other thing I want to point out, there has been some discussion initiated by the gentleman from Texas about corporate governance, and I should remind my colleagues that that is a creature of State law, and many States have competed to have the weakest corporate governance, the hardest system in which dissident shareholders would ever replace shareholders. And perhaps we ought to have Federal standards in this area instead of letting States compete for revenue by having the weakest corporate governance standards in their corporate law.

The CHAIRMAN. Gentleman from California Mr. Royce.

Mr. ROYCE. Thank you, Mr. Chairman.

Well, I have a copy of WorldCom's board minutes, and I did want to ask you about an observation here in the minutes. It states, that Mr. Sullivan indicated that Mr. Ebbers had proposed a 50 percent reduction in internal audit compensation expense, but that the final decision was to limit the reduction to 10 percent. He indicated that the preparation of the executive report as well as the commission's audit is consuming significant audit resources. Now, luckily at this point, Cynthia Cooper comes forward and she states that moving the preparation of the executive report into Ron Beaumont's organization would allow four persons who are dedicated part time to completion of the report to work full time on the audit. In other words, apparently what Mr. Ebbers tried to do here was to cut the size of the internal audit staff by two so that this would never be discovered.

Mr. ROYCE. My read of this is Cynthia Cooper, the internal auditor, stood her ground, insisted there was another way to get the personnel to complete the work; and it is probably because of her that it was uncovered. Am I correct in my reading of the WorldCom minutes?

Mr. ROBERTS. Are those the audit committee's minutes or the board minutes?

Mr. ROYCE. Yes, they are.

Mr. ROBERTS. I thought that happened in the audit committee and not the full board. Yes, I think Cynthia did stand her ground; and we commend her for finding the problem.

Mr. ROYCE. Well, speaking of standing one's ground, according to the Wall Street Journal, regulators probing accounting fraud at WorldCom are increasingly concerned that company officials haven't fully disclosed many details of the widening scandal. It goes to a comment by SEC Chairman Harvey Pitt, and he has called your disclosures to date wholly inadequate and incomplete. He goes on to say that they demonstrate a lack of commitment to full disclosure to investors and less than full cooperation with the Securities and Exchange Commission. How do you respond to these allegations, and what in the way of further disclosure do you intend to provide in order to answer the chairman of the SEC on these questions?

Mr. SIDGMORE. Well, first of all, I think Mr. Pitt was commenting on our submission from a week—it was over a week ago. Since that time, I have had a fairly lengthy conversation with him; and we

have been working with his staff to produce a new document that would be more responsive, which we filed today.

Mr. ROYCE. So if we contact the SEC we can expect a different answer?

Mr. SIDGMORE. We hope so.

Mr. ROYCE. Let me ask you another question. Mr. Ebbers departed WorldCom, as we have discussed today, with a $1.5 million a year pension, medical and life insurance for life. Should he die, his wife would receive three-quarters of a million dollars a year for the reminder of her life, should he expire. There has also been rumors about continued use of the corporate jet, a corporate boat, as well as ongoing use of corporate offices and administrative assistance.

My question is, how can either of you justify such a settlement when last week you let 17,000 employees go? My suspicion is that you must be trying to work your way out of that commitment right now, in terms of that $1.5 million a year. But what is the chance of actually obtaining that $406 million right now to help your company that you have loaned or that both of you voted to loan to Mr. Ebbers?

Mr. ROBERTS. Well, first of all, the seven independent board members that met and determined that they wanted to ask for the resignation of Bernie late April also put together that package. So that is how that came about. It was part of the process of asking for the resignation.

In terms of the loan, it is Bernie's intent to pay it back; and it is certainly the company's intent to get the loan paid back. It was disclosed in the proxy, I believe, that we have filed in terms of the payment schedule back.

We have also been working as a company with outside investment houses to potentially see if we can get that loan purchased from the company.

Mr. ROYCE. Has he put up that property that you say was offered as collateral for sale in order to allow the infusion of this cash into your—

Mr. ROBERTS. Part of it is. He has put up the boat yard, I know; and he has at least received one offer, which I think that he may have rejected. But I think that he may have another offer for that.

In the case of the big piece of property, the timberland, he is working, as we have tried to work, with people that are interested and understand that particular business.

The CHAIRMAN. The gentleman from Texas, Mr. Sandlin.

Mr. SANDLIN. Thank you, Mr. Chairman; and thank you, Mr. Sidgmore, Mr. Roberts, for coming today. We appreciate you being here to testify, rather than taking the bogus position taken by those on the last panel.

I noticed 2 weeks ago, Mr. Sidgmore, at a press conference you said that the deeds that were uncovered were part of the past administration, correct? And, of course, as has been established today, during the 2 years before being named CEO you were the chief operations officer of this same corporation.

Mr. SIDGMORE. Not the 2 years before. It was 1997 and 1998.

Mr. SANDLIN. So you were part of that same administration and you attended board meetings?

Mr. SIDGMORE. Yes. Ever since then.

Mr. SANDLIN. You mention that people on the board have to be able to depend on the information given by professionals such as accountants; is that correct?

Mr. SIDGMORE. Correct.

Mr. SANDLIN. But people also on the board, officers in particular, have a fiduciary duty to the corporation; is that correct?

Mr. SIDGMORE. Correct.

Mr. SANDLIN. It is the obligation of the officer and the obligation of the board member to ask questions of the advisors; is that correct?

Mr. SIDGMORE. Correct.

Mr. SANDLIN. And inaction by a board member or inaction by an officer is not an excuse, is it?

Mr. SIDGMORE. No.

Mr. SANDLIN. It is more of an indictment, isn't it?

Mr. SIDGMORE. It could be.

Mr. SANDLIN. Now, you said earlier that WorldCom has decent, hard-working employees; is that correct? And you said that your corporation was fighting for its life.

Mr. SIDGMORE. Correct.

Mr. SANDLIN. I want to go over a brief summary of what we are doing to fight for this company. Mr. Ebbers, although he refused to testify and is in contempt of this Congress, he dumped $35 million in stock. He got a contract for $1.5 million for life, $430,000 loan, perks of riding around on an airplane.

We find out you sold $87 million. Mr. Roberts had $22 million of stock. Your corporation leased an airplane, an extra jet to a board member for $1 a year, which is clearly a violation of fiduciary duty; and I find it very unusual that they are able to find that jet, but they can't find $3.8 billion in the accounting.

You employed crooked accounting procedures. You drove down the price to 6 cents per share. So really, instead of fighting for the life of the company, you are more or less fighting for the lifestyle of these executives. Isn't that more accurate to say?

Mr. SIDGMORE. No, I don't think so at all.

Mr. SANDLIN. Does Mr. Roberts have that same contract agreement that Mr. Ebbers has?

Mr. SIDGMORE. No, he does not.

Mr. SANDLIN. You don't have the $1.5 million for life, Mr. Roberts?

Mr. ROBERTS. No, I don't.

Mr. SANDLIN. Have you ever had that?

Mr. ROBERTS. No, I did not.

Mr. SANDLIN. What is your lifetime contract?

Mr. ROBERTS. I have no lifetime contract. Basically, what I have is a retirement from the MCI Company. We froze the retirement program when the companies merged. But my retirement was based on an executive retirement.

Mr. SANDLIN. It looks like everyone from the summary—everyone at the top is getting millions of dollars, but we are firing 17,000 employees, and we are pushing the stock down to 6 cents. That doesn't look like we are fighting for the life of the corporation.

Let me ask one final thing. You said, Mr. Sidgmore, that you had an agreement or contract now for a million dollar salary, which doesn't appear to be out of line. But you also said that there—you have a compensation package that you elected—you and Mr. Roberts elected not to take at this time. I am concerned about ″at this time.″ I am concerned about—if you can tell us what the terms of that compensation are.

Mr. SIDGMORE. Well, we have never implemented it, so it is not valid.

Mr. SANDLIN. What were the terms of that contract?

Mr. SIDGMORE. It was an annual bonus that would range in size from a million dollars to $10 million, depending on the performance of the company. There was also potentially a retention bonus for myself and three of the other senior executives.

Mr. SANDLIN. How much would that retention bonus be?

Mr. SIDGMORE. It would have been $7.5 million for 4 years.

Mr. SANDLIN. Each year or the whole time?

Mr. SIDGMORE. The whole time.

Mr. SANDLIN. Are you saying now that you don't intend to implement that at any time in the future?

Mr. SIDGMORE. I didn't say that. Not at this time.

Mr. SANDLIN. So it is okay to lay off the 17,000 employees and drive the price down to 6 cents, it is okay for your former chief executive officer to have a timber farm worth $658 million and a ranch worth $58 million, but you can't tell us whether or not you are going to give up that package?

Mr. SIDGMORE. I didn't say it was okay that we fired 17,000 people. I don't think it is okay. It is a terrible shame. I don't blame it on the fact that the compensation packages exist. The fact of the matter is, the telecommunications industry is in disaster mode and there are many other companies like ours that are out of business while we are still in business.

Mr. SANDLIN. That is a charming story, and we have gone over some of those today like Enron and others that did similar crooked accounting practices.

Thank you. I have no more questions. Yield back.

The CHAIRMAN. The gentlelady from Illinois, Mrs. Biggert.

Mrs. BIGGERT. Thank you, Mr. Chairman.

Mr. Sidgmore and Mr. Roberts, I have a published report here that was issued May 20th, 2002, of the Telecom Manager's Voice Report in which the publisher reports that internal WorldCom documents indicate that the company may have overbilled its customers by somewhere between $1.8 billion and $3.5 billion; and our committee has also received documents of individual overbilling of corporate clients. I also have received a letter from the SEC which was written to WorldCom on March 7th with a comprehensive request for information on numerous accounting issues including billing policies. So I would ask unanimous consent that these documents be entered into the record, as appropriate.

The CHAIRMAN. Without objection.

[The following information can be found on page 217 in the appendix.]

Mrs. BIGGERT. Okay. Can both of you gentlemen assure this committee and your millions of customers that WorldCom is committed

to ensuring that these issues will be resolved to the SEC's and the customers' satisfaction?

Mr. SIDGMORE. Well, we are certainly working with the SEC on all of these issues. We have complied with every request and every piece of investigative work that they have asked us to perform, and we are a hundred percent committed to working with them and all government agencies whenever these issues come up.

Telephone companies often face these issues multiple times a year. We investigate all of them.

Mrs. BIGGERT. But you will assure this committee?

Mr. SIDGMORE. Yes.

Mrs. BIGGERT. And you, Mr. Roberts?

Mr. ROBERTS. I agree with exactly what John said. We will get to the bottom of it.

Mrs. BIGGERT. Then, Mr. Sidgmore, you stated to WorldCom customers and employees that the company remains viable and committed to a long-term future. As Mr. Royce mentioned, last week 17,000 WorldCom employees were dismissed, or at least in the last week.

Secondly, how can you guarantee that your customers will continue to be provided with services when there is a threat and talk of a WorldCom bankruptcy and that is being suggested daily?

Mr. SIDGMORE. Well, let me just make this point, but I want to make it carefully.

First of all, the 17,000 employees, those weren't all employees that were fired. We took 17,000 head count off of our payroll one way or the other. About 5,000 of those were not WorldCom employees but were contractors that we were paying by the hour or by the day, whatever. Another 4 or 5,000 were employees of a business that we are selling, and so theoretically the employees may go and find jobs with the new company. About 8,000 I believe—maybe it was—and we have got some attrition also. But 8,000 real employees are coming off the payroll. Maybe they won't all be eliminated, but that is the rough scale there.

The reason why we were pretty confident that we would be able to provide ongoing service and steady service to our customers and to be able to employ most of our employees is because under any financing scenario, even a chapter event, a Chapter 11 event of some sort, we believe that the company can survive and make it through it.

Mrs. BIGGERT. If that were to happen and Chapter 11 would become a reality, how would WorldCom go about protecting investors and employees? And what about the average shareholders? What would happen to them?

Mr. SIDGMORE. Well, under that scenario the average shareholder would get hurt badly. Okay. Employees would come out on the other side with new stock options.

And one other thing I wanted to mention, because it has been raised in a couple of forums, that is about our 401(k) plan. People have asked whether this was like some of those other situations where everyone loses everything because everything is in stock.

Well, today only 4 percent of the 401(k) plan is in company stock, but that is because the price is so low. But if you took from end of the 1999 through May of this year, the average was—would

range from 20 percent to 50 percent. So most of the employees' 401(k) plans are not in company stock but actually in cash, and we have never forced anyone to take stock. We have always paid them cash.

Mrs. BIGGERT. Thank you. Thank you both for being here.

I yield back.

The CHAIRMAN. The gentleman from Washington state, Mr. Inslee.

Mr. INSLEE. I yield to the next in line. They have been waiting longer than I.

The CHAIRMAN. The gentleman from Kansas, Mr. Moore.

Mr. MOORE. Thank you, Mr. Chairman; and thank you, gentlemen, for being here today.

How much is Cynthia Cooper making?

Mr. SIDGMORE. How much money?

Mr. MOORE. Yes.

Mr. SIDGMORE. I have no idea.

Mr. MOORE. Can you guess? She is not making a million dollars a year, is she?

Mr. SIDGMORE. No, 140, 150.

Mr. ROBERTS. She is a vice president.

Mr. MOORE. She probably should be in line and get a bonus, don't you think?

Mr. SIDGMORE. She gets a bonus. She will get a bonus in addition to that every year.

Mr. MOORE. Maybe another bonus, too, as a result of what happened here?

Mr. SIDGMORE. She has done a good job.

Mr. MOORE. You know, there are three television cameras here and people out there in the country—it is a big country—are watching what is happening here; and I can't even imagine what I think I know, because I talked to my folks, my constituents at home last week. People are very, very angry; and they don't get it.

September 11, our country was hit. Three thousand people died in a terrorist incident in New York and Washington. And then when we think things are starting to get better and we are getting beyond this, all of a sudden we have Enron, Global Crossing, WorldCom, Merck, and on and on and on. People are wondering, what is happening in our country? It just seems greed is just taking over.

I know it is—we can't get so despondent I guess that we think this is happening in every country—I hope to God it is not—but I think we have got more of these coming, too; and I am worried what is going to happen and what is going to come out in the next several months.

I think people must think this whole situation is surreal. They watch this hearing—and I am not talking about you. I am talking mostly about the previous panel, but a little bit here, too. These are people that work for a living. They are making 30, 50, 75, or $150,000 a year. And they are seeing somebody who is borrowing $400 million when he is leaving the company, they are seeing somebody who is getting a million and a half dollars a year for the rest of his life after he is leaving the company and corporate use

of a corporate jet, and his wife gets $750,000 for the rest of her life, and a 2 or 3 percent loan, this $400 million.

And they see you selling stock, Mr. Sidgmore, $87 million. And you earned it. You have a right to that. But, I mean, people just don't talk in these numbers. I know a handful of people that have money like that.

And, Mr. Roberts, you are earning a million dollars a year. I am not begrudging you that at all. And you sold stock for $22 million.

But all I am saying is these people out here wonder, what is going on? You know, they don't have anything like this. They certainly maybe have $400,000 in a retirement account, but they don't have it in their kid's college fund.

I guess my question to you gentlemen is—I am not pointing fingers here because I really appreciate—the first thing both of you did was to apologize and be contrite. Didn't see much of that in the last panel. I really appreciate what you have said and what you have done. I think you are trying to turn things around.

But I am saying people need to understand and believe that you are going to do something to try to save these jobs in this company for the people who work for your company and not just thinking about the people on the board of directors and the corporate executives.

What can we do? You named one thing I think. But what else happens? Should CFOs and CEOs be given sworn statements about their belief about what the value of a company is and that the—the things—that these statements are correct, the financial statements, and the other reports are correct?

I see here that the Business Roundtable in this morning's Wall Street Journal said, enough is enough. When even one CEO betrays investors, this is one too many. I mean, when the Business Roundtable starts saying that something is wrong, they don't take that lightly.

The same thing that Judy Biggert I think referred to. I have a March 7 statement from the SEC talking about information on goodwill accounting policies and saying that WorldCom announced on March 7th it estimated it would take a 15 to $20 billion write-down, 15 to $20 billion write-down of its goodwill account at the end of the second quarter. Is there more coming out here?

What is happening here? I don't get it. Can you tell me what we here in Congress can or should do to make sure we don't have more of these in the future?

Mr. SIDGMORE. Well, let me answer for WorldCom for a moment. I agree with almost everything you said, so we are not trying to be argumentative. But what we have done in the last couple of months, we fired the CEO, we have a new CEO. We will have a new CFO. We fired the CFO. We fired our auditors and hired new ones. We hired Bill McLucas to go do an independent investigation.

So we are taking the steps that—the only steps we know how to do, how to take in order to get to the bottom of this. So that is priority one.

Right now, my priority personally and Bert's is to get this company back on a normal business footing.

Mr. MOORE. Let me stop you one minute. Can you just give me an answer, either one or both of you, very quickly, but everybody

else on this committee would like to hear this, too. What can we do? What should we do beyond WorldCom? Move beyond WorldCom and look to the future to make sure in this country we get this problem under control and this doesn't happen any more.

Mr. SIDGMORE. Well, my answer would be more controls. I think every company should have to have a second auditor to audit the first auditor and have them both sign off. I think separating research and investment banking like we talked this morning. I think a lot of these ideas that were brought up this afternoon are the right thoughts.

The CHAIRMAN. The gentleman from Pennsylvania, Mr. Toomey.

Mr. TOOMEY. Thank you, Mr. Chairman; and thank you, gentlemen, for being with us today.

My first question goes back to the meeting that you described in which Mr. Sullivan presented his white paper and which I envision, as you have described it, to have been a counterproposal or debate almost over the appropriate treatment of these accounts.

On the one hand, the professional auditors were arguing the way that they believed it ought to be done. Mr. Sullivan defended his approach.

A couple of questions. First of all, you were both present at that meeting; am I correct?

Mr. ROBERTS. I was by way of telephone.

Mr. TOOMEY. Did either of you find Mr. Sullivan's presentation particularly persuasive?

Mr. SIDGMORE. On the 24th now?

Mr. TOOMEY. Correct.

Mr. SIDGMORE. No.

Mr. TOOMEY. From all press accounts this is a relatively simple transaction. I am not a CPA. I am reasonably familiar with financial statements. It seems pretty clear to me what should have been done versus what was done. You understand these things far better than I do. Is it pretty obvious to you that he intentionally misallocated these accounts?

Mr. SIDGMORE. You know, I don't want to say that, because I will go back to what you asked before. When we had the same meeting on the 20th, this is before we had gone through the white paper exercise, Scott basically presented the same case. It sounded more reasonable to me then because I didn't know the accounting rules associated with operating lease capitalization. So I wouldn't want to say exactly what the motivations were and everything. But I can tell you that there was no doubt in my mind when we were done with that 24th meeting that the senior accounting team had to go and that there was no way we could support the accounting.

Mr. TOOMEY. Mr. Roberts, is it your opinion that Mr. Sullivan might very well have sincerely and genuinely believed that he was correct and the rest of the world was just all wrong on how this was to be accounted for?

Mr. ROBERTS. It is not my contention, but I believe it is what he was trying to say during that board meeting and when we talked to him on the 20th. I agree with what John has said, though. After you get into the detail one level it is difficult to see how that accounting treatment could have been made. It is more difficult to

see how Arthur Andersen would not have picked it up, advised the audit committee, advised the board.

Mr. TOOMEY. It is difficult for me to see how someone can avoid being punished for this kind of thing, because it strikes me as a pretty clear case of fraud. I know you gentlemen don't seem comfortable stating that, but it seems to be the case.

You both have stated, if you allow me to paraphrase, that the board of directors is essentially at the mercy of the CFO in terms of relying on—in combination with the outside auditors—in relying on numbers. Do either of you believe that that ought to be the case for CEOs as well, or do you believe that the CEO needs to take responsibility for the financial statements that are being generated, despite the fact that they are being prepared by a CFO?

Mr. ROBERTS. Let me answer then. Two things.

First of all, many U.S. Corporations, the chairman is the CEO of the company. So you have got one person.

Secondly, if the committee will go back and look at some of the information that was filed and had I been CEO of the company as I was with MCI and had I sat down with the auditors, had I seen the presentation that they would have given in the—you know, in the February time frame as we closed our books, I would have had nothing to base an answer on that there was something wrong.

You have to depend on your CFO, the veracity of the CFO, and his accounting knowledge; and, more important, you have to depend on your external auditors as they report to the audit committee.

Mr. TOOMEY. So I am taking that to say that you believe that the CEO is also at the mercy of the CFO for this kind of financial information, even on this order of magnitude.

Mr. ROBERTS. And at the mercy of the external auditor that is the check and balance of what should happen.

Now we fortunately had the check and balance of the internal auditors that found this.

Mr. TOOMEY. Does not a CEO also have responsibility for setting up internal procedures that would make it extremely difficult if not impossible for someone to get away with this sort of thing? I don't know if you have yet come to the conclusion about how many people were involved in falsifying these accounts, but it strikes me as unlikely that it could have been just an individual. But, however many it was, it was not identified by your internal procedures for five quarters.

Mr. ROBERTS. Right.

Mr. TOOMEY. Isn't a CEO ultimately responsible for setting up a system that prevents this sort of thing from happening?

Mr. SIDGMORE. I believe he or she is. I do think that things can change in that regard. I do think, for example, having a separation between the chairman and the CEO is a good thing, generally speaking. I think having an internal audit team with real teeth is a good thing, generally speaking. Having an audit committee on the board that has real expertise on it is a really good thing.

And we didn't mention this before, but WorldCom is out right now. We are trying to recruit some new board members. So we are going to wind up here shortly we think with a new team entirely—

I just want to say one more thing about Cynthia Cooper. This was raised before. She has a larger team than I thought doing other process work, billing process and operations. She actually has 24 people in total. So if I can just correct the record.

The CHAIRMAN. The gentlelady from Ohio.

Mrs. JONES OF OHIO. Mr. Roberts, Mr. Sidgmore, do both of you have counsel, sir, in your individual capacity as well as in your capacity as a representative of WorldCom?

Mr. SIDGMORE. No. I mean, we don't have individual counsels here today. We hired counsel to talk us through some of the process and procedure here.

Mrs. JONES OF OHIO. You don't have them here today? The question is, do you have private counsel as well as counsel that represents you in your capacity as a representative or member of the board of WorldCom?

Mr. SIDGMORE. We have counsel that represents the board and the directors; and, you know, we have lots of internal counsel.

Mrs. JONES OF OHIO. Do you have private counsel, sir?

Mr. SIDGMORE. No.

Mrs. JONES OF OHIO. Mr. Roberts?

Mr. ROBERTS. No.

Mrs. JONES OF OHIO. Now, you both have come here, it has been salutary that you are here, to converse with us about all that went on. I am going to have to presume that you believe through your counsel or through the counsel of WorldCom that neither of you have any individual exposure for the conduct of these two other people or three other people at WorldCom, and that is why you are so free to testify before this committee today. Is that a fact, sir, Mr. Sidgmore?

Mr. SIDGMORE. Well, I guess I don't think I need counsel, because I really don't think I did anything wrong.

Mrs. JONES OF OHIO. Mr. Roberts.

Mr. ROBERTS. I don't think I need counsel, because I don't think I did anything wrong.

Mrs. JONES OF OHIO. I am a former judge and prosecutor, and lots of people used to tell me that in my 20 years on the bench and as prosecutor they didn't think they did anything wrong. But I am presuming you wouldn't be sitting here telling us all of this if you felt that you had some personal exposure. Is that that a fair statement, sir?

Mr. SIDGMORE. It is.

Mr. ROBERTS. It is.

Mrs. JONES OF OHIO. Have either of you been granted transactional or testimonial immunity for helping or assisting the SEC or the Department of Justice in offering the information that you have been offering?

Mr. SIDGMORE. No. Where do you get that?

Mrs. JONES OF OHIO. I am merely asking a question, sir.

Mr. SIDGMORE. No, absolutely not.

Mrs. JONES OF OHIO. Now, you said there were seven independent board members who made a decision to give Bernie this great package for him to retire. Can you tell me who they were, either of you?

Mr. ROBERTS. Well, the seven independent board members are Judy Areen, Max Bobbitt, Styles Kellett, Francesco Galesi, Jim Allen, and Gordon Macklin. Do I have that right? Who am I missing? Carl Aycock. That is seven.

Mrs. JONES OF OHIO. From your conversations or your responses today, you are sitting here like Bernie is a great guy and Sullivan is a great guy. He was just managing or mismanaging or massaging the records of the company.

But the people sitting listening across this country and across the world don't think of them as such great guys. Are you saying if—you even said that, well, Bernie is going to pay us this money back. We believe that he has the intent to pay us back. You still hold him in this high esteem after all that has been presented here or that is being found out about your company, sir, Mr. Roberts?

Mr. ROBERTS. Well, I mean, I don't think I said that.

First of all—

Mrs. JONES OF OHIO. I wrote down that Bernie has an intent to pay us back and we have an intent to get it back from him and he has put up these farms. You did say that, didn't you?

Mr. ROBERTS. I did say that.

Mrs. JONES OF OHIO. So maybe it is not high esteem. How do you hold him then?

Mr. ROBERTS. He feels an obligation to pay back the loan. I think that we have an obligation as a company to get the loan paid back.

Mrs. JONES OF OHIO. He feels an obligation in light of the fact—what did you give him to leave? You gave him some amount of money to leave WorldCom, to put him out the door; and you say he has an obligation to pay it back.

Mr. ROBERTS. No, that is not quite what I said.

Mrs. JONES OF OHIO. Tell me what you said then, sir.

Mr. ROBERTS. The $400 million loan that he has, he has an obligation both legal and I think a personal commitment to pay back.

Mrs. JONES OF OHIO. And this man who put your company in the position it is, right now, today, you believe that he is going to stand by that personal obligation?

Mr. ROBERTS. I don't know that he put the company in the position it is today, because I don't know that he has said or admitted that he had a part to the accounting problems that we have. But I do believe, irrespective of that, he does have an obligation.

Mrs. JONES OF OHIO. He did have oversight over Mr. Sullivan, sir?

Mr. ROBERTS. Mr. Sullivan reported to him, yes.

Mrs. JONES OF OHIO. Let me turn to you, Mr. Sidgmore. Do you still hold Mr. Ebbers in high esteem and believe that he has an intent to pay this company back and is personally planning to do it so he can stand up to his personal reputation?

Mr. SIDGMORE. No. He has got a legal obligation to pay it back, and we will go after him if he doesn't.

Mrs. JONES OF OHIO. You did call him Bernie like you are old buddies still?

Mr. SIDGMORE. We are not old buddies at all. You know, I liked Bernie when I joined the company. We have had some famous fights over the years. But I like Bernie. But everybody calls him Bernie. Nobody calls him Ebbers. He has been on the job for 20

years. He is known by his first name everywhere. It is just a habit. But we are not trying to make him a hero. We don't know of anything to accuse him of right now, and we are planning on getting our money back.

The CHAIRMAN. The gentleman from Arizona.

Mr. SHADEGG. I thank both gentlemen for being here today and for your testimony. I appreciate your candor with this committee, and I wish you the best in rebuilding this company. I think that is in the best interest of the country. I hope you are successful in that effort.

I want to ask a couple of questions that are technical, and than to I want to follow up on some comments by Mr. Moore earlier in the evening regarding the perception of this hearing out across America.

First of all, our records indicate in October of 2000, specifically October 5th, Mr. Ebbers sold I believe it is 3 million shares of stock for $84 million. Then in February of 2002, he was issued this roughly $400 million loan which is secured, which you believe you are going to get repaid. Can you explain to me why it was not perceived as a problem for Mr. Ebbers to sell $3 million worth of shares in October of 2000 but perceived as a problem for that to occur in February?

Because I believe what you said was—and Mr. Roberts you were the one that made this testimony—you thought it was a problem for him to sell the stock in February, and that is why the company made the loan to him; is that correct?

Mr. ROBERTS. Yes, that is what I said.

Mr. SHADEGG. What changed between those two times?

Mr. ROBERTS. I don't know about that previous sale. I am not saying it is not correct. It might have been exercise of stock options or something that wasn't a direct sale of the actual holdings. I would have to go back and research that. We will get back to you.

Mr. SHADEGG. I would appreciate it, because our records show he sold 3 million shares for $84 million on October 5, 2000. Go ahead.

Mr. ROBERTS. But what I was going to add is that it was a compensation committee that interacted with Bernie Ebbers and came to the conclusion that he should not sell, perhaps, more shares or these shares in that it would be bad for the CEO to have—to be looked at as though he was selling shares in the marketplace and therefore perhaps not confident in the company.

The board did ratify that decision, but it was the compensation committee that met with him and came to the board for the ratification.

Mr. SIDGMORE. The October sale that he made was apparently his first margin call. So he actually had a margin call and then sold the stock to cover it.

Mr. SHADEGG. Second, Arthur Andersen apparently filed a report in February, specifically February 6, 2002, to the WorldCom audit committee indicating that it had internal control processes in place for preventing a material misstatement due to line cost allocations and the capitalization of assets and that those controls were effective. Obviously, that was incorrect. I guess my question is, did anybody challenge that?

And, second of all, specifically what have you done to ensure that that type of mistake—how that mistake happened and to make sure that it doesn't happen again?

Mr. SIDGMORE. Well, the audit committee and the internal audit department are looking at that right now. They are going to build a new process that is much more robust in terms of not only that piece of the accounting process but also the entire audit process.

How Andersen could react that way in the February 6th meeting honestly is just beyond us. We really have no explanation for it, and they have no explanation for it today.

Mr. SHADEGG. Are you contemplating pursuing them for that error, for that malpractice or that malfeasance?

Mr. SIDGMORE. I don't want to get into that here, if you don't mind.

Mr. SHADEGG. Your other answer is a perfect segue for where I want to go. You are now doing what you can to restructure WorldCom and to try to put in place mechanisms to prevent these things from happening in the future and to rebuild the company. We are required to do the same. I think my colleague from Kansas, Mr. Moore, made an impassioned statement saying the perception of what is going on in corporate America across America is pretty severe. We have got a serious problem here.

As Mr. Shays, my colleague, pointed out, many of us raised to believe very, very deeply in the free market system are now having that faith totally shaken. One member of this Congress, indeed a member of this committee, believes we should have the government go in and audit every corporation in America. I have no faith in the government to do that.

But as another one of my colleagues on the other side said earlier tonight, I view these hearings as a chance to look forward in a positive fashion. We have got to do something to rebuild American confidence in this market and to put in place some controls to ensure that doesn't happen again.

You have at least one suggestion that has been made, Mr. Sidgmore, was that the auditor should have an auditor. There should be a second auditor required to audit the first auditor so that they complete against each other and maybe is a good one that this committee should look at.

It seems to me—and I don't want to get petty about this in terms of retirement packages—but you look at the Enron executives that walked away with a fair amount of money, you look at the executives here that are walking away with a fair amount of money, maybe there should be a statutorily mandated requirement that if there is any evidence of fraud or any evidence of significant negligence, the compensation package, the golden parachute that they walk away with is negated and we can get back to all of that money.

The CHAIRMAN. The gentleman's time has expired.

Mr. SHADEGG. I guess I would like to conclude by asking, do you have, again, anything you can suggest to this committee as to what we can do to try to rebuild the confidence of the American people in this marketplace?

Mr. SIDGMORE. Well, I already made a couple of suggestions. But in terms of having the government audit every company in Amer-

ica, I mean, I don't know if there are enough people in America to do that. I mean, that would be a tough challenge. But I would say that—

Mr. SHADEGG. You would have to believe that the government can do it better than the private sector.

Mr. SIDGMORE. However, there could be some controls put in place and maybe monitored by the SEC; and we would probably require some more people there as well.

The CHAIRMAN. The gentleman from Washington State, Mr. Inslee.

Mr. INSLEE. Thank you, Mr. Chairman.

Would you explain to us and the American people why the WorldCom Corporation is paying its former CEO under whose watch almost $4 billion of chicanery went on, as a lifetime pension apparently, instead of taking that million and a half dollars and putting it into a fund for the thousands of people who lost a good part of their life savings as a result of this chicanery? Why isn't your corporation using that million and a half dollars a year for the people who have been injured, who have no ability to find that chicanery, instead giving it to the CEO who is no longer working with you under whose watch this took place?

Mr. SIDGMORE. Well, I would say it is not voluntary. We are under a contractual obligation right now. And, yes, I would admit that there have been some suggestions that maybe, you know, that can be rescinded now, given what happened. But, see, we have no basis for trying to prove or—or even accuse Mr. Ebbers of doing anything wrong. Until that would occur—

Mr. INSLEE. Well, how about running a ship where $4 billion in a corporate culture was allowed to exist, that was put into an alleged capital account, when clearly it was an expenditure by—every single human being on the face of the earth agrees to that—and taking personal responsibility for it? What happened with a little bit of accountability here?

People used to go down with their ship. Now they go to Bermuda on a million and a half dollar yacht. Why doesn't WorldCom take a position that there has got to be some personal accountability here? Why don't you take that position?

Mr. SIDGMORE. We have taken that position about personal accountability. All I am saying is, in this particular case, we have no way easily to get out of that contract. We are contractually—

Mr. INSLEE. Have you asked Mr. Ebbers to show a little accountability in that regard? Have you suggested it to him?

Mr. SIDGMORE. I have not spoken to Mr. Ebbers in any substantive way since I left.

Mr. INSLEE. Let me ask you a little different accountability. In this country, if you sell 50 grams of crack, you go to jail for 10 years—no ifs, ands or buts. It is a mandatory minimum sentence in a Federal penitentiary.

If Mr. Sullivan is held criminally responsible for intentionally defrauding investors due to his what I believe clear chicanery, do you think that he ought to serve 10 years minimum in a Federal penitentiary like a crack dealer selling 50 grams, considering the devastation that this has caused in America?

Mr. ROBERTS. I don't think—first of all, he hasn't been proven guilty of anything. I think it would be unfair for—

Mr. INSLEE. Let me make sure you understand my question. I am not asking you to say that he is guilty of anything at all. But if he is found guilty of this, if he is found guilty of intentionally defrauding American investors in this regard, do you think that is a sanction that ought to be imposed?

Mr. ROBERTS. I have no—nothing to base on what would be a proper guideline versus other white collar crimes on this. But I don't think there is anything worse than people perpetuating drugs on society.

Mr. INSLEE. Mr. Sidgmore, do you think he ought to spend 10 years?

Mr. SIDGMORE. I don't know about 10 years. I don't have experience to argue about how many years are appropriate. But I will say this. Our position as a company, I think personally, is that, you know, we want the people that did this harm to the company and to—

Mr. INSLEE. Well, we would like to give you an opportunity to make sure that that happens.

Let me ask you a question about your corporation's position right now on several issues.

The Democratic position on this is that we proposed having a truly independent public accountancy board. The Republicans failed to join us.

We on the Democratic side proposed strong and certain CEO certification of financial records. The Republicans refused to join us.

We proposed on our side of the aisle that there be a strong firewall of compensation so that analysts would not have a conflict of interest who allegedly were independent of analysts. The Republicans failed to join us.

We proposed requiring audit committees to require approval of nonauditing services. The Republicans failed to join us.

Now we hope as part of these hearings that the other party will have an epiphany, and we hope the President sends a strong message in that regard tomorrow night. But I would like to ask about your corporate position. Given the devastation that has occurred here, you have a front-line seat to what has occurred. Do you agree the four things I just talked about, that WorldCom supports those proposals in a strong reform effort?

Mr. SIDGMORE. I think we support a strong reform effort. I don't know enough about the specifics of each of these pieces to comment on them. But we certainly support stronger controls.

The CHAIRMAN. The gentleman's time has expired.

Mr. INSLEE. I could envoke the "Watt rule," but I won't in the interests of time.

The CHAIRMAN. I thank the gentleman for that, and I thank him for his vote for my bill in the committee and on the floor.

The gentleman from Massachusetts, Mr. Capuano.

Mr. CAPUANO. I guess a few minutes ago I heard that the entire telecom industry is in trouble because of an overbuilt capacity, and I agree with that. But I wanted to remind you that it was overbuilt by you. It was overbuilt by the people who financed you. It was overbuilt by you and your competitors who have—many of whom,

unfortunately, have been here before you, all of whom have said the same thing: We didn't do it.

I feel like I am watching a complete rerun of the Simpsons. We didn't do it. We didn't do it. We didn't do it. Who did it? Nobody did it. Somebody else did it.

I have got to tell you, I look at the testimony, Mr. Sidgmore, your written testimony. You say you are fully cooperating with the SEC. Yet even Mr. Pitt is a little bit too far in the pocket of industry. Even he wasn't satisfied. You have since filed a restatement. All it said basically is that we didn't do it. You say later on that WorldCom's presence ensures competition. Yet less than 2 years ago WorldCom tried to kill competition by buying your largest competitor. Competition wasn't good then, but it is good now; and therefore we have to save you.

Mr. Roberts, you asked—at the end of your written statement you say, with your support we will meet this challenge. I want to make it clear. You do not have my support; and you will not have my support until you, your board and your industry, actually does the right thing once.

Find me an independent CEO. Find me a board of directors who actually does anything. I have yet to meet a member of the board of directors on any company that has come before this committee in the last year that said, we said no. Everyone has said, well, we really didn't do anything. We really don't know anything, but we took stock options, and we got paid. Just what I heard today. Why bother to have a board of directors?

By the way, if you are looking for additional people on that board, I can name at least 650,000 of my constituents who would like to get a million dollars a year, corporate jets, some stock options; and each one of whom will be more honest than the members of your board. If they do something wrong, they might be just as contrite.

I am not a priest. Your act of contrition means nothing to me. It is your actions that mean something to me.

If you sit here and tell me you are doing it, well, great. Prove it to the market. If you survive, great. If you don't, the world will go on. And the truth is, one company's survival, other than to the employees that are involved with it, is of no importance. What is of importance is that this is repeating. Even today you have already been knocked off the front page by Merck. Their misstatement is three times larger than yours.

I wonder what is going to happen tomorrow? Who is it going to be tomorrow?

My concern is that we have a Federal Government for the last 10 years that has completely reduced governmental oversight. If you would tell me the auditor who—who is going to audit the auditor who is reporting to the auditor? At some point you have to have somebody who is not paid by you. That is called government regulation. For the last 10 years, government regulation has been a swear word around here. It is terrible.

What have we done? For all intents and purposes, we have dismantled the FCC—you know that better than I have, you have taken advantage of it—to whose benefit I don't know. My cable rates have gone up. I am actually sick and tired of getting your

phone calls in the middle of the night telling me to switch my phone company to you, which I won't do. I don't know what we have done.

We have made the SEC a toothless tiger. The SEC was created after the last round of repeated corporate greed. We have made them a toothless tiger. We have a Vice President whose own former company is under investigation right now for accounting questions. We have a President who made a million dollars doing the exact same thing that Enron did, the exact same thing. And there is no wrongdoing. Nobody did anything wrong.

I got to tell you, it is no surprise to me that as long as we say that somehow government oversight and government regulation is a sin, is anti-American somehow, we are not going to get out of this mess. Because an auditor auditing the auditor will not change a thing unless we, your government, hold somebody accountable and establish a system that worked for 65 years in this country to create the greatest economy in the history of the world. We have dismantled it in 10 years to make you rich.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from Kentucky, Mr. Lucas.

Mr. LUCAS. Mr. Chairman, I have listened today with a great deal of patience; and we have had about 8 hours of testimony, I believe, if I am accurate. It has been a real eye-opener. I think we have thoroughly vetted this thing. Everything that could be said has been said.

But, you know, one of the things that concerns me is we can do some things I think to shore up some of the problems. But I think the big problem is that we can't legislate morality. We can't legislate the amount of greed that is out there.

And my concern is that we as a country come together, because I do feel like one of the greatest things that is going to happen is that everybody, in trying to cover their backside—the accountants, the investment analysts, the officers of the companies, the members of the board—I think that out of all of this gloom and doom I think there will be some great benefit to come. Because we are going to have a—sort of a come-to-Jesus meeting here in their own professions to protect themselves.

So being the eternal optimist that I am, I would hope that, with all of this ugliness that has come out, that we can right the ship of our capital markets, because this is the foundation of our country. So I don't really have any questions, but I do think there is going to be some good that comes out of all of this.

The CHAIRMAN. I appreciate the gentleman's statement and also his patience.

The gentleman from Mississippi.

Mr. SHOWS. We love punishment. We have been with you here all day. Thank you, Mr. Chairman.

I want to make a suggestion. I got you some new board members.

Hewlett Anderson in Bassfield, Mississippi. He raised eight kids and sent six of them to Mississippi State and graduated from college and raised them on a cotton farm. The daddy paid for the first one to go to school, and when he graduated he paid for the younger one coming behind him.

J.D. Sparkman raised a family on a cotton farm. Never cheated anybody out of anything. He has passed away so he would do just as well or better than the analysts that we have.

Alex Ramsey, a farmer in Jeff Davies County who made good money. Never told a lie, was a good Christian man and did the right thing.

John McNease, my father-in-law, could squeeze the last dime out of anything he wanted to do. Very conscientious man.

Kermit Broome started with nothing. Quit school in the 7th Grade, has become a very successful man because he is honest, he worked hard and he didn't lie.

Howard Barnes. He is deceased. He can work—he was a court bailiff, but he managed to save money to end up with a hundred thousand dollars when he died on a court bailiff salary. He watched his money. He is deceased. He can do a lot better job than Arthur Andersen did.

Carol Holloway, he was our Farm Bureau Director. He had to answer to a board of directors. He did a great job.

Allie McNease, Ronnie Shivers, Pete Gates and Lewis Scene.

I believe all of these men that I have named would go down with their ship instead of watching it and themselves profit.

It just strikes me that I have seen businessmen out here—as long as it seems to take care of themselves, they don't really care what happens to anybody else;and I am afraid that is what the business—I am afraid that is what people out here are thinking about today. Who really cares about the working guy out there, and who really cares about the investor? People have never, ever trusted a market before in their life, and now we think that they are going to jump back in it.

You know, this happened in my State and within—with this company. I hope you can right the wrong, because a lot of people are dependent on you; and I want to do everything I can do as a Congressman to see this company make it. If you guys can do it, more power to you. But we just need some common people in there with some common sense and common ethics about trying to do the right thing.

I thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from New York, Mr. Crowley.

Mr. CROWLEY. Thank you, Mr. Chairman.

I thank both gentlemen for your testimony today and for being willing to come before this Congress and give testimony and know that a number of individuals have not come forward or refused to testify before this committee today.

Being the low man on the totem pole, as Ken Lucas has said very clearly before, every question that probably has been or should have been raised probably has been raised already. But I just have a couple of questions.

Mr. Sidgmore, you'd probably forgive me, but I noticed you mentioned before, I think the American people have a real interest in all of this, this corporate breakdown basically; and your laundry is being exposed to a lot of people. I think it is important to understand, you made a point before about you sold off about $400,000 worth of stock to invest for your nieces and nephew. I make a point. My nephew graduated from high school a couple of weeks

ago. I gave him 50 bucks. You know, the American people just don't really get how that can happen—all of the power to you.

But it just shows you that a Member of Congress and the head of a major company—you mentioned that there was a $400-some-odd million loan to Mr. Ebbers. You call him Bernie. What was the term of that loan? How long was it for?

Mr. SIDGMORE. It is now a 5-year term.

Mr. CROWLEY. So it is now 5 now. You say "now." was it originally something else?

Mr. ROBERTS. No, it was always 5 years.

Mr. CROWLEY. How is Mr. Ebbers—there is a lack of security. It is not totally unsecured, but it is not a terribly secured loan that you made in the first place. He is expected to pay back $400-some-odd million over a 5-year period plus 2 and a half percent interest; is that correct?

Mr. ROBERTS. Right.

Mr. CROWLEY. How do you propose that that is going to take place, given his assets, what he has put up in terms of his collateral? Does it reach $400-some-odd million? Is more than that that he has available to him?

Mr. ROBERTS. Again, we hope the collateral is adequate. Obviously, the part of that collateral that was stock is no longer certainly adequate, but if you take a look at the other assets that were pledged, particularly the Joshua Timber Farm and the ranch in Vancouver and the boat yard, and he has other assets that weren't pledged that presumably could be pledged and/or sold to pay off the loan.

He has got a legal obligation to do it. We have got a legal obligation to collect it.

Mr. CROWLEY. If something should happen to him, what would happen to that loan? Who is responsible for it then?

Mr. ROBERTS. It would go into his estate, and from there we would be a creditor. If you look at the terms of payback, next year is $25 million. I think a year after that is 25. Then it escalates from there.

Mr. CROWLEY. I appreciate it. Again, for a person who represents a district where it is difficult for some people to secure a loan for a home mortgage, these are really just astronomical figures that you are talking about today.

I think in the broader picture what I think this committee has attempted to do, and I think the chairman has really has tried to do this in the legislation that was passed, is he was trying to bring about some kind of audit responsibility and bring some resemblance back to the economy of this country.

I just see the Dow is down 105 points, NASDAQ is down 43, S&P is down 12. Not major numbers, given some of the ups and downs of recent weeks. But there is really a jitteriness out there in the public. People are concerned about the economy. Some have estimated between 20 and 30 percent, the real value of the market, but people aren't willing to make that commitment right now.

Where does this all end? I mean, today it is Merck. How many companies out there do you think are going to bust?

Do you believe people should be going to—do you believe some people should be going to jail? If so, who should be going to jail because of the debacle in your company?

Mr. SIDGMORE. Well, I think we tried to say this before. I guess we weren't very articulate about it. But I think that we believe that the bad guys should be punished severely and go to jail, whoever the bad guys turn out to be. We are not going to convict anyone or accuse anyone here.

Mr. CROWLEY. Do you think that there were bad guys in your company?

Mr. SIDGMORE. I think there is some likelihood that there were. I don't want to say that directly. But we want the bad guys to go to jail, and we want the rest of the company to survive. We don't think our 65,000 employees should be punished because of the deeds of a few bad ones.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from Arkansas, Mr. Ross.

Mr. ROSS. Thank you, Mr. Chairman; and thank you for being here for this hearing today.

I come from a very poor congressional district, the southern half of Arkansas where the average household income is $17,000 a year. It is difficult for me and for the people in my district to comprehend these million dollar salaries and these 80 and $90 million stock deals. Do you believe people should go to jail as a result of what has happened?

Mr. SIDGMORE. If they are convicted of fraud, I think they should go to jail.

Mr. ROSS. Do you believe that there are people within WorldCom that should go to jail?

Mr. SIDGMORE. I don't know that they will be convicted of fraud. I don't want to speculate on whether they will be.

Mr. SIDGMORE. I didn't say who is responsible.

Mr. ROSS. Who is responsible then?

Mr. SIDGMORE. Somebody at WorldCom is probably responsible for this, but I don't want to get involved in accusing somebody and convicting somebody before the evidence comes out. We are not a court. All we can do is allow the investigation to go on and be as open and honest as we can, and point out all issues as we know them, and we'll let the law enforcement people take care of it.

Mr. ROSS. You may not be a court, and we may not be a court here, but I can tell you this, I've got seniors in my district who had WorldCom stock to help them buy their medicines, to help buy their groceries, to help them pay their rent, help them pay their light bill. Can you tell me what that stock was worth in July of '01?

Mr. SIDGMORE. No. Not offhand.

Mr. ROSS. You have a lot of folks here with you.

Mr. ROBERTS. Six cents.

Mr. ROSS. No. July of '01.

Mr. ROSS. You can be within $10.

Mr. SANDLIN. $14 dollars in 2001. Six cents now.

Mr. ROSS. From $14 to 6 cents. We all agree with that assessment? And it seems like we want to blame everyone except ourselves. No disrespect, sir, but you keep talking about how you

weren't the CEO when all this went down, but you did work there then, correct?

Mr. SIDGMORE. I didn't work there. Specifically I was on the board. But I am not—we are not trying to push the blame on others. We are trying to expose exactly who was involved at WorldCom. We have had hired investigators to help. We have worked with the SEC and all of the judicial people to get at the facts here. We are not trying to hide anything. We are not trying to say that we're not at fault. We already apologized. We want to get the bad guys out and move forward with the company.

Mr. ROSS. We've got people living from paycheck to paycheck, and I'm talking Social Security checks, and they're subsidizing it with things like stock from WorldCom, and it's gone from $14 to 6 cents. And I'm sorry, but apology is not going to be enough here. When were you the chief operating officer at WorldCom?

Mr. SIDGMORE. I was never the chief operating officer. I was the chief operations officer in 1997 and 1998.

Mr. ROSS. Let me ask you this. You were on the board, though, when all this went down, but you don't blame yourself for that, you want to blame others.

Mr. SIDGMORE. I think what we're trying to say is the board has a certain ability to get to the bottom of these things. And when you have potentially a financial organization that is not giving the straight facts, when you have an auditor and one of the major auditors that does not hit the facts when they go through a standard audit, when the auditor comes in and tells us they look at the specific facts that are now being exposed, they thought everything was right, it's tough to get to the bottom of that.

Mr. ROSS. It seems like you keep wanting to blame the auditors. And believe me, I think there are some auditors that ought to go to jail over this too, but I also think people at the helm of WorldCom also ought to be going to jail. I'm a small business owner, sir. Nothing to the magnitude that you've got. I've got 12 employees in the little town of Prescott, Arkansas, some 3400 people. I have an accountant. I get a financial statement every month. I also know what my cash flow is, based on my checkbook and my bank statement. And whether you are a little business or a big business, it looks like, to me, you would catch on the checkbook, if nothing else, a $3.8 billion misreporting error.

Mr. SIDGMORE. The 3.8 billion has nothing to do with cash. It was moving it from one account to the balance sheet. There was no impact on cash whatsoever and I would just point out to you respectfully that a company of WorldCom size that operates in hundreds of countries that you know has $30 billion in revenue, 66,000 or 65,000 employees, sometimes that is difficult to catch. I am not saying we shouldn't have. We are here today because we want to figure this out with the government, and we want the bad guys to go to jail. The only thing I am pushing back on is I am not here to convict anyone of being a bad guy. That's the Government's job. We will support it 100 percent.

The CHAIRMAN. The gentleman's time has expired.

Mr. ROSS. One additional—30 seconds.

The CHAIRMAN. The gentleman is recognized for 30 seconds.

Mr. ROSS. What about others out there? I've always wondered how you could do this long distance thing for 5 cents a minute anyway. And it seems to me there has been competition going on to try to put the other guys out, so there would be one carrier out there so they could raise the price. Do you think the competition is also going to find themselves where you found yourself. You heard of Enron and Merck. And I think the Dow reflected it today. Are there others?

Mr. SIDGMORE. I think there had been others. There had been Global Crossing. Qwest has had problems. Level 3 has had problems. People are out of business now, Intelligent, Winstar, and et cetera. So a lot of telecommunications companies have gone out of business, and others are in trouble. It is a very, very serious situation in our industry.

The CHAIRMAN. The Chair thanks the witnesses for their testimony. Without objection, today's hearing record will open for 45 days for members to submit questions in writing to the witnesses. The witnesses are reminded that any answers provided to those questions are covered by the same oath taken at the outset of this hearing. The witnesses—

Mr. SANDLIN. Mr. Chairman, could I just inquire of the chairman. I know that the first panel remains subject to the subpoenas of the committee. I want to make sure that when we were going to continue to study the issue of contempt. I want to renew my motion for contempt and ask that a show cause order be issued asking the former witness to appear to show cause why he shouldn't be held in contempt and we get a resolution from this committee, doing that upon satisfactory completion of that, that he be held in contempt of the United States Congress and be ordered to testify.

The CHAIRMAN. We have counsel working on that very issue now and we will report as soon as we find out all the facts and the law that applies.

The committee stands adjourned.

[Whereupon, at 10:10 p.m., the committee was adjourned.]

A P P E N D I X

July 8, 2002

Opening Statement

Chairman Michael G. Oxley

House Committee on Financial Services

"Wrong Numbers: The Accounting Problems at WorldCom"

July 8, 2002

Good afternoon. I would like to begin by thanking my colleagues for returning early from their Independence Day District Work Period in order to take active roles in this important hearing. On July 4th, we celebrated the 226th anniversary of the issuance of the Declaration of Independence, which opened the door to freedom and self-government for Americans and, eventually, for all mankind. We celebrated American ideals such as selflessness, respect for others, and obedience to a higher law. We honored the ultimate sacrifice by our heroes who, long ago and just last year, placed those virtues above self-interest and beyond the temptations of affluence, protecting others instead of themselves.

Unfortunately we must return to the people's House today to investigate a stark and outrageous contrast to those ideals, and yet another example of the decline of ethics in American culture during the 1990s. The latest company to abuse the public trust is WorldCom. It appears that senior WorldCom executives deliberately hid almost $4 billion in expenses, disguising its true performance in order to keep earnings in line with analysts' estimates. The announcement of this fraud turned WorldCom from a world-beater into a penny stock and forced it to lay off thousands of blameless employees.

If these charges are proven, WorldCom executives who participated in the fraud should have to return any profits from stock sales made during the five quarters of misreported earnings. It would be simply wrong to allow them to profit from criminal behavior. I would note that the Committee's corporate and accounting reform legislation, CARTA, which passed the House on a strong bipartisan vote on April 24, includes a disgorgement mechanism for situations like this.

During the telecom boom of the nineties, WorldCom's stock was highly prized and was held by state pension funds, institutional investors and millions of average Americans. The stock has plummeted from a high of nearly $65 a share just a few years back. This betrayal to the spirit of the Fourth of July by senior WorldCom managers is so immense that it could cost tens of thousands of workers and average citizens their livelihood and life savings. How could something like this have happened and what can be done to try to prevent a recurrence?

To get the answers, we have invited a number of individuals here today who know or should have known what happened. They owe this Committee, and the public, a thorough explanation. Our witnesses include former and current CEOs of WorldCom, its Chairman of the Board of Directors, its former Chief Financial Officer, its former Controller, the Arthur Andersen partner in charge of the WorldCom audit, and Jack Grubman, a telecom analyst from Citigroup's Salomon Smith Barney unit who had an unusually close relationship with WorldCom executives, and who was for years WorldCom's biggest advocate on Wall Street. In the Committee's ongoing inquiry into the research practices of equity analysts, we want to explore the nature of these relationships and try to determine whether Mr. Grubman's failure to recommend that investors sell their WorldCom stock until it became virtually worthless can be explained by the hundreds of millions of dollars in underwriting fees that his firm collected from WorldCom.

In the late 1990s, many so-called experts proclaimed that there was virtually unlimited potential for telecommunications companies to carry high speed data over their fiber optic networks. As we have seen recently with the difficulties experienced by Global Crossing and others, that demand did not materialize. During my two decades of service in the House, I have worked on telecommunications issues of all kinds. It was long ago clear to me what the value of a robust, competitive telecommunications environment has meant to America's economy and our continued role in the forefront of the world marketplace. While different companies dealt with a changed market reality in a variety of ways, none has yet shown the audacity to commit fraud on the scale that has been alleged here.

I am hopeful that we will be able to learn a great deal from our witnesses today. At the same time, I am also aware that the concurrent investigations by the Securities and Exchange Commission and the Department of Justice will continue, as will this Committee's efforts, until a loud and clear message has been sent that accounting fraud, and all business illegalities, will not be tolerated. I fully expect the results of the investigations of the SEC and the Justice Department to return to the American public the confidence needed to invest in America's telecommunications companies and other industries. On Wednesday, our Committee agreed to a request from the Justice Department to assist them by not calling Ms. Cynthia Cooper, Vice President for Internal Audit for WorldCom, and Mr. Max Bobbitt, a member of WorldCom's Board of Directors and Chairman of its Audit Committee, to testify today.

The thousands of fired WorldCom employees who face an unknown future, and the millions of investors who lost so much of their retirement savings, all apparently due to the greed and selfishness of a few rich insiders, demand that we engage in the search for truth and justice. And make no mistake, the consequences to this sort of criminal activity, should it be proved, should be severe, and that may mean time in Federal prison.

From the founding fathers, to the heroes of 9/11, to our soldiers fighting the war against terrorism, Americans have always proven themselves willing to take risk and to do so in an honest and forthright manner. Today, we urge corporate America to live up to those ideals.

Opening Statement
Representative Shelley Moore Capito
July 8, 2002
Financial Services Committee Hearing

Mr. Chairman, let me paint a West Virginia picture for the Worldcom witnesses here before us today, for the Enron executives who have been before us in the past and for any other corporate executive who may find themselves before our committee due to what I will politely call accounting or management fraud.

It's evening, shortly after dinner. Three different couples are sitting around their kitchen tables worrying about the future. Each of them have been very diligent in saving for their individual goals - pinching pennies, clipping coupons, perhaps even holding off on buying that new family car.

Much of their savings has been invested. Some in individual stocks, some in mutual funds, and some in bonds. For one couple this money was to be used for retirement, for another a pending college tuition bill, and for the other the down payment on their first house.

Tonight's discussions are not pleasant. In the last year, these hard working families have seen their nest eggs all but evaporate as the financial markets have reacted to one corporate scandal after another. The financial statements these couples are poring over with shock and disbelief are showing losses of 60, 70 and even 85 percent. Money that they had counted on is simply no longer there.

The faces are all different but they reflect the same emotions, fear, disbelief, panic, and finally anger.

The people of the 2nd Congressional district of West Virginia are angry, and Mr. Chairman, so is their elected representative.

The market can work, but as the saying goes "garbage in, garbage out", and unfortunately for millions of Americans (not to mention the thousands of innocent employees who have lost their jobs) we have seen too much corporate garbage. From the magnitude of the problem, it is looks as though corporate fines are simply not enough to discourage almost $4 billion in fraud. So perhaps its time for stronger penalties.

As I understand it, tomorrow, President Bush will be proposing jail time for CEOs who knowingly engage in this kind of gross fraud and abuse. I agree with the President.

Playing Russian roulette with the savings of investors and the jobs of hard working employees is unacceptable and tantamount to criminal behavior.

Mr. Chairman, it's time for this committee to begin considering legislation that will restore the public's faith in its corporate citizens while at the same time holding the bad actors responsible for their actions.

Statement of the Honorable Wm. Lacy Clay before the Financial Services Committee, Monday, July 8, 2002

Good afternoon Mr. Chairman, members of the Committee, and witnesses.

The front page of this morning's newspaper did not report that the employees of ENRON, Global Crossing, and others still are in financial ruin as a result of the dealing of their employers and the subsequent crash in stock prices. These are real individuals and families that have lost their retirements, their children's college expenses, their homes, standards of living, families (separations caused by financial woes), and in many cases, their sanity. Their problems did not go away when they were not front-page news. We must not forget that!

This hearing is about a lot more than just WorldCom. It's about cracking down on criminal wrongdoing and about challenging the House leadership and the Bush Administration to join us in doing so. We cannot let this hearing become an all-too-familiar scene of corporate leaders pleading the fifth. Nor can we tolerate any longer the all-too-familiar ring of laxity and plans of letting corporations police themselves.

The success of our financial markets depends on the free flow of accurate and reliable information. This is particularly important as more and more Americans invest in the stock market and as more and more companies sponsor market-based 401(K) retirement accounts. Therefore, in the wake of the Global Crossing Bankruptcy filing in January and other more recent failings, Congress must do more than just investigate why the supposed safeguards in the system did/do not work.

We know that these are not isolated incidents, but, rather, a deep-rooted problem that is partially caused by soft punishments that are not deterrents when the criminals consider the vast amounts of money that can be gained and kept from the crimes. This is getting to be too common. We see hundreds of millions and also billions of dollars that have been lost by investors due to some type of fraud - -some prefer to call it mismanagement. I have serious concerns about the damage that is being done to the whole financial system in this country.

This is also a problem for the Judiciary. We have to have in place punishments that are deterrence to these acts and that do fit the crime. We have to make it so that the criminals keep no money, as has been the case in too many of these tragedies. We need to tighten auditing standards, reduce conflicts of interest among analysts and make securities fraud a felony.

We must consider legislation that is in line with the Sarbanes bill in the Senate. The Sarbanes Bill creates a strong independent board to oversee the auditing of public

companies; assures the independence of auditors by establishing statutory prohibitions on consulting services that can be provided to a public company and client and ensures comprehensive reform to protect investors.

My first question – which goes beyond just WorldCom – is this: Shouldn't corporate executives be held just as accountable as average Americans for breaking the law? When did corporate executives get stricken from the list of those who can be criminally prosecuted for wrongdoing?

My next question – which again goes beyond just WorldCom – is whether or not the Bush Administration is in any position to police the accounting business?

The country wants answers. The country wants results. We must provide them and make deliberate recommendations for change where needed.

I will end this statement like I started it. We must protect employees and their securities for their retirements and their families.

Mr. Chairman, I ask unanimous consent to submit my statement to the record.

Statement of Congressman Mike Ferguson
"Wrong Numbers: The Accounting Problems at WorldCom"
July 8, 2002

Good afternoon and thank you, Chairman Oxley, for holding this important hearing on WorldCom. The American people deserve to know why thousands of people lost millions of dollars because a few individuals fraudulently manipulated the company's financial condition and misled investors.

I was extremely disappointed to learn that two former WorldCom executives this committee subpoenaed - Bernard Ebbers, former chairman, and Scott Sullivan, former chief financial officer – have refused to testify. Your silence may have saved you today, but know that eventually we will get answers to difficult questions, and we will get to the bottom of this situation. There will be consequences. While it is your constitutional right to maintain your silence, know that it speaks volumes – there is no dispute that you have caused employees to lose their jobs and other hardworking Americans to lose their savings.

WorldCom's demise has not only been detrimental to retirement savings and other investments into mutual funds, pension funds, and other vehicles that invested in the company, it has had a tremendous impact on investor confidence, the strength of capital markets and overall health of our economy – which cannot be overstated. Strengthening these areas of corporate responsibility, accounting oversight, and investor information, is our highest priority as our economy recovers.

I commend Chairman Oxley and this committee for working on legislation that passed the House with over 330 votes and will ensure that our markets emerge stronger than ever. The legislation holds Corporate America more accountable to employees and shareholders through stricter accounting standards and tougher disclosure requirements. It also recognizes the need for corporate leaders to act responsibly, and holds them accountable if they fail to do so – specific language requires high-ranking executives to vouch for company financial statements and makes it a crime for any individual to interfere with a corporate audit. Most importantly, it ensures the highest standards of auditor independence, ethics and competence in a manner that will strengthen the financial future of America's retirees, investors, and employees of publicly traded companies.

The WordCom debacle highlights the need for such legislation. I urge the Senate to move forward with similar language that will allow us to move one step closer to meaningful reforms.

Finally, since there are some individuals who insist on illegally and unethically manipulating the system, let me be direct and succinct. To corporate CEOs and the accounting firms that audit their companies, let me be very clear: If you violate the public's trust, if you flush down the drain the retirement security of millions of Americans, you will -- and you deserve to -- go to jail. And to company executives: you will not be able to walk away with millions of stock options, having brought a company to bankruptcy, without there being consequences for your actions.

Thank you, Mr. Chairman and I look forward to hearing the testimony of these panels.

Congressman Harold Ford, Jr.
House Financial Services Committee
Hearing on "Wrong Numbers: The Accounting Problems at WorldCom"
July 8, 2002

I want to thank the chairman for holding this hearing today to examine the accounting scandal at WorldCom.

Like my colleagues on this Committee, I am outraged by this scandal. WorldCom employs nearly a thousand of my constituents in Memphis -- hard-working individuals who believed in the company but who were betrayed by its management. This scandal isn't about numbers -- the actions that took place represent a shameful betrayal of WorldCom's employees and investors.

On top of the anger and outrage, the members of this Committee are also feeling a strange sense of deja vu. It was only several months ago that we held a series of hearings into financial irregularities and alleged fraud at the Enron Corporation, which became the largest bankruptcy in American history. WorldCom has now joined it Enron in the record books of corporate infamy by submitting the largest earnings restatement ever -- $3.8 billion over five quarters.

It seems that every morning, American investors are awakened to news of yet another massive restatement, yet another financial scandal. Enron, Global Crossing, Tyco, Adelphia, Sunbeam, Waste Management, MicroStrategy, Rite Aid, WorldCom -- with every scandal that unfolds, investors become more certain that another is around the corner.

At stake here is the integrity of our financial markets. America's financial markets have been and must continue to be the driving force behind economic growth here at home and throughout the world. But our powerful economy is built on the delicate foundations of trust and confidence. The unending wave of corporate scandals poses the most serious threat to investor confidence since the Great Depression.

Tomorrow, President Bush will visit Wall Street to speak to corporate executives, and the nation, about these critical issues. Like millions of Americans, I will be listening closely to the President. I am certain that he will express outrage over the wrongdoing at WorldCom and other companies. But the President must do more than condemn the scandals and exhort corporate America to behave better. It is time for the President to lay out a roadmap for restoring investor confidence.

We can all agree that recent events cry out for measures to hold corporate executives accountable for their actions. But we must go further than holding individuals accountable after the fact. The recent scandals have exposed institutional flaws in our system of accounting and corporate governance that must be addressed through institutional reforms.

If the President is serious about protecting investors and workers from more WorldComs, he must announce his support for the bill introduced by Senator Sarbanes, which was approved by our counterpart committee in the Senate with a bipartisan 17-4 vote. Unlike the version crafted by this Committee and approved by the House, the Senate bill makes the bold reforms which are necessary to prevent future scandals and protect investors. The bill establishes a strong oversight body for public auditors. It takes explicit steps to untangle the pernicious conflicts-of-interest on the part of auditors and equity analysts. It fosters greater corporate responsibility by establishing new standards for corporate executives and audit committees. Finally, the bill provides the SEC -- at long last -- with the resources it needs to carry out its responsibilities.

I would also call upon the President to begin a campaign to revive the seemingly abandoned concept of business ethics. I would urge the President to convene a panel of about twenty CEOs of major American corporations, who would work to articulate a new code of business ethics. This group, comprised of model corporate citizens from across a wide range of industry sectors, could also advise the President, the Congress, and regulators about the state of business ethics in America.

In addition, I would expect the President to join the Business Roundtable in demanding that any corporate executive who personally profited from inappropriate financial schemes return their ill-gotten gains to the shareholders.

We are looking to the President not only to share in our outrage but to provide the specifics to move forward. By supporting the Senate bill, the President can provide fresh impetus to the reform effort. With the President's support for Chairman Sarbanes' bill, we can move forward in a bipartisan manner and in an expeditious manner. The markets are looking for certainty -- and investors are looking to Congress to act swiftly and decisively.

The concepts of accountability, transparency, and investor confidence are important but abstract. The consequences of our actions or inaction are more concrete -- at stake here are the jobs, livelihoods, retirement savings, college funds, and economic security of hard-working families.

July 8, 2002

Opening Statement by Congressman Paul E. Gillmor
House Financial Services Committee
Full Committee Hearing entitled, "Wrong Numbers: The Accounting Problems at WorldCom"

I would like to thank Chairman Oxley for calling this important hearing and for his leadership on this issue. This committee continues to move swiftly in investigating reports of corporate fraud, abuses, and mismanagement and, most importantly, has produced legislation successfully reported out of the House of Representatives to deal with the systemic problems revealed.

On April 24th, the House passed the Corporate and Auditing Accountability, Responsibility, and Transparency Act of 2002, sponsored by Chairman Oxley, which addresses several issues regarding Securities and Exchange Commission (SEC) rules governing corporate disclosures found to be insufficient in preventing the misinformation surrounding the Enron collapse.

Today, this committee is again seeking information as to how a major publicly traded corporation could deceive its shareholders and fail to comply with Generally Accepted Accounting Principles (GAAP) causing, in this case, the destabilization of the nation's second largest long-distance provider and a leader in electronic commerce. Shareholders in this country cannot continue to suffer the losses involved in recent corporate scandals, as many are participants in public and private pension plans and could stand to lose much if not all of their retirement savings.

The role of the analysts can also not be ignored in this particular situation. I hope that today's hearing will shed further light on the relationships that exist between the management of publicly traded corporations and the Wall Street analysts meant to objectively evaluate them. If inappropriate communications have taken place and inside information has been utilized for profit, the persons involved must be prosecuted.

Congress has the responsibility to investigate thoroughly all issues surrounding these recently publicized fraudulent corporate practices and to continue reviewing our current securities laws and passing appropriate reform measures.

Again, I applaud Chairman Oxley for his leadership and look forward to an informative session.

Statement

Congresswoman Stephanie Tubbs Jones

Committee on Financial Services
Subcommittee on Capital Markets, Insurance,
and Government Sponsored Enterprises

July 16, 2002

Mr. Chairman, Ranking Member Kanjorski, Colleagues, and Guests:

This Committee has previously and exhaustively examined the Government Sponsored Enterprises (GSE's), Fannie Mae and Freddie Mac. While recent events have underscored the need for reform in financial firms that operate without any financial regulator, Fannie Mae and Freddie Mac provide a strong example of sound reporting and management controls. These controls provide a measure of safety and soundness that is unmatched by unregulated financial firms.

On Friday, July 12, 2002, Fannie Mae and Freddie Mac announced that they would voluntarily register their common stock under the Securities and Exchange Act of 1934. The result will require Fannie and Freddie to comply with the Act's periodic disclosure requirements. Once these filings are made, Fannie and Freddie will be bound as a matter of federal law to continue to make their filings.

Fannie Mae and Freddie Mac negotiated this agreement even though they are already scrutinized by the Treasury Department, the Securities and Exchange Commission, the Office of Federal Housing Enterprise Oversight, and the Department of Housing and Urban Development.

Friday's action was consistent with Fannie Mae and Freddie Mac's announcement in October of 2000 to set in place financial reports and securities offering disclosures that meet or exceed the requirements of the Securities and Exchange Commission.

While recent events reinforce the need for sound operations and financial practices at major corporations, let's not lose sight of Fannie Mae and Freddie Mac's real mission of providing housing affordability to my constituents who have previously been denied access to home ownership. I have seen firsthand in my district the tangible results of their efforts. Furthermore, Fannie Mae and Freddie Mac have worked to execute their mission in a manner that enables many to reach the goal of home ownership without overly burdensome fees and costs.

I am on the Record as opposing efforts to disrupt housing markets by changing the GSE's Congressional charter to require the registration of their MBS securities. What Fannie Mae and Freddie Mac have achieved together with the Administration is a non-legislative way to assure their investors and policymakers once and for all that their disclosures meet the same

standard to which other publicly held companies are held. Their goal was to improve investor confidence without limiting their ability to fulfill the vital mission Congress has given them.

Let me make sure that we are clear on what disclosure means:
The disclosure requirement applies to everything they issue. When they enter into registration of their common stock, they will have to put their financial statements in the form that's acceptable to the SEC. Take financial statements and put them into offering documents for mortgage-backed securities. So, the disclosure rule with regards to Fannie Mae and Freddie Mac will be exactly the same, all of which will be defined by SEC requirements.

The only distinction that we have is whether or not the securities are registered. This is an important distinction. Last year, the Securities and Exchange Commission had 110 issuances during the year. Last year, Fannie Mae had 1,500 debt issuances and 40,000 mortgage-backed security issuances. It is easy to see that it would not be a small matter to register all of those securities. Of the 40,000 issuances, almost all of them were sold in a forward market prior to the time that the mortgages in them were identified – what they call their TBA or To-Be-Announced market.

When a buyer goes to get a mortgage and "locks in the rate" - that means that a lender is selling forward a mortgage. That's why a lender can tell a buyer, "We'll close your loan in two months and it's going to be 7 percent. They are not guessing; they've actually sold that mortgage forward.

This last point is critical because there isn't a To-Be-Announced market in a registration world because you can only register after you know exactly what the mortgages are. Therefore, it is clear that registration would have a detrimental effect on the availability of mortgages and the purchase of homes.

In real-world effects, Fannie Mae and Freddie Mac are the only companies with a corporate mission that focuses on helping American families purchase homes. Fannie Mae and Freddie Mac focus on low-moderate income and minority consumers who aspire to achieve the goal of homeownership. Homeownership is an important step toward building wealth in families.

Mr. Chairman, I believe that the time this Committee spends examining GSE's could better be used to examine unregulated financial firms. Recent events have proven that unregulated firms create significant systemic risk. Fannie Mae and Freddie Mac do not.

Mr. Chairman, I thank you for the opportunity to be heard.

COMMITTEE ON
FINANCIAL SERVICES
SUBCOMMITTEES:
CAPITAL MARKETS, INSURANCE, AND
GOVERNMENT-SPONSORED
ENTERPRISES
HOUSING AND
COMMUNITY OPPORTUNITY

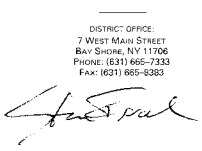
COMMITTEE ON
SCIENCE
SUBCOMMITTEE:
RESEARCH

Congress of the United States
House of Representatives

STEVE ISRAEL
Second District, New York

WASHINGTON OFFICE:
429 CANNON HOUSE OFFICE BUILDING
WASHINGTON, DC 20515
PHONE: (202) 225-3335
FAX: (202) 225-4669

DISTRICT OFFICE:
7 WEST MAIN STREET
BAY SHORE, NY 11706
PHONE: (631) 665-7333
FAX: (631) 665-8383



Statement of Congressman Steve Israel
Wrong Numbers: The Accounting Problems at WorldCom
Committee on Financial Services
United States House of Representatives
July 8, 2002

Mr. Chairman, I make these comments both in sadness and in anger. As someone who has consistently stood up in support for the business community over my time in Congress, I am sad that there are now so many egregious examples of how self-regulation has failed to serve the public interest. And as a Congressman who represents middle class, middle-income constituents on Long Island, I am angered that the people of my district have been directly abused by a system manipulated by executives to distort and mislead.

I am hardly a business-bashing class-warfare Congressman. But events over the last year have reinforced the very worst perceptions of the American business community, and abuses by some will surely have to lead to regulation of all.

We cannot tolerate business executives who cook their books to hide their failures.

We cannot tolerate business executives that base bonuses on phony profit reports.

We cannot tolerate business executives and accountants who cash out their stock options while the 401ks of our constituents disintegrate.

We cannot tolerate business executives who float on golden parachutes while middle-class American stockholders watch their portfolios and retirements crash and burn.

Deliberate mismanagement and deception at Enron, WorldCom, Arthur Anderson, Halliburton and other corporations have exposed faults in a system that must be repaired before even more egregious damage is done to average citizens who work hard and play by the rules. Companies must be made more accountable. Corporate executives must be held accountable for the papers they sign. We must build more transparency into the system, not only to make it more fair, but to restore the American public's confidence in our businesses, corporations, accounting procedures and executive integrity.

Let us get to work. This hearing is not about retribution. Rather what we seek here is restoration and reinvigoration of the very heart of our financial system. It is the obligation of Congress to respond.

Mr. Chairman, it is the business of this Committee to get business back on the right track. It is the business of this Committee to restore the world's trust in our system. It is the business of this Committee to bring back the small amount of confidence that American businesses earned from their workers over the years. And it is the business of this Committee to ensure that regulators regulate, that prosecutors prosecute and that criminals go to jail.

There is no difference between those who steal using a gun and those who steal with a fountain pen or a red accounting pencil. Thieves should go to jail. I am glad to see some movement in that direction from the Administration. But we should also note that while Andersen has been destroyed, Kenneth Lay and his cronies continue to walk freely. There have been no personal bankruptcies of senior management, there have been no jail sentences, there have been no disgorgements, there has been no accountability.

WorldCom is a symptom of a much larger problem. That problem is that CEO's are milking this country under the cover of a free market. It is long past time that this Committee, this Congress and this government put a stop to it.

OPENING STATEMENT OF
CONGRESSMAN PAUL E. KANJORSKI

COMMITTEE ON FINANCIAL SERVICES

HEARING ON WRONG NUMBERS:
THE ACCOUNTING PROBLEMS AT WORLDCOM

MONDAY, JULY 8, 2002

Mr. Chairman, we meet yet again to examine the legal problems plaguing America's corporations. As more and more scandals have come to light in recent months, the business section has often read more and more like the crime page. WorldCom's recent announcement that it had overstated its earnings by at least $3.8 billion in 2001 and the first quarter of 2002 is only one of the latest examples of this unacceptable behavior.

With the revelation of WorldCom's questionable accounting practices, it has become increasingly apparent that these scandals did not result from some idle mistakes or a few fraudulent acts. For me, the WorldCom deceit is just the latest development to make clear that there are systemic problems with accounting irregularities, executive abuse, and corporate governance misconduct in our country's securities markets. It also greatly troubles me how so many corporate insiders, outside auditors, investment bankers, research analysts, and countless others could miss this simple, yet staggering, accounting deception.

Pursuant to an order of the Securities and Exchange Commission, executives at our nation's largest public companies have begun a review to affirm the accuracy of their corporate books. I thus expect that we will learn of additional cases accounting chicanery in the weeks ahead. After all, these problems have steadily increased for a number of years. In fact, a recent study by Huron Consulting Group found that the overall number of restatements in 2001 was more than three times those released in 1997. As a result, investors have lost hundreds of billions of dollars in, and workers have lost tens of thousands of jobs at, the companies issuing false financial reports.

The corporate misdeeds at WorldCom, Tyco, Adelphia, Rite Aid, Xerox, Global Crossing, and Enron have also challenged the credibility of our corporate financial reporting system. Congress must therefore take strong, decisive, and quick action to bolster investor confidence. Only a strong law will restore confidence in the integrity of the market and protect the hard-earned investments made by millions of middle-class Americans.

Accordingly, I hope that the Senate will pass a strong corporate accountability bill in the coming days. We must hold corporate executives accountable, enhance the independence auditors, improve oversight of the accounting profession, and end stock analysts' conflicts of interest. Before the August recess, we must send to the President's desk legislation that is much stronger than the weak bill passed by the House in April.

Moreover, as we work to hold America's corporate leaders accountable, I hope that our nation's top executive will take accountability within his White House. In recent days we have heard much about how President Bush repeatedly failed to file timely reports with the SEC regarding his insider sales of Harken Energy stock in the early 1990s. His staff has unfortunately analogized these late filings as getting caught driving 60 miles per hour in a 55 speed zone. Nevertheless, I hope that the President in his speech tomorrow will refute his aide's careless

dismissal of the SEC's rules. If the President seriously wants to strengthen corporate accountability, he needs to send a message that everyone must follow the law. We cannot allow an environment of permissive attitudes toward enforcing our country's securities regulations to continue.

In closing, Mr. Chairman, investors expect to be able to trust the information that companies provide to them. Congress must therefore examine what went wrong at WorldCom and other companies. To restore investor trust and protect our nation's overall economic health, Congress must also quickly pass -- and the President should sign -- real corporate accountability reform. I will continue working toward that important goal.

COMMITTEE ON THE BUDGET

COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

COMMITTEE ON SCIENCE
SUBCOMMITTEE ON RESEARCH
SUBCOMMITTEE ON SPACE AND AERONAUTICS

COMMITTEE ON SMALL BUSINESS
(on leave of absence, 107th Congress)

Congress of the United States
House of Representatives

DENNIS MOORE
Third District, Kansas
www.house.gov/moore

431 CANNON HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-1603
PHONE: 202-225-2865
FAX: 202-225-2807

8417 SANTA FE DRIVE, #101
OVERLAND PARK, KS 66212
PHONE: 913-383-2013
FAX: 913-383-2088

500 STATE AVENUE, #176
KANSAS CITY, KS 66101
PHONE: 913-621-0832
FAX: 913-621-1533

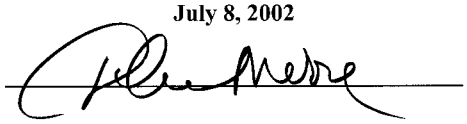
647 MASSACHUSETTS ST., #212
LAWRENCE, KS 66044
PHONE: 785-842-9313
FAX: 785-843-3289

MIAMI COUNTY
PHONE: 913-294-4122

OPENING STATEMENT BY REPRESENTATIVE DENNIS MOORE (KS-3)

Before the House Financial Services Committee

July 8, 2002



Mr. Chairman, here we are, again meeting to discuss yet another case of corporate malfeasance, accounting fraud and executive greed.

In December, it was Enron; in March, Global Crossing; and today, WorldCom. Truth be told, we could have also – and may in the future – conduct investigations on the likes of Qwest, Xerox, and new today to the questionable accounting list, Merck.

I think it is fair to say that the SEC, the Financial Accounting Standards Board (FASB), the Justice Department, the Department of Labor, Congress, and our legal system all have important roles to play in this matter. We all share responsibility for ensuring that the truth is revealed; serving justice in the face of criminal wrongdoing; and acting to develop a strong regulatory regime to fulfill the promise to all investors that they are receiving accurate information.

When this committee passed CAARTA in April, I voted for the Chairman's bill because, in my short time in office, I've noticed that Congress has a tendency to overreact. CAARTA, I believed at the time, struck a good balance to protect investors and allow our free market system to operate without big government constraints.

Advocates of this legislation, including myself, hailed it as "significant reform" that would "prevent future Enrons." And, while I recognize that this legislation has not yet been signed into law, the story I think we will all hear today will demonstrate that CAARTA did not go far enough, it at least one critical respect.

Additionally, investors need to be able to trust the financial analysts who, more often than not, recommend that investors buy the stocks of companies like Enron. In the case of

PRINTED ON RECYCLED PAPER
PRINTED WITH SOY INK

Enron, its stock plummeted from its 52-week high (from $90 a share down to 24 cents). Most financial analysts that covered Enron continued to issue "buy" or "strong-buy" recommendations. Today, we'll learn that one influential telecommunications analyst did not downgrade the WorldCom's stock to "sell" until June 24, the day before its fraud announcement and after an over $60/share decline in stock value over the previous 2 ½ years.

CAARTA did not sufficiently address the issue of analyst independence and I hope that this committee will examine carefully the issues of auditor and analyst independence and frame responsible solutions that balance new business needs, strengthen transparency and disclosure of critical information, and, most importantly, protect investors.

Mr. Chairman, the healthy functioning of our capital markets depends upon reliable auditing and accounting information, as well as accurate financial statements. While investors should always scrutinize their investments and make informed decisions on where to invest their money, investors have to be able to trust the financial statements of the companies in which they have decided to place their money.

Congress can help improve investor confidence with reforms *starting* with those like CAARTA; the NYSE and SEC can and have helped with their recent reform proposals; however, none of these reforms can check unethical, greedy corporate behavior that cheats the public and taints financial markets – for that we need to look to the justice system; and justice needs to be swift and sure.

I thank the Chair for holding these hearings and look forward to hearing the testimony of those who choose to help discover the truth.

Statement of Bob Ney
before the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises
July 16, 2002

Thank you Mr. Chairman for holding this important hearing. You have established a lengthy track record of diligence in overseeing our nation's Government Sponsored Enterprises.

In recent moths, this committee has held a number of hearings that demonstrated how vital it is for investors for corporations to be transparent and open. President Bush has highlighted this as part of his comprehensive corporate governance plan, and the Financial Services Committee passed H.R. 3763, which would increase corporate accountability and transparency.

I am sure that everyone here supports increasing corporate transparency. That is why I was proud to be part of a press conference last Friday where Fannie Mae and Freddie Mac voluntarily agreed to file financial disclosures with the SEC, subjecting them to the full panoply of SEC review. They will no have to file 10K, 10Q and 8K's with SEC, just like any other corporation and their disclosures will be available for all to see in the SEC's EDGAR system.

In the past I have openly and strongly opposed efforts to repeal the Fannie Mae and Freddie Mac SEC registration exemption.

I have done this not because I oppose transparency or openness. The events of the past few weeks with companies such as WorldCom have proven that transparency is vital for investors and to enforce corporate responsibility.

I have opposed legislation because of the threat it poses to our housing markets and because the disclosures provided by Freddie Mac and Fannie Mae go meet or exceed those required by the SEC. Housing was one of the few bright spots in our last economic downturn; we cannot threaten its stability.

This disclosure announcement is a very big victory for the financial marketplace and the housing finance system. It will increase transparency and disclosure without harming the housing market that is so vital to our economy – and millions of Americans seeking homeownership.

One important point is that this registration is of their common stock, not their mortgage backed securities, however that does not mean that the disclosure will be any less meaningful or important. The disclosures will cover the financial position, the conduct of their officers, insider trading, debt, reserves, and any other relevant financial information. This is vital information. Those who have called for repeal the SEC exemption have had two critical complaints: 1) that the information provided by the GSE's is voluntary, not mandatory, and 2) that it is not uniform and easily comparable.

Last Friday's announcement answers both of those concerns. Once the GSE's subject their financial disclosures to SEC review, they cannot withdraw without SEC approval. They will be filling out the same SEC forms as every other company.

I want to emphasize that because of Fannie Mae's and Freddie Mac's critical role in the United States housing finance system, I do not believe that Congress supports repealing their SEC registration exemption.

Less than a month ago, these two companies joined the Administration to announce a new effort to expand minority homeownership. The President, along with Freddie Mac and Fannie Mae, have pledged to close the gap between minority homeownership and the rest of the population.

Friday's announcement is the second time in less than a month that Fannie Mae and Freddie Mac have stepped up to the plate and have responded to the President's call for leadership. With their commitment to provide more than $700 billion for minority homeownership, these companies will be vital in closing the homeownership gap.

These companies have shown their commitment to homeownership and helping restore corporate accountability. They have demonstrated their accountability in both arenas.

Again, thank you Mr. Chairman for holding this important hearing. I look forward to hearing from Undersecretary Fisher.

Opening Statement
Congressman Ed Royce (CA-39)
8 July 2002
WorldCom Hearing

Today, this Committee has been summoned to address a $3.8 billion misstatement of earnings at WorldCom throughout 2001 and the first quarter of 2002. This restatement at WorldCom marks yet another example in a seemingly endless parade of corporate accounting scandals in which corrupt managers are found to have manipulated financial data and enriched themselves by hundreds of millions of dollars, leaving shareholders to suffer the consequences when the truth about their companies' financial health becomes public. In this case, the same culture of deceit and self-interested behavior by management that contributed to the demise of Enron and Global Crossing also appears to have afflicted the management at WorldCom.

Executives who engage in this type of deceit should be divested of their ill-gotten gains. I note that last Friday, WorldCom filed a lawsuit seeking to reclaim a $10 million bonus given to its former Chief Financial Officer. Earlier this year, in a hearing before this Committee I asked SEC Chairman Harvey Pitt if there were mechanisms available to the SEC that would allow them to prosecute effectively, and to collect and return for the benefit of shareholders, all corporate managers' compensation obtained through misconduct, and if he would employ them. He indicated that there were, and that he would. His job will hinge on whether he demonstrates the capability to accomplish this task. The President will disclose tomorrow a new requirement that top executives personally certify that their companies' public financial reports are accurate. If this certification should prove false and if there are self-dealings, they should go to jail.

Aggressive, inaccurate and misleading accounting practices are undermining the transparency and international reputation of America's capital markets. Without reform, our capital markets -- which had until recently been held up as a model for the rest of the world to emulate -- may take a long time to recover.

At WorldCom, individuals in senior management appear to have committed outright fraud by accounting for current operating costs as capital expenses, in direct contradiction of Generally Accepted Accounting Principles. They were aided and abetted by the irrationally exuberant proclamations of sell-side analysts whose own compensation packages are influenced by the extent to which they can generate fees and inflate the costs of securities underwritten by the investment banking divisions of their employers.

This self-interested and fundamentally conflicted business model is untenable, and must end. The 80 million American investors who own stock, either through individual holdings or mutual funds, and entrust their retirement security to our capital markets deserve much better than watching their life's earnings be drained away by unscrupulous executives and self-interested, cheerleading analysts.

In response to this spate of recent scandals, this Committee crafted and passed a bill that addresses many of the problems plaguing corporate accounting and governance. The recent steps taken by the SEC and the NYSE and NASDAQ to rein in analysts and corporate managers

should also help to restore shaken investor confidence in the transparency of America's capital markets. Tomorrow, the President will outline additional reforms to restore faith in our markets. I hope, for the sake of the greater economy and for the many business executives who behave ethically and report their financial data in an accurate manner, that the actions of these unscrupulous managers does not continue to spoil investor confidence. I look forward to hearing explanations for the $3.8 billion restatement of earnings from our witnesses today, and how they plan to ensure that this scandal does not deepen international and domestic investor skepticism in the integrity of American capital markets or corporate ethics. I yield back the balance of my time.

STATEMENT FOR FINANCIAL SERVICES COMMITTEE HEARING, "WRONG NUMBERS: THE ACCOUNTING PROBLEMS AT WORLDCOM"

Representative Max Sandlin

July 8, 2002

Mr. Chairman and Ranking Member LaFalce, I would like to commend you both for holding this timely and necessary hearing on the recent revelations of alleged accounting fraud at WorldCom.

Unfortunately, this type of hearing is becoming all too common in the Financial Services Committee. Beginning in December, and extending into February, the Capital Markets Subcommittee held a series of hearings on the collapse of Enron. In March, the Oversight and Investigations Subcommittee held a hearing examining the impact of Global Crossing's bankruptcy on investors, markets and employees. And now here we are in July, holding a hearing on yet another corporate meltdown at yet another former stock market darling.

The details of the WorldCom debacle are by now well known. During a period of several years, WorldCom's Chief Financial Officer Scott Sullivan improperly capitalized several billion dollars worth of expenses, allegedly in violation of generally accepted accounting principles [GAAP]. This potentially fraudulent activity reduced reported operating expenses and artificially inflated profits during 2001 and the first quarter of 2002. According to WorldCom's internal investigation of this matter, Mr. Sullivan may have inflated profits since the beginning of 1999. Not coincidentally, Mr. Sullivan's creative accounting allowed WorldCom to meet Wall Street analysts' profit expectations, and the company's profit margin goals, during the period in question. According to a June 28 *New York Times* article, federal investigators examining WorldCom's situation had found no records to support Mr. Sullivan's decision to capitalize several billion dollars in expenses that should have been accounted for as operating expenses under generally accepted accounting principles. As of this afternoon, I am not aware that investigators have found any records to support Mr. Sullivan's apparently arbitrary decisions.

The unfolding scandal at WorldCom, unlike the scandal at Enron, is stunning not for its complexity and layers of obfuscation, but rather for its ultimate simplicity. Perhaps not surprisingly, WorldCom's accounting firm, Arthur Andersen, found nothing unusual with Mr. Sullivan's accounting methods. I will be very interested to hear Mr. Dick's explanation of how WorldCom could allegedly have perpetrated the largest accounting fraud in American history without being detected by the company's auditors.

While there are important differences between the Enron and WorldCom scandals, there exists a common tie that binds these companies together – greed. Though it currently

does not appear that Mr. Sullivan sought to enrich himself in the manner of several high-ranking Enron executives, I find it difficult to believe that he employed allegedly fraudulent accounting methods for entirely selfless reasons. Mr. Sullivan's actions warrant an updating of Gordon Gekko's infamous motto, "Greed is good." In the case of WorldCom, it appears that greed is good for some, and absolutely devastating for all the rest. Mr. Sullivan's actions would make Gordon Gekko himself blush with embarrassment. Within one week of WorldCom's announcement that it would need to restate earnings for 2001 and the first quarter of 2002, the company fired 17,000 of its employees, or approximately 20% of its workforce. Additionally, WorldCom's actions have rendered its stock worthless and jeopardized nearly $30 billion in WorldCom bonds. According to the *Wall Street Journal*, public pension funds, mutual funds and insurance companies in my home state of Texas hold approximately $870 million in WorldCom bonds that could be worth nothing more than the paper they are written on in the event of a Chapter 11 bankruptcy filing.

Further, WorldCom's financial situation, when considered in the context of other recent corporate accounting scandals, raises the troubling question of these scandals' immediate impact on investor confidence, and potentially long-term impact on investors' faith in the integrity of the capital markets. Access to accurate financial information is essential to the proper functioning of the markets, and as corporate America seems unwilling thus far to enact reasonable reforms, Congress and the administration must act to save corporate America from itself.

While Congress cannot legislate an end to greed, we can create and sustain an environment in which there exist sufficient checks on greed. This committee, and subsequently the full House, passed an accounting industry reform bill in April that would create a public regulatory organization to regulate auditors of public companies. This legislation is an important step in the right direction, and the other body needs to consider and pass accounting reform legislation this month. In the short term, Congress needs to send such legislation to the president for his signature on behalf of America's workers and investors. In the long term, Congress needs to continue to hold hearings and investigate possible corporate wrongdoing to ensure that our free market system functions accurately and effectively for generations to come.

Opening Remarks of Congressman Brad Sherman
July 8, 2002 – Financial Services Committee

I have little fear that we'll hear big rhetoric on this issue. My fear is that we'll do little; and then, with audacity that would make David Duncan blush, announce that we've solved the problem. There are many ideas on how to strengthen the system. I'd like to bring to the committee's attention two new ideas and two older ideas. The first new idea is that perhaps the top one thousand companies should be audited every six months instead of every year. This would only modestly increase audit cost. The world operates more than twice as fast as it did when the 1933 Securities Act was adopted, and I think WorldCom might have found it more difficult to misstate five different quarters if they had been audited every other quarter.

Second, we ought to have a way of certifying as independent those stock analysts who do not work for investment banking firms and get no compensation from underwriters, consultants or issuers. Anyone can pontificate on the value of a stock, but perhaps investors would learn to trust those who do not have their bread buttered by those who would like to see only positive recommendations.

Mr. Chairman, this committee rejected a measure by only one vote instructing the SEC to read the filings of the top one thousand companies. And instead, we passed a provision saying it was the sense of Congress that the SEC do so, but we're not instructing them to do so. This suggestion has been reacted to with great hostility by Chairman Pitt, who as of yet has not resigned. Chairman Pitt not only hates the idea, and virtually any new idea, but he has reneged on his promise to this committee to even provide a cost estimate for that concept.

Mr. Chairman, WorldCom is another client of Arthur Andersen and this is not a coincidence. Chairman Tauzin, of a committee that formerly had jurisdiction of these matters, explained it well on the Sunday talk shows yesterday. He stated that Arthur Andersen was the only one of the major accounting firms in which total authority was vested in the engagement partner – the partner responsible for golfing with the client, and keeping the client happy, and getting the audit bill paid. At Arthur Andersen, the technical quality review department operated on a "don't ask, don't tell" basis – where they only heard those questions that the engagement partner felt like asking – and the engagement partner was free to ignore their answers.

Mr. Chairman, well over a month ago I put forward an amendment to this committee that would ban the Arthur Andersen structure, and solve what Chairman Tauzin identifies as the Arthur Andersen problem. It would have required the technical review to sign off on any audit of a publicly traded corporation. While that amendment was defeated on pretty much a party-line vote, I hope that we will get a chance to revisit it.

Mr. Chairman, I wish to take this opportunity to commend the Financial Accounting Standards Board (FASB) whose slow and ineffectual response to the Enron debacle makes this Congress look speedy and decisive.

Mr. Chairman, I note that we have gone directly from hearings on Enron to those on WorldCom. We have had to skip over Global Crossing, Xerox, etc. etc. I suggest that we may need to create several subcommittees to hold simultaneous hearings, so that all the pillars of the corporate community who wish to do so, will have the opportunity to assert their 5th Amendment rights.

Congresswoman Maxine Waters' Statement
WorldCom Hearing
July 8, 2002

Mr. Chairman,

Thank you for calling this hearing and for your patience in allowing members to speak.

Americans are watching and waiting to see if the Members of Congress are going to get serious about investigating Corporate Crime and supporting tough legislation to prevent the corporate fraud deceit and schemes we have witnessed unveiled in recent weeks.

WorldCom, Inc., joins a growing list of corporations accused of wrongdoing and criminal activities--Enron, Arthur Anderson, Tyco International, Adelphia Communications, Rite-Aid, Global Crossing Imclone, Xerox, and more to come--corporations whose executives stand accused of abuse of stock options, sweetheart loans, conflict of interest, excessive compensation and severance pay, and now, the Securities and Exchange Commission has filed a fraud lawsuit in Federal Court against WorldCom, Inc. The suit alleges WorldCom, Inc., was "directed and approved by top managers to keep earnings in line with Wall Street expectations and to support WorldCom's stock prices."

In essence, WorldCom has revealed they inflated their books by $3.9 billion. They treated on-going operating costs as capital investments. They reduced their operating expenses, that is, the cost they paid to other carriers for using their networks by spreading the cost into the future.

This improper accounting is no error, no mistake, it is calculated to enhance the company's net income and to hike its earnings before interest, depreciation, taxes and amortization. This made WorldCom appear healthier than it was, and thus more attractive to investors.

A syndicate of banks hold $2.65 billion in unsecured loans and bondholders about $30 billion of WorldCom bonds–all of which are in jeopardy. The banks could call in their loans, and the WorldCom bonds could be thrown into default. My own state of California Public Employee Retirement Pension funds could lose approximately 580 million dollars. WorldCom could easily file the largest bankruptcy in history. The impact of such a bankruptcy will be felt around the world. Aside from the 17,000 WorldCom employees, thousands of employees in related industries could be laid off. Thousands of pensioners will lose their pensions and the damage to our economy is incalculable.

This cowboy capitalism must stop! The President of the United States cannot simply treat this as damage control for his future election--a stump speech with the right sound bites--is not good enough. The President of the United States must support tough legislation and he must use the power of the White House to get the support of the usual chorus of defenders of the mega thieves of corporate corruption to vote to live up to their "tough on crime rhetoric" with mandatory minimum prison sentences. The shameful corporate culture of old boy relationships, where major banks led by Citigroup with J. P. Morgan, Bank

of America, Fleet Boston, Bank One and Wells Fargo, made billions of dollars of uncapitalized loans to WorldCom without any due diligence, but at the same time, cannot find in their corporate hearts a way to provide home mortgages to working families to own a home is disgusting.

The analyst, Mr. Jack Grubman from Salomon Smith Barney, with close ties to WorldCom and who recommended WorldCom as a good investment while WorldCom was on the brink of collapse, should be indicted. (He calls it synergy rather than conflict of interest). The founder, Mr. Ebbers, the Board of Directors and certainly the auditor of record, the now infamous Arthur Andersen, should have known and should be held responsible. Mr. Sullivan simply committed the simplest, most easily detectable accounting fraud. He lied about operating costs, hid debt and is still trying to justify operating costs as capital costs. Everyone should have known and I believe they did know.

I was alerted the principals we have subpoenaed today will take the Fifth Amendment, and that is their constitutional right to do so. However, I expect the Justice Department to determine if there was a conspiracy to commit fraud. I expect the Justice Department to go after WorldCom's auditor, the consistently insider conflict-of-interest wrongdoer, Arthur Andersen again. I expect Mr. Sullivan to return the $10 million retention bonus given to him. I expect the SEC and the Justice Department to delve into the sale of his WorldCom stock to determine if he benefitted from the inflated stock prices he created by his fraudulent accounting practices even at the risk of jeopardizing the completion of his multi-million dollar mansion. I also expect the Justice Department to examine Mr. Ebbers' WorldCom loans and stock options to determine if he, too, benefitted from the cooking of the books.

I demand SEC to exercise its authority to get into the details of the WorldCom fraud.

- $ What other operating expenses have been reported as capital expense?
- $ How can we protect the pensioners and how will MCI and other customers be protected?

The immoral and unconscionable practices of corporate America have been festering for a long time. Corporate America in general and some corporations such as Enron and WorldCom have gained power and influence by their connection to politicians by way of campaign contributions and cozy relationships. These same companies have enjoyed tremendous tax breaks and less regulation then they deserve. Corporate America has run wild with huge compensation for top executives, outrageous stock options, severance pay and personal loans. The conflict of interest of auditors and analysts is obvious, yet there are those who will argue, don't go overboard with regulation. Don't create criminal charges.

Many of us will be charged with being anti-business as we insist on jail time and tough prosecutions. However, I encourage this Congress and my colleagues to think about workers who deserve living wages, better health benefits, and protected pension plans. Think about the workers who cannot get a loan from the same banks that provided unsecured loans of billions of dollars to companies like WorldCom without due diligence and think about the very customers who are now expected to save WorldCom. There are those who would advise customers to stay with MCI. WorldCom is depending on customer earnings to repay loans and give bigger compensation packages. Some even suggest because of WorldCom's relationship to the Pentagon, government should save WorldCom. I say, "no." It is time to reign in

corporate America gone wild. There are small-time crooks and criminals convicted to hard time in prison for theft and crimes of several hundred dollars. Surely we can see the contradiction in our criminal justice system. How can we develop confidence on Wall Street and get respect and justice from the ordinary everyday citizen of America if we do not seize this obvious opportunity to clean up this corporate crime? The time is now, the responsibility is ours, and every member of Congress who has received contributions and whose campaigns have benefitted from corporate wrongdoing should return the money--both Democratic and Republicans.

Remarks of Melvin Dick
United States House of Representatives
Committee on Financial Services
July 8, 2002

Chairman Oxley, Congressman LaFalce, Members of the Committee:

I am Mel Dick. I am a graduate of the University of South Dakota. Upon graduation in 1975, I joined Arthur Andersen as a staff auditor. I was a partner at Andersen until I left Andersen on June 1 of this year. I have spent the majority of my career working with diverse telecommunications companies.

Beginning with WorldCom's fiscal year ended December 31, 2001, I became the engagement partner responsible for Andersen's audit of WorldCom. In addition to the year end audit, Andersen's work included quarterly reviews beginning with the quarter ending March 31, 2001, and including the quarters ending June 30, 2001 and September 30, 2001.

Andersen's audit report for WorldCom's 2001 financial statements was delivered on March 7, 2002, and WorldCom filed its 10-K report with the SEC on March 13, 2002. Andersen's review of WorldCom's first quarter 2002 was completed on May 15, 2002. On May 16, 2002, Andersen concluded its relationship with WorldCom and was replaced by KPMG.

On June 1, 2002, I resigned from Andersen. I am presently serving as Executive Vice President and Chief Financial Officer for an apparel company.

One week ago, on July 1, while I was on a business trip, I was contacted by counsel for the Committee and invited to attend today's hearing. Through my attorney I offered my full cooperation in the Committee's work and I agreed to attend this hearing voluntarily.

The Chairman's letter of invitation, faxed to my attorney on the night of July 3, states: "This hearing will focus on the recent announcement that WorldCom overstated profits and understated liabilities in the amount of $3.9 billion."

The Chairman's letter refers to the disclosure by WorldCom on June 25 that approximately $3.1 billion in expenses were improperly booked as capital expenditures in 2001 and an additional $797 million of expenses were improperly booked as capital expenditures in first quarter of 2002. The newspaper reports that I have read allege that senior financial management at WorldCom improperly transferred line costs expenses to capital accounts in the company's accounting records.

Let me state clearly and without any qualification that, prior to June 21, 2002, when Andersen was first contacted about this matter, neither I, nor to my knowledge, any member of the Andersen team had any inkling that these transfers had been made.

In fact, in connection with our quarterly reviews for March 31, June 30 and September 30, 2001, our year end audit at December 31 2001 and our quarterly review for March 30, 2002, the Andersen audit team specifically asked WorldCom senior financial management whether there were any significant top side entries. On each occasion, management represented to Andersen that there were no such entries.

The fundamental premise of financial reporting is that the financial statements of a company —in this case WorldCom— are the responsibility of the company's management, not its outside auditors. WorldCom management is responsible for managing its business, supervising its operational and accounting personnel, and preparing accurate financial statements. It is the responsibility of management to keep track of capital projects and expenditures under its supervision. The role of an outside auditor is to review the financial statements to determine if they are prepared in accordance with Generally Accepted Accounting Principles and to conduct its audit in accordance with Generally Accepted Auditing Standards,

which require that auditors plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Our audit and our reviews of WorldCom were performed by experienced audit professionals. Our audit plan was the product of a deliberative and diligent evaluation of a global telecommunications company with over $100 billion in assets.

As with any audit, we planned our audit of WorldCom in general reliance on the honesty and integrity of management of the company. One of the key elements of evidence all auditors rely upon are management's representations. As all auditors do, we also tested and, based on our tests, concluded that we could rely on the company's management processes and internal controls, including the internal audit function. We relied on the results of our testing and the effectiveness of these systems in planning and performing our audit. At the same time, we approached our work with a degree of professional skepticism, alert for potential misapplication of accounting principles.

Additionally, we performed numerous analytical procedures of the various financial statement line items, including line costs, revenues, and plant and service in order to determine if there were any significant variations that required additional work. We also utilized sophisticated auditing software to study WorldCom's financial statement line items, which did not trigger any indication that there was a need for additional work.

In performing our work, we relied on the integrity and professionalism of WorldCom's senior management, including Scott Sullivan, WorldCom CFO and David Myers, WorldCom Controller, and their staff.

If the reports are true that Mr. Sullivan and others at WorldCom improperly transferred line cost expenses to capital accounts so as to misstate the company's actual

performance, I am deeply troubled by this conduct. In addition, if reports are true that WorldCom's internal auditors discovered these entries, I would be very interested to know how and when they discovered these entries.

I do not know the specifics of what Mr. Sullivan did or directed others at WorldCom to do, and I have not had the opportunity to review the entries that are at issue here. I understand that Mr. Sullivan has acknowledged that he never told Andersen about the accounting he is said to have employed.

At this point, however, while I can explain our general approach to the WorldCom audit and explain generally the work that we did, I do not have enough information to comment on the entries that WorldCom senior financial management are said to have made, or how they were hidden from the Andersen auditors.

Mr. Chairman, I will answers any questions you or the members of the Committee may have for me at this time.

Testimony of Jack B. Grubman
House Committee on Financial Services
Hearing regarding WorldCom
July 8, 2002

Good afternoon, Mr. Chairman. My name is Jack Grubman. Thank you for your invitation to testify before the Committee today. I am a managing director in the U.S. Equity Research Division of Salomon Smith Barney. My area of research is the telecommunications services sector and I am the firm's senior telecommunications services analyst. I have been a telecommunications analyst on Wall Street since 1985. I began to cover WorldCom's predecessor company, LDDS, in 1990 and have covered the company called WorldCom since 1995.

Let me say at the outset that I am saddened by the events that have brought us here. WorldCom is a company that I have believed in wholeheartedly for many years. I am sorry to see investors suffer losses. I am sorry to see employees laid off. And I am distressed by the apparent fraud that the company announced 13 days ago. In addition, in hindsight, I regret that I was wrong in rating WorldCom highly for too long, though in this regard I note that I surely would have downgraded the company much earlier had I known the truth about its financial performance. Finally, I want to commend this Committee for stepping quickly to the plate to begin assessing what went wrong and what should be done to prevent such conduct in the future.

Let me also say that I am aware of speculation that I had advance knowledge about WorldCom's $3.8 billion earnings misstatement before my June 21 downgrade of the company. As I will describe in some detail in this statement, that speculation is categorically false. My

June downgrade -- actually my *fourth* downgrade of WorldCom since March 2002 -- was based solely on publicly available information. I had no advance knowledge of WorldCom's $3.8 billion accounting fraud.

The work of a research analyst. As an equity research analyst for the past seventeen years, my job has been to make judgments about the future prospects of companies in the telecommunications industry. Assisted by my research team, I render opinions and make forecasts about the industry and individual companies using publicly available information to develop financial models, earnings estimates, and price targets for the companies we follow. I also analyze industry trends, and seek to forecast the impact on individual stock prices of such variables as the overall health of national and local economies, regulatory policy and the supply and demand balance for telecommunications services. And, like all research analysts, I talk regularly to company managers, customers, suppliers, competitors and investors.

The importance of audited financial statements. The pivotal starting point for my work and the work of other analysts is the information publicly released by a company -- in particular, its audited financial statements and other SEC filings. Analysts must rely on the accuracy and completeness of such public SEC filings. Neither I nor any other analyst has the ability to conduct independent audits of the companies we follow. Analysts do not have access to internal company information such as audit trails, internal account entries, invoices or the like. In short, analysts are not auditors. Like ratings agencies and investors, we rely -- and are supposed to rely -- on the assurances of those whose job it is to prepare and certify a company's financial statements. If the public financial information on which we rely is wrong, our ultimate

judgments about a company will be flawed. Our judgments are only as good as the public information on which they are based.

In the case of WorldCom, I relied on the accuracy of its audited financial statements and other SEC filings just as I have relied on such documents for every other public company I have ever covered.

Let me say once again: I had no advance knowledge of any kind about WorldCom's accounting fraud. I first heard about it when it was reported late in the day of June 25 on CNBC.

My evaluation of WorldCom. As I said at the outset, I found WorldCom's announcement of accounting fraud to be extremely disturbing. WorldCom was, after all, a company I had rated highly for a number of years.

For the past seventeen years, I have held a consistent thesis that the newer, more nimble and entrepreneurial telecom companies such as WorldCom could successfully compete with and even outperform the entrenched industry giants. This thesis did, in fact, unfold for competitive long-distance providers such as WorldCom during the decade and a half after the 1984 AT&T divestiture. And I thought that passage of the Telecommunications Act of 1996 would allow my thesis to unfold with equal force in local telephone markets. More recently, in the mid-1990s, I amplified my thesis to include the notion of global spheres of influence where the most successful companies in the industry would be those that combined entrepreneurial drive with a scale and scope of "end-to-end" network assets and operations.

From the late 1990s, until a few months ago, I believed that WorldCom was the company best positioned in terms of assets, earnings and business model to outperform the industry over the long term. During that period, various factors led to my positive views about WorldCom,

including its ownership of an unparalleled array of "end-to-end" network assets on a global basis. As I noted in an April 9, 1998 research report, after WorldCom's merger with MCI, the company was the second largest long-distance carrier in the U.S., the largest Internet service provider in the world, the second largest carrier of international voice traffic in the world, the largest Competitive Local Exchange Carrier in the U.S., Western Europe, and Japan, and the largest U.S. provider of overseas private line networks. Moreover, it also had an impressive base of corporate customers, and reported consistently healthy profit margins. Finally, both WorldCom and MCI had the entrepreneurial culture of competitive upstarts, as compared to the slower, more staid incumbents like the regional Bells, with their monopoly birthright.

Others were bullish on WorldCom as well. WorldCom was a widely followed and widely held stock. Many others shared my bullish view of WorldCom, including other major Wall Street analysts, and sophisticated investors. Citigroup, the parent of my own company, invested over $300 million in WorldCom bonds. During the 1990s, WorldCom was one of the very best performing stocks in the broad Standard & Poor's 500 index.

Downgrading WorldCom during the past three months. However, beginning in March of this year, my published views on WorldCom became increasingly negative, as WorldCom disclosed the existence of an SEC accounting inquiry, reduced its earnings estimates, changed CEOs, suffered multiple rating agency downgrades, and drew closer to a restructuring that would likely have diluted the equity of existing shareholders.

On March 18, 2002, I increased -- which is to say worsened -- my risk rating on WorldCom from "medium" to "high" partly in response to a recently announced SEC accounting inquiry. On April 21, I downgraded WorldCom two levels from "buy" to "neutral," in response

to the company's announcement of reduced earnings. On May 9, I further increased my risk rating on WorldCom from "high" to "speculative." I also lowered my stock price targets several times during April, May and June and warned investors that the SEC inquiry was "overhanging" WorldCom's stock.

Thus by June 21, 2002, when I downgraded WorldCom again, this time one level, from neutral to "market underperform," I had already made several significant negative changes to my published views on the company, including especially my April 21 rating downgrade from "buy" to "neutral" and my risk rating changes from "medium" to "high" to "speculative."

June 21 downgrade of WorldCom -- reasons. My June 21 downgrade from "neutral" to "market underperform" was appropriate both in substance and timing. My research team and I undertook our review of WorldCom the week of June 17 in the ordinary course of business. As a matter of course, near the end of each quarter, we make a practice of reviewing all companies we cover to update our earnings model in preparation for what we call our "Model Book," which we publish in anticipation of quarterly earnings. Our review of WorldCom was undertaken in that context. During the same end-of-quarter review, we revised earnings estimates and in some instances revised risk ratings for several other companies as well.

Our downgrade was fully justified by the facts, as I explained in my June 21 research note. Standard & Poor's had further downgraded WorldCom's debt on June 17, and Moody's followed suit on June 20. In addition, I had concerns about (i) our reduced estimates of the company's earnings, (ii) continued softness in corporate spending on telecom services, (iii) the details and components of the $5 billion credit facility the company was seeking to negotiate, (iv) our view that the company would be compelled to recapitalize its balance sheet to reduce the

level of its debt in a manner that would severely dilute the equity of current shareholders, and (v) WorldCom's high relative valuation given its then current condition, compared to AT&T.

June 21 downgrade -- approval process. My June 21 downgrade went through Salomon Smith Barney's standard approval process. During the week of June 17, while I was in China, my research staff became convinced by the factors cited above that a downgrade was appropriate. They discussed their views with me, and I agreed. We then sought clearance from Management of the Research Department, as is required at SSB any time a ratings change is proposed. Following a conference call on June 21, senior executives in Research Management approved the downgrade. We also submitted the report for clearance to the firm's Supervisory Analysts, whose approval is required for any research report published by SSB.

June 21 downgrade -- blast voicemail. In short, my June 21 downgrade was a measured, deliberative action, taken in accordance with standard SSB compliance procedures, and based entirely on publicly available facts -- not on any knowledge or suspicion about the announcement WorldCom was to make four days later. Even so, after publishing the note I became concerned that the market might interpret it too negatively, and I thus sent out a "blast voicemail" on June 24 to make clear that I believed the company would stay solvent, that it had substantial assets and a lot of customers, and that I expected things would stabilize. This is obviously not the sort of communication one would send out if he had advance warning that the wheels were coming off this company 24 hours later.

Others downgraded at similar times. My gradual downgrades of WorldCom between March and June were consistent with the actions of many other Wall Street firms as such as Goldman Sachs, Lehman Brothers, Bear Stearns, Merrill Lynch and J.P. Morgan and Sanford

Bernstein -- a pure research house that does no investment banking. Sanford Bernstein and Bear Stearns did not move off their "buy" ratings until after the company's announcement of accounting fraud.

The role of WorldCom's fraud in my analysis. It is critical to understand that, but for WorldCom's fraud, I would have seen a more dire picture much earlier. My positive view of WorldCom depended on the continuation of WorldCom's healthy profit margins. If I had seen how badly and quickly those margins eroded, it would have shaken my overall view of WorldCom's long-term prospects and I would undoubtedly have downgraded WorldCom much earlier than April 2002.

One remarkable aspect of this fraud by WorldCom is that the company went to great lengths to create the appearance of transparency with respect to its purported capital expenditures. WorldCom appeared to meet the guidance for capital expenditures it had put out at the beginning of 2001, masking any hint that operating expenses were being improperly recorded as capital expenditures. Moreover, in each of its regular analyst calls, WorldCom provided what appeared to be a detailed breakdown of its capital expenditures in various categories, instilling in analysts and investors a false sense of confidence in those capital expenditure numbers. Moreover, WorldCom made no attempt to hide its cash outlays. And its consolidated margins for "earnings before interest, taxes, depreciation, and amortization" (EBITDA) were in line with those of its chief competitor. These facts taken together all helped ensure that WorldCom's mishandling of expenses would not be uncovered by analysts, investors or ratings agencies.

Interactions with management. Before closing, I'd like to briefly address two additional issues that have been the subject of considerable comment. The first concerns my

relationships with management of the many companies I cover. I make a point of trying to develop good working relationships with management. Sometimes, working relationships of this kind include a social element, whether an occasional dinner or other outing, as is true in virtually all walks of life. Some think such relationships are inappropriate for research analysts. Respectfully, I disagree. As I see it, part of my job is to know how an industry is developing and to engage in a serious, active dialogue with the people who make the decisions in order to put SEC filings and audited financials into context and to assess management's capability to execute its plans. There's no question that you have to manage these relationships carefully, and it is critical not to let your own judgment get clouded. But if you strike the right balance, your opinions will be more informed.

Relationship with investment banking. The second issue concerns my relationship with investment banking. It is the nature of the business that companies seeking to raise capital by issuing securities look for a firm with both strong investment banking ability and a strong research reputation. This should never mean that a research analyst alters his genuinely held view about a company in order to win investment banking business, but it does mean that companies looking to issue stocks will naturally be more inclined to choose underwriters whose research analyst is a credible voice to investors and who tends to have a positive view of the company. Conversely, if a company knows that the research arm of a firm views it negatively, the company will generally go elsewhere, since these negative views will undermine the potential success of the underwriting.

In my case, as I outlined above, I have had a consistent investment thesis for more than a decade, which guided my view of which companies were likely to be the winners and losers in

the telecom future. As you would expect, when I form a favorable opinion on a particular company, the investment bankers have found it easier to convince that company to retain our firm for investment banking transactions, and the converse is true as well. The investment bankers found my opinions on many (but not all) CLECs, WorldCom and Global Crossing helpful to gaining investment banking business, but found my views on companies like 360 Networks, Sprint, and many of the regional Bells to be an impediment. Through it all, I have listened to investment bankers, when appropriate -- as I listen to all market participants, as appropriate -- in order to understand companies and the factors that drive their performance, but I have always formed my own independent opinions. Right or wrong, I have always called them as I saw them.

Conclusion. Research analysts at Salomon Smith Barney are taught from the day they start that the integrity of their research product is their lifeblood. We are taught that the analyst's most valuable asset is his reputation with investors. We are taught that any analyst who squanders that reputation with investors to curry favor with any interested party is pursuing a fool's errand. I certainly have made mistakes. In retrospect, I regret staying with my point of view for too long. For most of the last decade, I was right and I was roundly praised, and now I've been wrong and am being roundly criticized. That is the nature of this business. Through it all, I have always written what I believed. I have always called the shots as I have seen them.

Thank you for the opportunity to appear today and I will be happy to answer any questions.

STATEMENT OF

BERT C. ROBERTS

CHAIRMAN OF THE BOARD

WORLDCOM, INC.

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

JULY 8, 2002

My name is Bert Roberts. I am the Chairman of WorldCom's Board of Directors.

First, I agree with John Sidgmore's comments. The accounting irregularities that are the subject of today's hearing are an outrage to me. To my mind, the failure of our outside auditors to uncover them is inconceivable. That said, it is important to emphasize that our company's internal controls brought the problem to light. I commend our internal auditing group not only for their discovery of the problem, but also for having the fortitude to bring this matter forward to the Board's Audit Committee.

When I first learned of a potential accounting problem on June 20, 2002, I was stunned. My emotions ran the gamut, from disbelief to concern to anger. When the problem was

confirmed and brought to the Board's attention, action on the part of the company was swift and decisive. The principal, specific actions taken by the Board after being apprised of the situation are summarized in a statement we filed with the Securities and Exchange Commission (SEC) on July 1, 2002, a copy of which is attached to John's testimony.

At this point, we have more questions than we have answers. Let me assure the American people and the members of this Committee that we are absolutely determined to get to the bottom of this. We will work with Congress, with regulators, with the Department of Justice and with independent investigators to resolve all issues associated with these accounting irregularities, as well as to develop standards and systems to prevent this from happening again, at WorldCom or anywhere else. We must. Restoring public trust in our company -- and in the marketplace – demands it.

To that end, William McLucas has been retained to conduct an independent investigation. Mr. McLucas is a former Chief of the SEC's Enforcement Bureau. His integrity and competence ensures that this investigation will enable us to know exactly what happened, when and why. Then we can take all of the steps necessary to prevent any similar future occurrences.

Secondly, I would like to amplify something else John mentioned: WorldCom is a great company that we will do everything in our power to save. I have spent nearly thirty years trying to open telecom markets to competition – originally at MCI and, for the last few

years, at WorldCom. No other company on the planet has the legacy that MCI, now a part of WorldCom, does in promoting competition and in advancing the Internet:

- Unlike every other major telecom firm, our company is the only one that had to compete for – and win – every customer we have. Unlike many of our competitors, we were never a monopoly.

- We have consistently beaten our competitors in the marketplace and, as a result, we have the privilege of serving over 20 million customers. Today we are:

  - The second largest long distance company in the U.S.;
  - The largest competitive provider of local telephone services;
  - The largest carrier of international traffic; and
  - The world's biggest Internet backbone provider.

- We have world-class employees whose great ideas and marketing savvy have produced – year in and year out – innovative services and consumer savings. Savings may be the ultimate measure of our success and our continuing value to the marketplace. Since MCI introduced competition to the old Bell System, residential consumers and business users have saved many tens of billions of dollars.

The last thirty years in the telecom business have been tumultuous. Truly, we have been witness to a revolution. In the process, we've seen, and had to manage through, many ups and downs. Never before, though, has this company faced a greater challenge. But never before has our resolve been greater.

With your support, we will meet this challenge. We will deal with this matter openly, expeditiously and responsibly to restore trust in our corporate and financial institutions – to the satisfaction of both government officials and the American people. And we will rebuild the value of this great company and ensure its long-term viability for our customers, our employees, our lenders and our shareholders.

STATEMENT OF

JOHN W. SIDGMORE

PRESIDENT & CHIEF EXECUTIVE OFFICER

WORLDCOM, INC.

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

JULY 8, 2002

My name is John Sidgmore and I am the President and Chief Executive Officer of WorldCom, Inc. About two months ago, when I agreed to take over as CEO, it was clear that the company faced significant challenges. But I never imagined what was in store for us.

Since WorldCom's public announcement on June 25, 2002 that the company misstated its earnings for 2001 and the first quarter of 2002, there's been an understandable outpouring of anger from every quarter of American society. While the misdeeds we uncovered occurred before I became CEO, I want to apologize on behalf of everyone at WorldCom. And I want to underscore that WorldCom's new management team — and our more than 60,000 employees — share the public's outrage over these events.

I cannot change the past. But I am responsible for what we do now and in the future. In this statement, I will outline a number of important steps that we have already taken and that we will take in the coming months. Let me remind you at the outset, however, that WorldCom uncovered this problem internally. In effect, we audited our external auditors -- we found what they missed -- and promptly brought this matter to the attention of the Securities and Exchange Commission (SEC). Looking ahead, my actions will be guided by my commitment to restore public confidence in this great company and to operate WorldCom according to the highest standards of ethics and integrity.

One of the most important steps we can take is to make sure that past transgressions are fully investigated and that wrongdoers are punished. Then we can move forward in an open and honest manner. We are therefore cooperating fully with the various official investigations – by the SEC, the Department of Justice and the Congress -- to ensure that those responsible are brought to justice.

For example, on July 1, 2002, we filed a written statement with the SEC that included a summary of key events, known to us at that time, that led to our June 25th announcement. A copy of the statement we provided to the SEC is attached. As you will note, it detailed how the accounting irregularities were recently discovered by our internal audit team, led by Ms. Cynthia Cooper. The kind of initiative demonstrated by our internal audit group is to be applauded and will continue to be encouraged. Our SEC statement also documents

actions taken by our Board of Directors when the matter was brought to its attention. The Board moved swiftly and decisively. Its actions included terminating our Chief Financial Officer and promptly reporting the matter to the SEC and to the public.

Our SEC filing was not, of course, the last word. I had a productive telephone conversation with SEC Chairman Harvey Pitt and his staff last week. We offered to clarify certain points in our July 1 statement and reiterated our commitment to work closely with the Commission's staff as its own investigation moves forward.

Many questions still remain. We won't know the answers until the conclusion of the pending investigations. We will continue to cooperate fully with the various agencies and the Congress to answer those questions.

WorldCom is being proactive. With the full support of WorldCom's new management team, the company's non-management directors retained William McLucas, former Chief of the Enforcement Division of the SEC, to perform an independent investigation of the facts and circumstances underlying the transfers. He will investigate not only our past and current management team, but also our Board regarding any individual involvement. His report will identify the wrongdoers and it will clear those who had no involvement. Let me emphasize that Mr. McLucas' investigation also has a broader purpose; namely, to enable us to put into place new or modified internal procedures to prevent any recurrence of this type of event.

If we are to be a model for corporate behavior going forward, we must be transparent and above reproach. Therefore, in our July 1 SEC statement, we clearly stated that we were examining whether additional earnings restatements might be required for periods going back to 1999 with respect to the accounting for reserves established by the company. We are committed to completing this analysis, with the assistance of our new external auditors, KPMG, at the earliest possible date and to announcing the results of that analysis promptly.

Through these and other steps, we will restore public trust in WorldCom. While our reputation has suffered a tremendous blow, ours is a great company that the new management team will do everything in our power to save.

Millions of people have a real stake in WorldCom's survival – our customers, our employees, our lenders, our shareholders, and our suppliers. But it goes beyond that: the United States itself has a major stake in our survival. We play a vital role in America's telecommunications infrastructure:

- WorldCom is a strong, innovative company with tremendous assets. We have annual revenues of more than $30 billion, and even after our recent layoffs, we have more than 60,000 employees.

- WorldCom has more than 20 million customers. On the residential side, our MCI phone service handles 70 million phone calls *every weekend alone*. And tens of thousands of businesses depend on our services to support their mission-critical applications.

- WorldCom is the largest Internet carrier in the world. Our operations provide Internet services to some 100 countries on six continents.

- WorldCom is a provider of network services for critical applications for the United States Government. These applications include the provision of customer service to 80 million Social Security beneficiaries, air traffic control applications for the Federal Aviation Administration, network management for the Department of Defense, and critical data network services for the U.S. Postal Service. In addition, WorldCom provides long distance voice and data communications services for the House, the Senate, and the General Accounting Office. Our company provides those same kinds of services for virtually every government agency under its FTS2001 contract. In addition, WorldCom provides support for law enforcement and homeland security agencies, as well as agencies concerned with national security.

In other words, WorldCom is a key component of our nation's economy and communications infrastructure. Both commercial and national security interests rely upon WorldCom's operations continuing without disruption. Let me assure this

Committee that WorldCom is honored by the faith and trust placed in us by our customers, large and small, public and private. We have earned their business by providing them superior pricing and service. We intend to keep their business by continuing to provide them with unsurpassed quality and value.

Furthermore, WorldCom's presence ensures competition in the rapidly consolidating telecom industry. No other company's legacy matches ours in terms of promoting competition and delivering its benefits to consumers and businesses in both pricing and product innovation. WorldCom is one of the last hopes for America to realize the intended benefits of the 1996 Telecom Act.

We are committed to our company's survival. I have been fighting hard to keep the company operating at full speed despite the issues that now surround us. Although we have significant cash on hand, we are in close communications with our lenders to secure replacement lines of credit.

We are also streamlining the business by selling non-core assets and taking other steps to raise capital and trim expenses, allowing us to focus on our core business and our customers' needs. When all is said and done, the best way to rebuild shareholder value, serve our customers, save jobs, and promote our nation's interests is to have an ethical and profitable business.

Today, WorldCom needs the support, understanding and patience of our customers, our suppliers, our lenders and the American people. And we need your support. We will continue to be straight about any problems we may discover and act aggressively to solve them.

Mr. Chairman and members of the Committee, we will work hard to regain your trust and that of the American people, as well as to rebuild the value of the company. We will return your faith in us by making a significant difference in the marketplace – providing industry-leading telecom services and unsurpassed value to consumers and businesses everywhere.

REDACTED

PRIVILEGED

STRICTLY CONFIDENTIAL -- NOT FOR CIRCULATION COMMITTEE MEMBERS AND STAFF ONLY

-----Original Message-----
From: Grubman, Jack B [EQRE] [mailto:jack.b.grubman@citigroup.com]
Sent: Monday, June 24, 2002 10:42 AM
Subject: SSB Bond Research - WorldCom Inc.

Good afternoon,

Our bond analyst, Robert Waldman, published a WorldCom note, which we thought would be of interest to our clients. Please see attached.

<<WCOM_0624.pdf>>

Cheryl Cua
Salomon Smith Barney
Telecom Services Equity Research
ph: (212) 816-3371
email: cheryl.cua@citigroup.com

> IMPORTANT DISCLOSURES
> The # symbol signifies that within the past 12 months, Salomon Smith Barney ("SSB"), including its parent, subsidiaries, and/or its affiliates ("the Firm"), has acted as manager or co-manager of a public offering of this company.
> For important disclosures on the companies recommended in this report, please refer to research reports and notes that have been published on or after June 3, 2002.
> Guide To Investment Ratings: RATING is a guide to the expected total return over the next 12-18 months. The total return required for a given rating depends on the degree of risk (see below) in a stock. The higher the risk, the higher the required return. A Buy (1) rating indicates an expected total return ranging from +15% or greater for a low-risk stock to +30% or greater for a speculative stock. Outperform (2) indicates an expected total return ranging from +5% to +15% for a low-risk stock to +10% to +30% for a speculative stock. Neutral (3) indicates an expected total return ranging from -5% to +5% for a low-risk stock to -10% to +10% for a speculative stock. Underperform (4) indicates an expected total

HR 000993

Mike Salsbury

From: Scott Sullivan
Sent: Monday, June 24, 2002 12:14 PM
To: Mike Salsbury
Subject: Fw: Rumors of the Day

Scott Sullivan

-----Original Message-----
From: Waldman, Robert [FI] <robert.waldman@citigroup.com>
To: Sullivan, Scott <Scott.Sullivan@wcom.com>; Mayer, Susan <Susan.Mayer@wcom.com>
Sent: Mon Jun 24 10:00:17 2002
Subject: Rumors of the Day

Things are nuts again, latest rumors are that WCOM has an undisclosed $3 billion off balance sheet liability and that by not paying on the MCI pfd., the company has no ability to upstream cash. I can not over emphasize how important communication is with the market, even if there is not anything new it still gives the market access to you.

Bob

SALOMON SMITH BARNEY
A member of citigroup

Corporate Bond Research
High Yield Notes

June 24, 2002

WorldCom, Inc. (WCOM)

Senior Debt Rating: B1/B+

Waldman, Robert A. (212) 816-8716
robert.waldman@citigroup.com

Mitchell, Jr., Henry (212) 816-8794
henry.mitchell.jr@citigroup.com

Davey, Justin (212) 816-1106
justin.davey@citigroup.com

Haym, Louis H. (212) 816-0968
louis.h.haym@citigroup.com

Clarification on WCOM Report

Opinion

We want to clarify a couple of statements to the bond market made in a recent research report by Jack Grubman on WorldCom, Inc. (WCOM) (B1/B+) dated June 21, 2002.

First, bondholders should not be alarmed by Grubman's characterization on the state of WCOM's bank negotiations. His statement was a clarification for equity investors. The state of WCOM's bank negotiations is already known by bondholders who have been following the negotiations closely. Nothing has changed. To reiterate, the proposed $5 billion senior secured bank facility is expected to be negotiated as follows:

1) An existing $1.6 billion term loan due 2006, which is undrawn;

2) An existing $2.65 billion 364-day facility, currently drawn and which WCOM is currently in negotiations with its banks to extend the term beyond 2003; and

3) New money of $750 million, of which approximately $400 million has already been committed by WCOM's lead banks

We would like to emphasize that the proposed facility, as detailed above, has been the expectation for bondholders for quite some time. The report to the equity market was meant to provide an update to a group of investors who have not followed the bank negotiations as closely.

Second, one of the major points of the report is that Grubman is concerned about a possible recapitalization that would dilute equity investors in order to address leverage issues. With this in mind, we agree that WCOM can stay the course and survive as a long-term viable entity without a Chapter 11 restructuring. Chapter 11 is not a strategic alternative for WCOM due to the risk of potential churn on WCOM's key corporate and government customers. Chapter 11 restructurings are best served by entities that do not have any alternative and whose customer base is not meaningful. When Grubman talks about recapitalization, it does not imply Chapter 11. What Grubman was referring to was some form of equity dilutive initiative whose purpose would be to reduce leverage on the balance sheet, which does make sense once the bank negotiations have been completed.

As a result, our view on the debt has not changed. We continue to be buyers of WCOM's 2003 and 2004 paper as we judge that WCOM has adequate liquidity to meet its short-term financing needs. However, our view remains the same for the long-end of the curve, as bonds with maturities after 2004 will remain volatile as a result of the equity like risk inherent in those extended maturities.

ADDITIONAL INFORMATION AVAILABLE UPON REQUEST

Salomon Smith Barney ("SSB"), including its parent, subsidiaries and/or affiliates (the "Firm"), may make a market in the securities discussed in this report and may sell to or buy from customers, as principal, securities recommended in this report. The Firm may have a position in securities or options of any issuer recommended in this report. An employee of the Firm may be a director of an issuer recommended in this report. The Firm may perform or solicit investment banking or other services from any issuer recommended in this report.

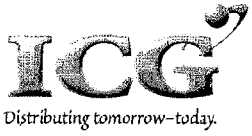
Within the past three years, the Firm may have acted as manager or co-manager of a public offering of the securities of any issuer recommended in this report. Securities recommended, offered, or sold by the Firm: (i) are not insured by the Federal Deposit Insurance Corporation; (ii) are not deposits or other obligations of any insured depository institution (including Citibank); and (iii) are subject to investment risks, including the possible loss of the principal amount invested.

Although information has been obtained from and is based upon sources the Firm believes to be reliable, we do not guarantee its accuracy and it may be incomplete or condensed. All opinions and estimates constitute the Firm's judgement as of the date of the report and are subject to change without notice. This report is for informational purposes only and is not intended as an offer or solicitation for the purchase or sale of a security.

Investing in non-US securities by US persons may entail certain risks. Investors who have received this report from the Firm may be prohibited in certain US States from purchasing securities mentioned in this report from the Firm; please ask your Financial Consultant for additional details.This report is distributed in the United Kingdom by Salomon Brothers International Limited, Citigroup Centre, 33 Canada Square, Canary Wharf, London E14 5LB, UK. This material is directed exclusively at market professional and institutional investor customers and is not for distribution to private customers, as defined by the rules of the Financial Services Authority, who should not rely on this material. Moreover, any investment or service to which the material may relate will not be made available to such private customers. This material may relate to investments or services of a person outside of the United Kingdom or to other matters which are not regulated by the Financial Services Authority and further details as to where this may be the case are available upon request in respect of this material. If this publication is being made available in certain provinces of Canada by Salomon Smith Barney Canada Inc. ("SSB Canada"), SSB Canada has approved this publication. This report was prepared by the Firm and, if distributed in Japan by Nikko Salomon Smith Barney Limited, is being so distributed under license. This report is made available in Australia through Salomon Smith Barney Australia Securities Pty Ltd (ABN 64 003 114 832), a Licensed Securities Dealer, and in New Zealand through Salomon Smith Barney New Zealand Limited, a member firm of the New Zealand Stock Exchange. This report does not take into account the investment objectives, financial situation or particular needs of any particular person. Investors should obtain advice based on their own individual circumstances before making an investment decision. Salomon Smith Barney Securities (Proprietary) Limited is incorporated in the Republic of South Africa (company registration number 2000/025866/07) and its registered office is at Citibank Plaza, 145 West Street (corner Maude Street), Sandown, Sandton, 2196, Republic of South Africa. The investments and services contained herein are not available to private customers in South Africa. This publication is made available in Singapore through Salomon Smith Barney Singapore Pte Ltd, a licensed Dealer and Investment Advisor.

Salomon Smith Barney is a registered service mark of Salomon Smith Barney Inc. Schroders is a trademark of Schroders Holdings plc and is used under license. Nikko is a service mark of Nikko Cordial Corporation. © Salomon Smith Barney Inc., 2002. All rights reserved. Any unauthorized use, duplication or disclosure is prohibited by law and may result in prosecution.

A member of citigroup



425 S Sixth Avenue
City of Industry, CA 91746
626-923-1133
fax 310-388-5245

2 July 2002

The Honorable Michael G. Oxley
Committee on Financial Services
US House of Representatives
Washington, DC 20515

Re: MCI / WorldCom

Dear Chairman Oxley:

We are a small entity focused on wholesaling computer peripherals throughout the United States. Our success is founded on personal service provided to our customers by quality service and regular communications, the bulk of which are by way of telephone.

ICG, ("The Company") signed a contract with MCI / WorldCom ("MCI") in January 2000. That contract called for rates and discounts because of term and volume commitments. It was noted, after a careful review of the billing during the latter part of 2000, that MCI was billing at rates higher than agreed to. The Company had been paying the invoiced rates. When this was brought to the attention of the sales representative he promised to look into it and make the corrections, nothing was done. We prepared detailed spreadsheets showing the overcharges in detail, submitted them in early 2001 and were told that the credits would be forthcoming. We did receive a credit of $33,000 representing marketing funds, but the $38,215.35 of credit due at that time for over-billing were not forthcoming.

In March we had a face to face meeting with Shannon Harris, the Manager-Account Relations San Jose Accounts, we explained the issues, she took notes and asked for some time to investigate, I agreed to give her thirty days, after all it had been fifteen months now, what was another thirty days going to hurt. At the end of the thirty days she had a list of credits that MCI was going to credit to our account on the May billing.

When the May billing arrived, without the credits, we were told we needed to discuss the matter with John Barrett, Vice President Sales Support, located in Southern California. He then explained that the credits were being reviewed and they would appear on the June or July billing. When they did not, we figured it was time to move it to the top, we contacted Wayne Huyard, Chief Operating Officer of MCI via e-mail (attached is a copy). The amount in question was approximately $63,000, since the over-billing had continued. Contact brought immediate response from John Barrett, in not so pleasant a mood, we assumed he had received communication from Mr. Huyard or one of his staff. He assured us he was on top of the issue.

425 S Sixth Avenue
City of Industry, CA 91746
626-923-1133
fax 310-388-5245

In November we wrote to Mr. Huyard indicating that silence was not an indication of satisfaction. His reply was "I'm sorry for the delay". MCI's total lack of concern for over-billing and their delayed response time was to us a clear indication that the problems were not at the lower levels of the organization, it was, and still is, their corporate policy. Even today we are being billed for circuits that we requested be terminated on January 5th, 2002. The matter is far from being resolved and I am sure that it will end in a court of law.

In the shareholder's zeal and zest for ever increasing stock prices and the pressure applied with large rewards for performing managers, nobody is monitoring the veracity of the number they are posting. Having once practiced as a CPA, I am sad to say that they too have been caught up in the frenzy, so many clients crying for their services and so much money to be made by issuing reports. Because of the size and scope of organizations like MCI, there is no way to monitor a few billion in over-billing, tens of thousands here, tens of thousands there and nobody will ever know, just immaterial amounts, unless summed together and recognized in one accounting period.

We do not pretend to know the answer. We do know that we have spent hundreds of hours trying to correct what was once a small problem that grew because of MCI's corporate policy to delay, demand documentation, and pass the baton of responsibility hoping that we would just surrender. We could and would have spent our time improving internal processes, making our business more productive and profitable and thus paying more income taxes.

We beg of you to continue the pressure on entities like this, make sure that the ones that come behind know, without a doubt, the penalty is much greater than the opportunities if not caught.

We thank you for your attention, best of luck.

David G Thompson, CFO, CIO

David Thompson

From: David Thompson
Sent: Friday, August 03, 2001 2:50 PM
To: 'wayne.huyard@wcom.com'; 'victoria.harke@wcom.com'; 'joyce.dorris@wcom.com'
Subject: Resolution to a long standing set of issues

Please pardon my interruption to your day, we are but a small customer, but have a problem that your staff can't seem to solve.

We have been over billed for over 18 months. We have brought this to the attention of numerous people and they continue to drag there heals. I am beginning to feel that there is a conspiracy to over bill, over report income, and deceive the public, your customers, your investors and the many hard working people who do care about their jobs.

Please have someone look into our issues, $63,000 may seem small, but to a small company like ours it is substantial.

I will not begin contacting the PUC for the state of California for one week, then I will launch a full press on the PUC, the Attorney General and the SEC.

Thank you

David Thompson, CFO
International Computer Graphics, Inc.
510-471-7000 x 375

-----Original Message-----
From: Shannon Harris [mailto:Pshannon.Harris@wcom.Com]
Sent: Friday, August 03, 2001 9:23 AM
To: 'Mahmoud H. Hiyasat'
Cc: 'David Thompson'; 'Denny coate (E-mail)'; 'Fretias McGary (E-mail)'; 'John Barrett (E-mail)'; 'KRISTIAN HOHENBRINK (E-mail)'; 'Lynn F. Coker (E-mail)'; 'Mike Ahmar'
Subject: RE: Credits

John has been working on the credits and I have updated the access and discounts to reflect through July and August.

The addendum to the contract which will automatically apply the new discounts will not be reflected until the August invoice. That is why I have already calculated for July and August.

The approval process is sometimes cumbersome and lengthily.

John has been focusing on these credits and is trying to push all of them through.

He is on vacation today and unavailable. I do not have any further status for you at this time.

PSH
408 533 4780

-----Original Message-----
From: Mahmoud H. Hiyasat [mailto:hiyasatm@ICG.com]
Sent: Friday, August 03, 2001 5:25 PM
To: 'Shannon Harris'
Cc: David Thompson; Denny coate (E-mail); Fretias McGary (E-mail); John Barrett (E-mail); KRISTIAN HOHENBRINK (E-mail); Lynn F. Coker (E-mail); Mike Ahmar; Shannon Harris
Subject: Credits
Importance: High

Hi Shannon,

I sent an e-mail to John Barrett, and did not get any response back. The credits we discussed have not been applied to our account yet, to top this off we have to go through the whole process for July and August; assuming we get the credits by September bill.

Please let us know that status of the Credits. The contract is nearing its end and if we are to continue with MCIWorldcom this issue must first be resolved

Thank you

Mahmoud H. Hiyasat
ICG Inc.
(510) 471-7000 ext 336
<http://www.icg.com/>

David Thompson

From: David Thompson
Sent: Thursday, November 01, 2001 1:49 PM
To: 'wayne.huyard@wcom.com'
Subject: FW: Outstanding Credits

Just so you are aware.

-----Original Message-----
From: Barrett, John [mailto:john.barrett@wcom.com]
Sent: Thursday, November 01, 2001 1:04 PM
To: 'David Thompson'
Cc: Harris, Pshannon
Subject: RE: Outstanding Credits

David,

We did review your bill and found that most of the credits did not hit. They are going through an audit process. I have escalated and will monitor it daily to be sure they get through and show up on your next bill. I apologize for the delay but to reiterate you may deduct these credit amounts from your billing and only pay the undisputed portion of your bill. You will not be penalized for doing that.

We did verify that the Redmond and Mapleshade circuits were disconnected as we indicated in September. Some of the Redmond credits showed up on your October bill. Mapleshade still billed and we are getting that fixed.

Please let me know if you have any other questions.

John

-----Original Message-----
From: David Thompson [mailto:thompsond@icg.com]
Sent: Friday, October 26, 2001 9:44 AM
To: Huyard, Wayne E.; Barrett, John; Harris, Pshannon
Cc: Mike Ahmar; Sami Aljanabe
Subject: Outstanding Credits

I just received the bill date 10-25-2001 for MCI WorldCom services and to my "surprise" there were no credit for the overcharges.

Three questions:

1. Will our bill ever reflect the credits? If yes, when? Would you forward a copy of the internal credit memo with all signatures?
2. Who is responsible? Should there be a termination? In our company it would have happened on the first e-mail to the President.
3. What address and name do you want me to use for legal service?

Thanks

David Thompson

From: Wayne Huyard [wayne.huyard@wcom.com]
Sent: Thursday, November 01, 2001 3:34 PM
To: 'David Thompson'; Wayne Huyard
Subject: RE: Outstanding Credits

I'm sorry for the delay.

David Thompson

From: Barrett, John [john.barrett@wcom.com]
Sent: Monday, November 26, 2001 2:12 PM
To: 'thompsond@icg.com'
Cc: Harris, Pshannon
Subject: Credits

David,

I want to give you an update on where we are. We have good news and bad news. First, the good news...

We have disconnected Mapleshade T1, the last of the late disconnects, and issued credits back to the disconnect date of 9/21/01 on your November bill. At this point, except for credits to post, your billing on your account should now be correct. Please advise if you do not agree that your billing is correct for November. We have also posted 3 of the 5 credits. We posted on 11/15/01 the credits for $2750 Install charges and $2742.38 vendor wiring charges on account 99256576. We also posted the $15,840.45 credit listed on your spreadsheet for late disconnects on account 01899160. You will not see this on your current bill as it missed the cycle. However, they will show up on your December bill. We can also forward you screen prints as needed for these credits to prove they are posted if you need that.

The bad news is that we are still auditing 2 credits...the $12,424 Access discount credit and the $16,088 credit for Port charges prior to turn up of the host. We are confident this will be posted on the December bill. Again, you may deduct these amounts from any amount due on your bill as disputes.

Please let me know if you have any questions. I know it is slow but we are making progress and will have complete resolution to these issues shortly. Thank you for your patience.

John

The Telecom Manager's

Voice Report

News and guidance for end users on getting the best rates, services and equipment

This Issue...

May 20, 2002
Vol. 23 No. 10

Publisher Jonathan Stern prepared this report with contributions from reporter Peg Brickley.

- Are Credits Paid in a Bankruptcy? 2
- How to Keep Bills Offset, Down & Out. 3
- Little Satisfaction for Ex-WorldCom Users. 3
- How Cowboy Culture Led to Practices 4
- 7 Practices that Block Genuine Refunds... 5
- Technicalities Behind WorldCom's Plight. 7
- Lawsuits Point to Titanic Problems 8

Plus: Documentary Support on p. 5, 6 & 8

Telecom question or comment?
Contact publisher Jonathan Stern
301-287-2604 or at
jstern@ucg.com

Frustrating Policies Obstruct Refunds

WorldCom Holds at Least $1.8 Billion in Billing Credits

WorldCom has surrounded itself with a maze of policies and procedures that severely obstruct enterprise end users from collecting between $1.8 billion and $3.5 billion in credits for billing errors, according to internal WorldCom documents, lawsuits, letters and e-mails to customers obtained by *Voice Report.*

WorldCom declined to say how much it holds in disputed billings and non-issued credits. But in a prepared statement, WorldCom notes that it subtracts credits and errors from revenue before it's reported. It gave no proof of this, saying it's not required to report it. But accountants say it's not a generally accepted practice to subtract credits – just sales returns and discounts – indicating that WorldCom knows its billing problems are massive. WorldCom also did not say it actually had refunded any subtracted credits. On Wednesday, WorldCom replaced its auditor, scandal plagued Arthur Anderson, with KPMG.

WorldCom revenue would be so inflated by the practice – some users say they are owed up to $250,000 in credits to which the carrier has agreed or have waited years for resolution – that it appears to use the credits as a buffer against bankruptcy, speculate stock analysts who study WorldCom. It also is under investigation by the Securities & Exchange Commission (SEC). WorldCom says it is in no danger of bankruptcy, but here are the numbers:

In its 2001 annual report to the SEC, WorldCom notes it set-aside $1.08 billion as an allowance for doubtful accounts. But this is for unpaid bills it can't collect, not already banked charges it must refund because they were billed in error. Holding back credits thus would give WorldCom an interest-free cushion that analysts estimate at 10% of revenue, or $3.5 billion based on 2001 revenue.

Even if you include only commercial voice (domestic LD, local), data (ATM, frame relay) and international services – excluding small business, Internet and consumer revenue – the number would be $1.82 billion in credits due to business users. And if the entire bad debt reserve of $1.08 billion were applied only to disputes with business users (the reserve includes consumer accounts), WorldCom still would be *at least* $740 million short, a siphon on future earnings.

"It could be a hell of a lot bigger than 10%," warns Drake Johnstone, a stock analyst with Davenport & Co., Richmond, Va. "Our work validates it," adds Richard Valencia, CEO of San Diego telecom audit firm ProfitLine.

The Horror: WorldCom Users Depict Frustrating Quagmires

What's unusual is not WorldCom's 10% error rate. AT&T users also say they have frustrating long-term billing issues, but Ma' Bell has been open about why they occur and how to resolve them (VR 11/19/01, VR 5/22/00). By contrast, WorldCom is distinguished by its unwillingness to award credits, numerous users say. Therein lies the problem.

What Happens to Billing Credits in a Bankruptcy?

WorldCom CEO John Sidgmore says a bankruptcy filing is not in the cards. But if WorldCom did file for Chapter 11 protection from its creditors, you'd be unlikely to fully recover outstanding credits or amounts in dispute, and you'd have to wait a long time to get any money at all, says bankruptcy attorney Jim Widdon of Atlanta. While a company in Chapter 11 is permitted to pay ongoing business expenses – like an electric bill – debts that don't threaten its survival are set aside in order of importance, he says. That means taxes and secured creditors who can claim tangible assets like equipment come first, he says. An unsecured creditor – users awaiting credits agreed upon **in writing** likely would fall into this category – would have to wait until the others are paid. **But:** determining the value of a credit would be an "accounting nightmare," Widdon warns. And forget about bills in dispute. Tips:

- **Demand a risk premium** in negotiations for a new contract, urges attorney Hank Levine. "Clients are willing to do business with them, but they are facing significant questions about will they be there," he says. Use that uncertainty to your favor.
- **Get a backup carrier,** and not just on the chance a bankruptcy could leave you without dialtone. Service will fall if WorldCom is forced to ax reps and techs. "People are nervous. They don't know if they're going to have a long-term job," says telecom bankruptcy attorney Ken Irvin of Morrison & Foerster in D.C.

A Message on *Voice Report's* News Gathering

Over the past three weeks, *Voice Report* asked WorldCom PR director Les Kumagai, PR senior manager Debbie Caplan Lewis and spokesperson Claire Hassett several times to be put in touch with satisfied business users who could vouch for its service, ability to correct billing mistakes or award credits efficiently. WorldCom did not provide any. The request was made because all 27 WorldCom users we contacted said they had billing problems. Consultants, attorneys, analysts and bill auditors echoed their concerns. *Voice Report* also asked to interview an appropriate senior executive at WorldCom to address its billing and credit policies. WorldCom instead gave a written response hours before deadline, part of which are included where appropriate. But this prevented *Voice Report* from asking appropriate follow-up questions.

WorldCom's billing snarls are so overwhelming, even large users are driven to despair. Consider Johnson Outdoors, a recreation equipment manufacturer in Sturtevant, Wis., where telecom specialist Myra Larsen now "ignores" the pile of WorldCom bills on her desk.

Over the past **five years**, Larsen has addressed issues repeatedly and won assurances from WorldCom that errors would be resolved, only to see them reemerge on different billing platforms or under new account numbers. "I don't have time to chase these around every month," she says.

One of the bills in Larsen's pile is a "past due" invoice that's popped up **every month since it was paid and closed in 1997**. Another is for several non-existent frame relay spans. Months ago, WorldCom agreed to issue credits, but they have not appeared, she claims. Johnson was forced to file a complaint with the FCC to force WorldCom to stop switching it to a $3/minute rate from its contract rate, she says. Three times, a WorldCom rep refused to correct the bill unless Larsen revived the cancelled account, she says.

WorldCom confirms that it fired "roughly" 14 salespeople recently for setting up phony accounts in order to book $4 million in commissions. It says this "had no impact on WorldCom customers or shareholders," and it's "recovering the overpaid commissions." But that sounds a lot like what happened to US Oncology, a 300-site cancer treatment network based in Houston, says its senior telecom analyst Rosalind Blacoe.

Blacoe's list of disputes with WorldCom starts with what she says are unauthorized accounts not associated with any US Oncology lines but which appear each month. A WorldCom rep in Houston named Elma admitted to Blacoe that the carrier had a problem with salespeople setting up duplicate accounts on separate billing platforms in order to double their commissions.

"We are so caught up in the day-to-day managing of the account that we don't have the opportunity to look for credits," Blacoe says. But she also found 100 lines tacked on to a 10 x 1FB order, including DID numbers she intentionally omitted but WorldCom put on. PICC charges were applied to every one, and she's still chasing thousands of dollars in credits. US Oncology also was charged for ID codes it doesn't have.

WARNING: Copyright violations will be prosecuted. *Voice Report* shares 50% of net proceeds of settlements or jury awards with individuals who provide essential evidence of illegal photocopying or electronic redistribution. To report violations contact Roger Klein at Howrey & Simon, 1299 Pennsylvania Ave., N.W., Washington DC 20004-2402. Confidential line: 202-383-6846. Copyright 2002. Price: $398/year. For photocopying or electronic distribution permission, call 1-888-287-2223, and ask for our copyright waiver, bulk subscription or site license programs. Email: customer@ucg.com. ***The Telecom Manager's Voice Report*** (ISSN 1527-3032), is published biweekly by UCG, 11300 Rockville Pike, Suite 1100, Rockville, MD 20852.

It took The Aerospace Corp. six months just to get WorldCom to admit there was a problem when Aerospace's Web Digital Reconfiguration Service bill zoomed from about $10,000 to $30,000/month in early 2000 for no reason, says Carol Cutting, telecom manager at the Los Angeles firm. It took several more months to fix the problem so that Aerospace again is paying $10,000/month. But it's still waiting for a $64,000 credit that WorldCom promised in August 2001, she says.

The SEC is investigating WorldCom's accounting, billing and sales practices dating to January 1999 (VR 5/6/02), including a $685 million write-off of accounts on which it can't collect due to bankruptcies and litigation, the WorldCom Website notes. Qwest and Global Crossing say they're also under SEC scrutiny. WorldCom "believes all of its policies, practices and procedures have complied, and continue to comply, with all applicable accounting standards and laws," it notes on the Website. "It is not aware of any information that would give rise to the Commission's inquiry."

Former Users Also Say They're Stuck in a Billing Quagmire

Even users who leave WorldCom altogether end up with *new* billing disputes. Consider FDC Reports, a publisher in Chevy Chase, Md., that cancelled its T1 circuit in October **1995** and has spent seven years stamping out new WorldCom bills, says IT director Richard Browne Jr. Every six months or so, Browne says he wrestles a credit out of WorldCom, only to have the charges reappear. "You'd think that after many thousands of dollars of credits, they might get the picture," he says.

Or consider a Midwest manufacturer that had few problems during its 10 years with MCI, says the telecom coordinator, who – like several sources in this story – asked not to be identified, fearful WorldCom would sue it. (WorldCom bought MCI in 1998, and it retains a consumer-side group called MCI, but many business users still refer to WorldCom as MCI.) The company needed to cut costs, so last May it solicited offers from AT&T, Sprint, Qwest and WorldCom for LD, frame relay and T1 lines.

Strangely, "MCI seemed uninterested," she says. But it turned out to be a delay tactic. "The other three were hot on our trail and were very eager to keep offering lower and lower bids on the total package. At the last minute, MCI seemed to suddenly wake up and say, 'Wait a minute!' and asked that we extend our deadline to give them time to include their package." The manufacturer complied several times, but WorldCom's bid was ***worse* than what it provided in the existing contract**, she says.

The manufacturer thus selected AT&T and sent letters and faxes to the WorldCom rep 30 days before the cutover in October 2001. Soon, the telecom coordinator found herself confronted by a rep that acted like "Mr. Hyde. Rude, distant, obnoxious, he told me he was out of it now and that I needed to call the customer service 800 number to get anything done," she says. "But customer service said it had to come from him. And he wouldn't accept our disconnect order." Why? Its IT director says he was "told directly by the regional sales manager he was on a quota and couldn't deal with service issues."

Seven months later, the company still hasn't gotten all of its circuits disconnected, and bills keep coming **at casual call rates** despite its stream of phone calls, faxes and e-mails. "I've received disconnects for a few things, but I have bills on my desk for over $2,000," she says. "I cannot wait to rid myself

...& How to Keep Your Bills Offset, Down & Out

‣ **Add a "right of set-offs" amendment to your contract, and get one into any new deal, too.** Such a clause takes advantage of a provision in the Bankruptcy Code that lets filers use disputed amounts to pay off bills, Irvin explains. "But the Code only permits set-offs that are provided for in agreements or recognized at common law," he adds. In the case of WorldCom, its multiple business units and overlapping billing platforms may call for a set-off that lets you deduct amounts in dispute on, say, voice services from what you owe for wireless.

‣ **Pay only for services already provided, and then only for charges you agree are owed.** "Unfortunately, contracts often provide that you pay first and dispute matters later," Irvin says. "So you need to make sure you are not in breach of your contractual duties. But to the extent that you can keep your payments even with what you've received, do so."

‣ **Request a "Change of Control" clause that lets you void a contract** in case of a carrier's bankruptcy, says Chris Cannon of the Cannon Group, a telecom consulting firm in Spring House, Pa. He cites one WorldCom just signed that lets a Fortune 500 user "terminate this agreement without further liability," except for outstanding bills. The catch: service must be "materially deficient," and WorldCom gets 60 days to correct the problem with a 30-day "ramp down period," if needed. Michigan-based insurer First Mercury has a clause with Global Crossing that lets it terminate with 24 hours notice of a bankruptcy filing, says IS manager Kristi Lines (VR 3/25/02).

WorldCom Responds: 'No Provider is Perfect,' But it is 'Customer-Focused'

"WorldCom is a customer-focused company," it says in a prepared statement. "We recognize that our continuing success is determined by our ability to win new business as well as our capacity to retain and grow with our existing customers. We take every customer issue and concern seriously. While we constantly strive for perfection in the delivery of our service to our customers, no provider is perfect. That is why WorldCom is constantly at work developing new systems, practices and procedures to improve in a variety of areas, including service delivery and billing. We welcome the opportunity to respond to questions posed by the *Telecom Manager's Voice Report* because it allows WorldCom to correct misstatements about its policies and practices and further communicate our customer service commitment... WorldCom honors its contractual commitments at all times. In those situations where specific credits are due based upon negotiated contractual commitments, WorldCom applies these appropriately. In those isolated occasions where a billing error has occurred, WorldCom issues credits."

of this nightmare. There is one light at the end of the tunnel: I got a phone call from MCI's research department in Colorado saying they're looking into it. They didn't leave a number, and I can't call them directly."

In a letter obtained by *Voice Report* sent by a WorldCom tax analyst to a different end-user, WorldCom rejects any obligation to research or issue credits when "the account discontinued our services." WorldCom says this doesn't reflect its practices or policies: "WorldCom makes every effort to resolve issues with former customers because it's the right thing to do *and* because each is a prospect for potential business win-back."

Occasionally there is a happy ending. Metro Machine, a naval ship repair firm, got embroiled in a $15,000 billing dispute with WorldCom in February 2001 after it transferred LD and frame relay services to a rival carrier, says its Philadelphia-based IT and telecom manager Larry Ehmer.

Though Metro had filled out all appropriate paperwork a month in advance, it received bills for frame relay and dedicated LD for another year, he says. WorldCom insisted that Metro failed to cancel one frame relay circuit, resulting in the $15,000 in charges. But not only was it a circuit ID that had never appeared on Metro's bills prior to cancellation, it was for a single port, the company's extensive paperwork shows. "I tried to get them to understand that it was not possible for us to have just one frame relay node that was active," Ehmer says. "Where was it sending information to? This point was lost on them." Finally, WorldCom figured out that the circuit ID must belong to someone else, he says. What happened to the $15,000? "We settled for $161.32."

How a 'Cowboy' Culture Led to Rough 'N Ready Tactics, Questionable Practices

Where did this culture of billing practices come from? WorldCom – which built itself from CLEC to voice/data behemoth by gobbling up more than 70 rivals, including MCI in 1998 and Internet pioneer UUNet in 1996 – is renowned for a cutthroat culture that gauges success on quarterly revenue figures at the expense of service, says telecom attorney Hank Levine of Levine, Blaszak, Block & Boothby in Washington, D.C.

"They can write something in a contract that says if the customer does not stand on his head, they're screwed," says Levine, who's gone toe-to-toe with WorldCom in negotiations and court. "The cowboy business mentality means guys who don't have an ethical compass are [making] legal contractual decisions," he charges.

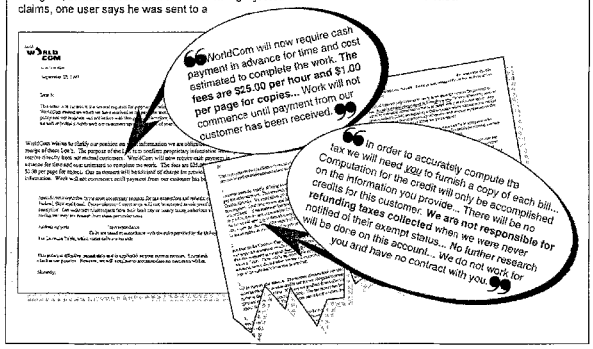
Then, there's what Levine calls WorldCom's "golden goose" tactics. This strategy is designed to get fleeing users to pay casual call rates of about 25¢/minute by driving contract negotiations past expiration of the old term by pleading for more time to submit a competitive bid, he says. But the bid never comes or it's outlandishly poor, as with the Midwest manufacturer.

WorldCom states that it does not engage in the practice, and on the contrary tries to accelerate negotiations to ensure stability in its customer base. However, these very tactics did allegedly happen to Reese Brothers, a telemarketing firm that revealed the tactic in a Pittsburgh court two years ago. The case eventually was transferred to the FCC at Reese's insistence and settled, and the parties declined to state the outcome.

But this was not before an exchange of briefs that listed Reese's gripes and included WorldCom's insistence that its reps' negotiated promises are meaningless. In early 1999, Reese was set to switch carriers but

Users Say They Must Leap Multiple Hurdles to Get Their Credits

Telecom managers say it's tough to get WorldCom to correct billing errors if they've left it for another carrier. And WorldCom's contracts give current users only six months to stake a claim, anyway. Even then, one user says WorldCom would only compute credits on documents the user provided, and another said it was charged $25/hour to research a claim. Among rejected claims, one user says he was sent to a WorldCom "credit review board" for a determination, while another was forced to use an arbitrator to settle a billing dispute. Among those whom WorldCom agrees have been incorrectly billed, it still won't issue a credit without the user signing a non-disclosure agreement and settlement agreement that rules out future refunds.



agreed to a delay so MCI WorldCom could design a more competitive bid, the lawsuit notes. Over the next five months, MCI calculated that Reese racked up $3 million in service charges and fees, but paid only $733,000 of it. As a result, it went to court to collect the alleged $2.25 million shortfall.

The catch: MCI charged Reese the casual caller rate of about 25¢/minute rather than the contract rate of 5.4¢ (see graphic, page 8). And the carrier told a federal judge it didn't care that strategic account manager Suzie Davisson assured Reese this was an error that would be corrected. "Even if MCI personnel did assure Reese that the rate would be corrected to reflect a better rate, Reese cannot legally enforce such an assurance," WorldCom wrote. Meantime, it never provided Reese a bid. Reese thus accused the carrier of deliberately stringing it along.

7 WorldCom Practices that Make Billing Refunds Remarkably Hard to Get

But the first problem for any WorldCom user seeking a credit is its policy that any billing error not discovered and reported in writing **within six months of the invoice date** is not an error at all, according to WorldCom's Standard Business Services agreement. In another letter obtained by *Voice Report* that originated in WorldCom's Louisville, Ky., office, WorldCom gives the user **30 days** to detect erroneous charges.

"This is standard commercial practice in the telecommunications business and reflects WorldCom's desire to address customer concerns in a timely fashion by ensuring that records and recollections are readily available to equitably resolve a dispute," WorldCom notes.

Under section 201 of the Communications Act, carriers and **users are given up to two years** to recover improperly billed amounts, but that timeframe can vary **by agreement of all parties**. "If a carrier shortens by too much, what it's trying to do could be found unjust and unreasonable," Levine says. "The FCC has said that, depending on the circumstances, a carrier can't go back much more than a year to assess and collect a charge it forgot to bill initially, but it's not clear that mutuality applies here. Notice that the WorldCom provision is not mutual. The customer has six months to report an error, not MCI."

Indeed, one user, Aon Consulting in Winston Salem, N.C., actually was told to submit an over-billing to a WorldCom **"credit review board"** for disposition and was rejected – twice, says telecom manager Scott Marvill. Aon, which was owed "several thousand," eventually got the credit, he says – but only after Marvill *called every day for several months* to ever-higher officers at WorldCom.

Letters from WorldCom local offices to other end users, shared with *Voice Report*, indicate that, at least in the late 1990s when they're dated, it only would compute overcharges and credits on **documents provided**

Sorry, the check's not in the mail

E-mail Regarding WorldCom's Billing Refund Policy
Sent to a Large Enterprise End-User
(Portions have been redacted to protect the source)

Subject: [redacted]
Date: [redacted], 2002
From: [redacted]@wcom.Com>
To: [redacted]

[redacted]:
Please find attached [redacted]. WCOM Legal and Financial agreed to [redacted], but not to issuing a check. This is against Corporate Policy and [redacted] has been escalated [redacted] within the Legal and Financial Services organizations, but was not approved.

by the user. In one case, WorldCom said it would charge $25/hour and $1/page for the initial research (see graphic, page 5). "Work will not commence until payment from our customer has been received," states the letter from its San Antonio office. World Com says it continues the practice.

"In situations where a customer has not retained its WorldCom invoices, WorldCom will always evaluate the appropriateness of a charge for billing data requests," it states. If "the requested information would require significant effort and/or expense to obtain and compile, WorldCom may elect to charge an amount that is representative of its costs to fulfill that request" – at least the current rate to hire a temp plus at least 15¢/page, especially for "voluminous research" and printing invoices that are more than six months old.

WorldCom also requires use of non-disclosure agreements **(NDAs)** to limit how deeply an audit firm can probe for evidence of billing errors, it confirms. That's not unusual, except that WorldCom insists on seeing customer-by-customer **letters of authority** delineating which people at the audit firm are permitted to see the client's specified records, according to another WorldCom letter obtained by *Voice Report*. Other carriers require evidence that the auditor is entitled to work for an end user, but they're satisfied with general statements.

"The NDA should be real simple," says Richard Valencia, CEO of San Diego-based telecom cost management firm ProfitLine. "It should say, 'We'll show you stuff you can't show to anyone else.' But WorldCom will try to throw in other terms and conditions that limit our work scope. They try to tell us that we can only do certain things in our work for our client, which of course we would never sign."

Even with those protections in place, once billing errors are found WorldCom further bogs down the customer's ability to win credits by requiring it to sign a **"settlement agreement"** that rules out future refunds. "It's not a settlement, it's a credit for an actual billing overcharge," says another auditor. "It's a nasty little thing that wipes out the chance to get any more, even overcharges not brought to light yet." WorldCom confirms the practice but says it is used on a case-by-case basis to "allow the parties to amicably resolve any and all outstanding disputes, allowing our business relationship to move forward, free of any overhanging issues."

In instances when disgruntled users wanted to sue WorldCom, their options were further limited by a long-standing **arbitration clause** buried in its tariffs. The clause essentially said that WorldCom could force companies to go before an arbitrator of its choosing, on its pay, who *had to* rule for WorldCom if the user didn't respond within a few weeks (VR 1/17/00). WorldCom says it has discontinued the practice, but it does not say when.

Once you get through these obstacles, one last stipulation awaits you, according to a 2002 e-mail shared with *Voice Report* (see the graphic above). In it, WorldCom tells the user – which has waited since November for a $250,000 agreed-upon refund – that it is **"against corporate policy" to cut a check**. Instead, the customer only can

Pass this on to a colleague who could benefit from The Telecom Manager's Voice Report (www.thevoicereport.com)
Please enter my subscription for one-year (24 biweekly issues) of the Voice Report right away at $398.
_____Payment Enclosed _____Bill Me _____Initials
Name_____ Title_____ Organization _____
Address_____
City_____ State_____ ZIP_____
Phone_____ Fax_____ E-mail_____
Mail to: The Voice Report, 11300 Rockville Pike, Suite 1100, Rockville, MD 20852-3030. Tel: 888-287-2223 P01642

How WorldCom's Sales Commission, Incentive Structure Works Against Your Interests

A revealing e-mail from one rep that tackled the billing problems for Johnson Outdoors of Sturtevant, Wis., suggests the carrier's compensation system has a role in holding up its issuance of credits. After weeks of promising back-and-forth exchanges, the rep wrote to telecom specialist Myra Larsen that, since she had purchased services from a different *WorldCom* unit, he could not resolve her error. "It is not in my best interest (per my job requirements) to work on getting these issues resolved," he wrote. WorldCom says this does not reflect its practices and policies. But WorldCom confirms that account reps do **not** have authority to independently issue credits or modify its billing. And that's what makes rep consistency critical, says telecom analyst Rosalind Blacoe of US Oncology in Houston. Once a rep leaves your account, all previous efforts he made with those who can issue credits go down the drain. Johnson Outdoors, for instance, has had 13 reps on its WorldCom account in two years, Larsen says. WorldCom says its turnover rate in sales and marketing is down 6 percentage points since the beginning of 2001, and its service arm has "one of the lowest employee turnover rates in the service industry." In all, WorldCom says it has axed 12,700 workers in 2001 and 2002, leaving it with about 71,000.

get a credit... for $250,000 in future services. WorldCom claims this is not its policy but allows that it does prefer to issue credits. "We have issued checks to customers in certain situations," it says. AT&T users also say they typically get credits. But unlike WorldCom users, several AT&T users said they have received checks, too.

Technically Speaking, Why WorldCom has Billing Problems

Some WorldCom billing problems are related to a patchwork of software billing platforms inherited from its string of acquisitions, users suspect. For instance, WorldCom has two Internet backbones, two frame relay and two ATM networks. WorldCom says this is critical for redundancy and scalability, and that the networks are fully integrated for ordering, provisioning and billing. Nevertheless, the SEC is investigating WorldCom's integration of its computer system with MCI's, notes the carrier's Website. MCI stock still trades separately from WorldCom's.

WorldCom reportedly has had up to 55 different billing systems. Les Kumagai, public relations director for enterprise-side WorldCom Group, says this is a function of acquiring many companies and says WorldCom integrates them as quickly as possible. "It would be insane for anyone to run 50-odd billing systems," he says. "Has integration been done? Absolutely." WorldCom did not specify how many "legacy" billing platforms it now has but says it's converging them into five "growth" platforms, including ones for "global," "major" and "international" accounts. It did not specify how, say, a major account with international sites would be classified.

Either way, negotiated contracts common among business users sometimes are hand-entered monthly as discounts against normal tariff or price guide rates, says Gary Rosenberg, a 42-year telecom veteran who has served on an FCC task force, obtained the patent for call waiting and now is telecom director at Nortek in Providence, R.I. Nortek has been fighting with MCI for two years over incorrect bills. And Rosenberg contends it's because reps must read and interpret contract terms and conditions to figure out the right billing platforms. "Even when problems are corrected, it is not unusual that they fall incorrect a month or two later," he says. WorldCom says the system is fully automated. "If an existing customer adds new services at customer-specific rates, we would then have to set up rates and/or discounts in the billing systems for that service," it adds.

"Billing systems were created to bill customers at the highest possible rates," counters telecom bill auditor Valencia. "To put in discounts, it takes people, and people make mistakes." The carrier thus churns out a constant barrage of errors that include phantom circuits, disappearing discounts and, in one case, two 56,000-minute (39 days) inbound toll-free calls and two more 30,000-minute (21 days) calls on a bill, says the telecom pro at the bewildered marketing firm in Minnesota. WorldCom also billed an 8-day call to a healthcare market research firm in Owings Mills, Md. "I pulled trunk records from our call accounting system showing that a call to the number was made on trunk X, and 40 seconds later a call to another number was made on that same trunk X," says the telecom coordinator. Yet it took WorldCom six months to award a credit.

Lawsuits Point to a Problem of Titanic Proportions

The issue can't be blamed completely on WorldCom's maze of billing systems. WorldCom has been subject to several huge lawsuits regarding its billing practices, including one in an Illinois federal court last year in which it agreed to pay consumers **$88 million for wrong billings**. WorldCom faces another ongoing class action – filed in federal court near its Mississippi headquarters – brought by shareholders who accuse WorldCom of deliberately leveraging goofs to inflate revenue.

Subscriber Services

We want to help you in every way. Here's how to reach us:

EDITORIAL: Want more details on a story? Idea? Call publisher Jonathan Stern at (301) 287- 2604. The fax number is (301) 816-8945. You can also send email to: jstern@ucg.com

SUBSCRIPTIONS: $398/year for 24 issues. For questions about newsletter delivery and account status, call (888) 287-2223, or e-mail to: customer@ucg.com

FREE LISTSERV: *The Telecom Managers Forum/Telecom Talk* is a free service to help you get advice from your peers and share your experience on daily challenges such as LD rate negotiations, PBX troubleshooting, bill audits, LEC provisioning & IP telephony. To sign up, go to www.thevoicereport.com, click on "Telecom Manager's Forum E-mail Chatroom," and enter the requested information.

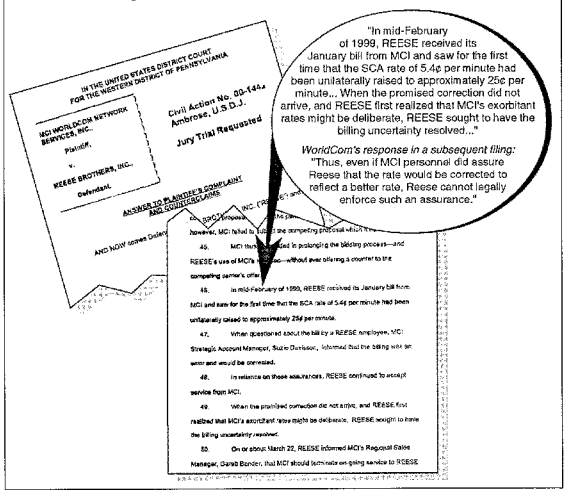
OUR ADDRESS: ***The Telecom Manager's Voice Report*** (ISSN 1527-3032), 11300 Rockville Pike, Suite 1100, Rockville, MD 20852-3030.

www.thevoicereport.com

☆☆☆☆☆☆☆☆

Extra Tip: Scour your telecom bills monthly for errors, and get your customer service record (CSR) from your LEC at least once or twice a year, if not monthly, to identify unnecessary and inaccurate charges (VR 11/5/01).

WorldCom Sued to Collect a $2.25 Million Shortfall After Asking for a Delay And then Raising the User's Rate to 25¢/minute Once the Contract Expired



"If WorldCom is having to settle up with customers in disputes between what they have been billing and what the customers really owe, it could drive the revenues down sharply," says stock analyst Drake Johnstone of Davenport & Co.

This prompted him to recommend that customers sell their shares of WorldCom stock, though it was trading at $1.34/share midday Thursday, down from $64/share in June 1999.WorldCom owes $29 billion in debt, with $172 million due this year and $1.7 billion due in 2003. It renegotiated a line of credit two weeks ago that removes repayment triggers based on credit ratings, but WorldCom's short-term debt now has reached junk status. And last week, WorldCom was dropped from the S&P 500 stock index. Its market cap now stands at $3.97 billion.

"We don't believe there is any way, under any scenario, that we will run out of cash," WorldCom CEO John Sidgmore said in a conference call with reporters April 30th after replacing Ebbers, noting that it has $2.3 billion in cash and $8 billion in available credit to cover its near-term needs. "The company has a much more negative face and a negative perception than it deserves."

Such liquidity would cover WorldCom's near-term needs – unless you include the $1.8 billion to $3.5 billion it may owe in billing credits. "WorldCom will dig in, stand their ground and fight even when they are clearly in the wrong, even when they admit they owe the money. This is deliberate dragging of the feet in hopes that people will just throw their hands up, " says Valencia. Concludes Johnstone: "They're trying to delay payment so their financial results look better and they don't get driven into bankruptcy."

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
ENFORCEMENT

March 7, 2002

Via Facsimile

Thomas F. O'Neil, Esquire
Sr. Vice President, Chief Legal Counsel
WorldCom, Inc.

Re: *In the Matter of WorldCom, Inc.*, File No. HO-09440

Dear Mr. O'Neil:

In connection with the Division of Enforcement's inquiry into the above-captioned matter, we request that WorldCom, Inc. voluntarily produce the documents and information described in the attachment hereto. You may produce copies of the relevant documents as long as the originals of the documents are retained.

Please send these documents no later than Thursday, March 21, 2002, to my attention at the following address: U.S. Securities and Exchange Commission, Division of Enforcement, 450 Fifth Street, N.W., Washington, DC 20549-0807.

Please consecutively number and mark each document produced with a symbol that identifies it as being produced by the company, and provide an index that briefly describes each document. If you withhold any responsive documents based on an assertion of privilege or any other reason, please provide a list setting forth for each document: (i) the date of the document; (ii) the author(s) of the document; (iii) all recipients of the document; (iv) all others who are known to have been informed about the substance of the document; (v) the subject matter of the document; and (vi) the nature of any privilege asserted (*e.g.*, attorney-client, work product, etc.).

In the event that any document requested has been lost, destroyed or otherwise disposed of, that document is to be identified by author, addressee, indicated recipients or blind copy recipients, date, subject matter, all persons to whom distributed, shown or explained, date of loss, destruction or other disposition, person authorizing destruction or other disposition, and person destroying or disposing of the document. Please also describe WorldCom's document retention policy, if any, and produce copies of all documents describing the document retention policy.

This inquiry is confidential and should not be construed as an indication by the Commission or its staff that any violation of law has occurred, nor as an adverse reflection upon any person, entity or security.

For your reference, we have enclosed SEC Form 1662, which contains important supplemental information.

We appreciate your assistance. Should you have any questions about this matter, please call me at 202-942-4537 or, in my absence, Chip Welch at 202-942-4821, or Matthew Rogers at (202) 942-4730.

Sincerely,

Jose M. Rodriguez
Senior Counsel

Enclosures: SEC Form 1662
Voluntary Document Request

VOLUNTARY
DOCUMENT REQUEST TO
WORLDCOM, INC.
March 7, 2002

Definitions and Instructions

The following definitions and instructions apply to this attachment:

As used herein, the term "document" or "documents" means any and all records, and other tangible forms of expression in the possession or custody, or subject to the control of, WorldCom (as defined below) whether such documents are drafts or unfinished versions, originals, or annotated or nonconforming copies, however and by whomever created, produced or stored (manually, mechanically, electronically or otherwise) including books, papers, files, minutes, summaries, records, analyses, plans, correspondence, memoranda, ledger sheets, schedules, invoices, account statements, reports, wires, telegrams, telexes, electronic mail ("e-mail"), telephone logs, notes or records of conversations or meetings, contracts, agreements, calendars, date books, work sheets, working papers, bills, records of payment, magnetic tape, tape recordings, disks, diskettes, disk packs, and other electronic media, microfilm, microfiche, storage devices, appointment books, diaries, notices and message slips.

The term "concerning" means relating to, referring to, describing, evidencing, constituting, reflecting, or otherwise establishing any reasonable, logical or causal connection.

As used herein, "WorldCom" refers to WorldCom, Inc., and all of its divisions, groups, committees, subsidiaries, operating units, reporting units, affiliated or related entities, successor and predecessor companies, present and former employees, representatives and agents, and any other persons acting on its behalf.

The connectives "and" and "or" are to be read both disjunctively and conjunctively in order to bring within the scope of this request all otherwise responsive documents.

All requests are to be read irrespective of the time period unless otherwise noted.

Production

Please produce the following documents:

1. All documents connected with the disclosure "[s]elling, general and administrative expenses for the three months ended September 30, 2000, includes a $685 million pre-tax charge associated with specific domestic and international wholesale accounts that are no longer deemed collectible due to bankruptcies, litigation and settlements of contractual disputes that occurred in the third quarter of 2000," noted under the selling, general and administrative expense caption of WorldCom's Form 10-Q for the third quarter of 2000, including, but not limited to:

   a. all reports and schedules detailing and accounting for the individual components of the charge;

   b. all internal communications, memoranda and analyses concerning the charge, including, but not limited to, all such documents concerning the basis for the charge, the timing of the charge, and the charge's compliance with company accounting policies and generally accepted accounting principles;

   c. all communications between WorldCom and it's independent auditors concerning the charge;

   d. all documents created or reviewed by WorldCom's Chief Operating Officers ("COOs"), Chief Executive Officers ("CEOs"), Chief Financial Officers ("CFOs"), Controllers or Boards of Directors, and all committees thereof, concerning the charge;

   e. all minutes from any WorldCom Boards of Directors meeting, and all committees thereof, concerning the charge;

   f. all e-mail messages and other documents concerning the charge written or received by WorldCom senior management or WorldCom finance and accounting personnel; and

2. WorldCom summary accounts receivable aged trial balance reports as of March 31, 1999, June 30, 1999, September 30, 1999, December 31, 1999, March 31, 2000, June 30, 2000, September 30, 2000, December 31, 2000, March 31, 2001, June 30, 2001, September 30, 2001, and December 31, 2001, and all other documents sufficient to show, as of those dates, the accounts receivable outstanding by customer name, account number, amount owed, and age of receivable.

3. All documents concerning account reconciliation, including, but not limited to, all analyses reconciling the amount of accounts receivable per the summary accounts receivable trial balance reports to the accounts receivable balance that was reported in WorldCom's periodic reports filed with the Commission for the quarters ending March 31, 1999, June 30, 1999, September 30, 1999, December 31, 1999, March 31, 2000, June 30, 2000, September 30, 2000, December 31, 2000, March 31, 2001, June 30, 2001, September 30, 2001, and December 31, 2001.

4. All documents concerning monthly, quarterly, or other periodically prepared reporting packages concerning accounts receivable since January 1, 1999, including, but not limited to, all such documents concerning accounts receivable inherited from the MCI merger since January 1, 2000, including, but not limited to, all reports concerning litigated, disputed, bankrupt, or otherwise doubtful accounts receivable or possible doubtful accounts receivable.

5. All documents concerning WorldCom's "general uncollectible reserves" and "specific reserves for items such as bankruptcies, litigation and contractual settlements" referred to in WorldCom's Form 10-Q for its third quarter of 2001, including, but not limited to:

   a. all reports and schedules detailing and accounting for these reserves for the quarter ended March 31, 1999, through the quarter ended December 31, 2001;

   b. all internal communications, memoranda and analyses concerning these reserves, including, but not limited to, the adequacy thereof and the method(s) for calculating the appropriate amount of each reserve, since January 1, 1999;

   c. all communications between WorldCom and its independent auditors concerning these reserves since January 1, 1999;

   d. all documents created or reviewed by WorldCom's COOs, CEOs, CFOs, Controllers or Boards of Directors, and all committees thereof, concerning the specified reserves, since January 1, 1999; and

   e. all minutes from WorldCom Boards of Directors meetings, and meetings of all committees thereof, concerning the specified reserves, since January 1, 1999.

6. All documents connected with the billing, accounts write-offs or accounts receivable provisions noted in the selling, general and administrative expense section (pages 47-48) of WorldCom's Form 10-Q filed for the third quarter of 2001, including, but not limited to, documents connected with the following specific disclosures:

   a. the wholesale customers that either filed for bankruptcy or changed their status from reorganization to liquidation;

   b. the affects the 2000 declines in stock prices had on accounts receivable;

   c. the billing and collection matters with traditional phone companies and local exchange carriers; and

   d. the court rulings and congressional discussions that led WorldCom to settle disputes with customers for certain receivables and record specific provisions, including, but not limited to, documents sufficient to identify the settling customers, the date settlement was reached, and the amount of the disputed receivable for each customer.

7. All documents concerning WorldCom's customer service contracts, including, but not limited to, renegotiated contracts, customer billings, customer account cancellations and employee sales commissions since January 1, 1999, including, but not limited to:

   a. all internal audit reports and audit work papers;

   b. all documents concerning disputed customer billings;

   c. all documents concerning complaints by customers about over-billing;

   d. all documents concerning renegotiated customer contracts;

   e. all documents concerning customer account cancellations;

   f. all documents concerning disputed employee commissions;

   g. all documents concerning inflated sales commissions;

   h. all documents concerning over-booking of sales;

i. all documents concerning any internal investigation related to fraud, theft, embezzlement or any matter of accounting;

j. all documents concerning monthly, quarterly, or other periodically prepared reporting packages concerning customer service contracts, including, but not limited to, renegotiated contracts, customer billings, customer account cancellations and employee sales commissions, including, but not limited to, any report concerning disputed customer billings and disputed sales commissions;

k. all documents concerning communications between WorldCom and its independent auditors concerning customer service contracts, including, but not limited to, renegotiated contracts, customer billings, customer account cancellations and employee sales commissions, including, but not limited to, disputed customer billings and disputed sales commissions;

l. all documents created or reviewed by WorldCom's COOs, CEOs, CFOs, Controllers or Boards of Directors, and all committees thereof, concerning customer service contracts, including, but not limited to, renegotiated contracts, customer billings, customer account cancellations and employee sales commissions, including, but not limited to, disputed customer billings and disputed sales commissions;

m. all minutes, agendas and notes concerning department meetings concerning customer service contracts, including, but not limited to, renegotiated contracts, customer billings, customer account cancellations and employee sales commissions, including, but not limited to, disputed customer billings and disputed sales commissions; and

n. all minutes from WordlCom Boards of Directors meetings, and all committees thereof, concerning customer service contracts, including, but not limited to, renegotiated contracts, customer billings, customer account cancellations and employee sales commissions, including, but not limited to, disputed customer billings and disputed sales commissions.

8. All documents concerning WorldCom's accounting policy for accounting and reporting for goodwill, including, but not limited to, the measurement and recognition of goodwill, the allocation of goodwill to operating units (or the like), goodwill impairment testing, and recognition and

measurement of impairment loss from January 1, 1999, including, but not limited to, all such documents concerning or reflecting adoption of the Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*—FAS 142).

9. Documents sufficient to identify the components of goodwill from January 1, 1999, including, but not limited to, all such documents for the period after adoption of the Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*—FAS 142.

10. Documents sufficient to identify each of the related acquired entities that gave rise to the recognition of goodwill, including, but not limited to, documents concerning how management viewed the acquired company's financial and operating performance since its acquisition.

11. All documents concerning how goodwill was assigned (*e.g.*, to subsidiaries, to operating units, to reporting units, or the like) or how goodwill was otherwise viewed by management for each from January 1, 1999, including, but not limited to, all such documents for the period after adoption of FAS 142 and all documents concerning the methodology used for assignment of goodwill.

12. All documents concerning any review of goodwill for impairment or possible impairment since January 1, 1999, including, but not limited to, any assessments of expected future profitability or cash flows.

13. All annual historical financial statements or other discrete financial information reviewed by management for each of the acquired companies for which goodwill was recorded in connection with its original acquisition since January 1, 1999.

14. All annual original budgets (forecasts or the like) for each of the acquired companies for which goodwill was recorded in connection with its original acquisition since January 1, 1999, including, but not limited to, the budgets for 2002.

15. All documents concerning the useful lives assigned to goodwill from January 1, 1999, including, but not limited to, all such documents for the period after adoption of FAS 142 and all documents concerning how such assignations were made.

16. All documents concerning the WorldCom disclosure on the adoption of FAS 142 noted in the company's February 7, 2002 press release regarding fourth quarter and full year operating results for 2002, including, but not limited to:

    a. all documents concerning the facts and circumstances occurring since December 31, 2001 that indicated that the carrying amount of goodwill or any of its allocated components are no longer recoverable;

    b. all documents concerning the assertion that goodwill has an indefinite life; and

    c. all documents concerning the estimated goodwill adjustment of $15 to $20 billion.

17. All documents received from, or provided to, WorldCom's independent auditors concerning goodwill since January 1, 1999.

18. All documents concerning WorldCom's policies and procedures concerning revenue recognition, accounts receivable, accounts receivable-related reserves, customer billings, sales commissions, disputed billings, disputed employee sales commissions, accounts receivable provisions and write-offs, or goodwill.

19. WorldCom organizational charts, internal directories and internal personnel schedules, or other documents sufficient to:

    a. identify WorldCom's complete corporate structure since January 1, 1999, including, but not limited to, all WorldCom reportable divisions, segments and subsidiaries;

    b. identify all WorldCom employees since January 1, 1999, including, but not limited to, all employees of WorldCom's reportable divisions, segments and subsidiaries.

    c. identify all individuals responsible for analyzing, reporting, adjusting, or establishing reserves for accounts receivable since January 1, 1999, including, but not limited to, all documents sufficient to identify their names, job titles, job descriptions, office locations, and supervisors;

d. identify all individuals responsible for reviewing, analyzing and reporting customer billings and employee sales commissions, including, but not limited to, all disputed or litigated billings and commissions since January 1, 1999, including, but not limited to, all documents sufficient to identify their names, job titles, job descriptions, office locations, and supervisors.

e. identify all individuals responsible for analyzing, reporting, or adjusting goodwill, including but not limited to, impairment or possible impairment of goodwill since January 1, 1999, including, but not limited to, all documents sufficient to identify their names, job titles, job descriptions, office locations, and supervisors;

20. For all individuals employed by WorldCom since January 1, 1999, but no longer employed by WorldCom, produce documents sufficient to identify the termination date and the contact information for such former employee.

21. All documents concerning loans made by WorldCom to any of its officers or directors since January 1, 1999, including, but not limited to, documents concerning the related accounting treatment thereof.

22. All documents concerning problems with the integration of WorldCom's and MCI's computer systems, including, but not limited to, problems with the integration of the two companies' billing and accounts receivable computer systems.

23. All documents concerning WorldCom's tracking and review of analysts' earnings estimates for WorldCom since January 1, 1999, including, but not limited to, such documents created by WorldCom's investor relations department.

24. All documents created since January 1, 1999 concerning any federal or state agency investigation of WorldCom.

BRT Press Release

The Business Roundtable Statement on Restoring Investor Trust

Contact: Johanna Schneider
(202) 872-1260

Release Date: 07/08/2002

The chief executive officers of The Business Roundtable, representing many of the largest companies in the United States, have been appalled, angered and, finally, alarmed at the stream of revelations which have emerged in the past six months concerning a number of public companies. Where there have been violations of law, we believe that the violators should be prosecuted – promptly and to the fullest extent possible.

While the list of affected companies is small in comparison to the more than 11,000 publicly traded U.S. companies, even a few transgressions are too many. Those of us who have the privilege to be leaders of corporate America have a special responsibility to our investors, employees and the public. We are responsible for setting the ethical standards under which our companies operate, and for creating and maintaining a corporate culture driven by always doing what is right, not just what is legally allowable. We also understand that public confidence in America's system of corporate governance and its trust in our financial reporting mechanisms have been shaken to the core. It will take much more than words to restore that confidence and trust.

In May, we addressed many of these issues in our "Principles of Corporate Governance," but we recognize that is not enough. In recent weeks the President, Congress, the SEC, the NYSE and the NASDAQ have all come forward with proposals that would reform the current system. Because we agree that restoration of public trust is paramount, we believe each of these proposals should receive careful and prompt attention. In the end, the most important issues which we feel must be addressed are:

Full and accurate disclosure: We support the SEC's proposals to require CEOs to certify that their financial statements completely and accurately reflect the true condition of the company. What you see in financial statements must be what you get when you invest.

Trust and accountability: Corporate leaders must be held accountable for any abuse of public trust. We believe that executives should be required to return monies they received as a result of fraudulent accounting practices, as embodied in the Sarbanes bill.

Independence: Boards of directors must exercise independent judgment and a substantial majority of board members must be independent of management, as advocated in our Principles of Corporate Governance. The three key committees of the board -- the audit, compensation and governance committees – must be made up entirely of independent directors.

Auditing reform: The Roundtable supports strong oversight of the accounting profession to ensure independence of auditors and credibility of the auditing process, a measure included in the Sarbanes and Oxley bills.

Stock options: We support shareholder approval of all company stock option programs to help

restore confidence in our compensation systems.

Insider trading: We support stronger controls on and disclosure of stock trading by insiders, as embodied in the Sarbanes and Oxley bills.

We urge the SEC to move forward with the implementation of its proposed reforms. We feel strongly that the NYSE and the NASDAQ must proceed to improve their listing standards. We support passage of the Sarbanes bill that the Senate will be taking up this week and support the Oxley bill that has passed the House. We urge Congress to act expeditiously to present the President with a bill that he can sign to enact these reforms.

We applaud the President for taking a stand on this issue and look forward to his upcoming remarks in New York.

And, finally, as CEOs of the nation's leading companies, we have a duty to help restore the American system of corporate governance to a place of trust. We must and will be at the forefront of supporting these reforms and helping to restore confidence in our financial markets.

# # # #

The Business Roundtable is an association of chief executive officers of leading corporations with a combined workforce of more than 10 million employees in the United States and $3.5 trillion in revenues. The chief executives are committed to advocating public policies that foster vigorous economic growth and a dynamic global economy.

Return to top

© 2001 The Business Roundtable

The Free Market Needs New Rules

by Sen. John McCain
New York Times
July 8, 2002

WASHINGTON---In a string of corporate failures and scandals from Enron to WorldCom, we have seen the first principles of free markets - transparency and trust - fall victim to corporate opportunists exploiting a climate of lax regulation. I have long opposed unnecessary regulation of business activity, mindful that the heavy hand of government can discourage innovation. But in the current climate only a restoration of the system of checks and balances that once protected the American investor - and that has seriously deteriorated over the past 10 years - can restore the confidence that makes financial markets work.

Congress and the president must work quickly to frame new legislation and reform corporate governance and government oversight. And I would add one more suggestion. The president and Congress should ask for the resignation of Harvey Pitt, the chairman of the Securities and Exchange Commission. While Mr. Pitt may be a fine man, he has appeared slow and tepid in addressing accounting abuses, and concerns remain that he has not distanced himself enough from former clients.

The need for government action and oversight is clear. Corporations fabricated revenues, disguised expenses and established off-balance-sheet partnerships to mask liabilities and inflate profits. Executives maximized their compensation with stock option plans that burdened their companies with huge costs hidden from investors. Venerable accounting firms, having looked the other way as companies cooked the books, shredded documents to hide their misdeeds. Although American tax policy encouraged them to do so, corporations that move their legal headquarters offshore to avoid paying taxes appear conspicuously ungrateful to the country whose young men and women are risking their lives today to defend them.

Reforms must ensure a complete separation of the auditing and consulting services provided by an accounting firm; a firm that audits a company must be prohibited from providing any consulting service - ever - to that company. Legislation sponsored by Senator Paul Sarbanes would create an Accounting Oversight Board to establish and enforce the standards for audits of publicly traded companies. But this oversight board should be completely independent from the industry, financed either as part of the S.E.C. or a separate

agency.

Stock options, while a legitimate and valuable form of employee compensation, must be identified as an operating expense in a public company's financial reports. Top executives should be precluded from selling their own holdings of company stock while serving in that company. Executives should be allowed to exercise their options, but their net gain after tax should be held in company stock until 90 days after they leave the company.

Executives should be required to return all compensation directly derived from proven misconduct. Also, a corporate compensation committee should be made up of members of the board who have no material relationship with the company or personal relationship with its management. Indeed, the entire board should be similarly independent, with the exception of the chief executive.

Top executives should be required to certify personally that the company's public financial reports are accurate and that all information material to the financial health of the company has been disclosed. If their certification is false, they should go to jail.

Government should remove egregious conflicts of interest in "full-service" financial institutions. Investment services, including research, should be separated from lending, underwriting and securities trading.

Even as we take these and other necessary actions, asking for the resignation of Mr. Pitt would help show the public our seriousness. During his first 10 months as S.E.C. chairman, he did not participate in 29 of the commission's votes, most of which involved his former clients. To address corporate misconduct, he seems to prefer industry self-policing to necessary lawmaking. Government's demands for corporate accountability are only credible if government executives are held accountable as well.

What is at risk is the trust that investors, employees and all Americans have in our markets and, by extension, in the country's future. To love the free market is to loathe the scandalous behavior of those who have betrayed the values of openness that lie at the heart of a healthy and prosperous capitalist system.

# # #

citigroup

Jane C. Sherburne
Deputy General Counsel
Litigation and Compliance

Citigroup Inc.
1101 Pennsylvania Avenue NW
Suite 550
Washington, DC 20004

Tel 202 220 3690
Fax 202 220 3699
New York 212 793 4942
sherburnej@citi.com

July 11, 2002

The Honorable Paul E. Kanjorski
2353 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Christopher Shays
1126 Longworth House Office Building
Washington, D.C. 20515

Dear Congressman Kanjorski and Congressman Shays:

We have nearly completed the process of gathering information responsive to your inquiry regarding whether WorldCom senior executives have participated in IPO allocations at Salomon Smith Barney (SSB). However, as Congressman Kanjorski and I discussed earlier this afternoon, we have been unable to find a lawful way to provide you with this information without violating the privacy provisions of the Gramm-Leach-Bliley Act of 1999.

That Act prohibits a financial institution from disclosing nonpublic personal information about its customers without their consent unless one of a small number of exceptions applies. Under the law, unless a customer consents, the only circumstance under which SSB could provide you with the information you have requested would be in response to a subpoena. See §248.15 of Regulation S-P. In the absence of either customer consent or a subpoena, we cannot provide the information to you without violating the law. Although we are seeking to obtain consents, we have not yet received responses.

Please be assured that we are ready and willing to provide this information, if the legal impediment can be cleared. Indeed, we are preparing to produce the information you seek to the NASD, whose recent request falls within one of the specified exceptions of Gramm-Leach-Bliley and to which we therefore are not barred from responding.

It is important to put the IPO allocation matter in some context. SSB, like many other major brokerage firms, acts as an underwriter of securities, including IPOs. An underwriter sells shares of securities that it has purchased from a company seeking to raise capital with the purpose of distributing such shares to the public. All investors to whom shares are allocated must purchase those shares by paying the offering price to the underwriter. The manner in which SSB allocates shares of IPOs is consistent with applicable laws, regulations and industry practice. Indeed, many securities offerings have multiple underwriters who work together to allocate shares to investors.

The securities laws permit underwriters very wide discretion with respect to allocations of IPOs and the SEC has acknowledged this is standard practice. If an IPO is oversubscribed -- i.e., the demand for the shares exceeds supply -- the underwriters must necessarily choose which interested customers will receive shares and the size of each allocation. It is common practice among the syndicate departments of brokerage firms to allocate such shares to institutional investors and wealthy individuals who have the financial wherewithal to buy blocks of shares and assume the related financial risk. The SEC's own website describes the underwriting process for IPOs:

> The underwriters [of an IPO] in consultation with the company decide on the basic terms and structure of the offering well before trading starts, including the percentage of shares going to institutions and to individual investors. Most underwriters target institutional or wealthy investors in IPO distributions.

In short, current law, rules, and practice recognize and permit allocation programs like those at SSB and a great many other Wall Street firms.

We hope to continue to work with you constructively on this matter.

Sincerely yours,

Jane C. Sherburne
Deputy General Counsel

CONGRESSMAN
PAUL E. KANJORSKI

Contact: Ben Turner
(202) 225-6511
E-mail: ben.turner@mail.house.gov

CONGRESSMAN
CHRISTOPHER SHAYS

Contact: Katie Levinson
Office: (202) 225-5541
Mobile: (202) 236-0240

FOR IMMEDIATE RELEASE / July 12, 2002

Congressmen Kanjorski and Shays Release Salomon Smith Barney's Initial Response on IPO Allocations to WorldCom Executives

Washington, DC -- Congressmen Paul E. Kanjorski (D-PA) and Christopher Shays (R-CT) today expressed disappointment with the initial response they received from a Salomon Smith Barney attorney regarding their request for information about whether and how the investment bank allocated shares in initial public offerings (IPOs) to WorldCom executives. They also called on Salomon to seek immediate waivers from individuals affected by their request to produce this information.

"Because of financial privacy laws, Salomon's attorney unfortunately could not directly and comprehensively respond to our questions about the investment bank's IPO allocations to WorldCom decisionmakers like Bernie Ebbers," said Congressman Kanjorski. "Pursuant to its letter, I hope that Salomon will be forthcoming with this information as quickly as possible."

"Salomon has indicated it is working to gather the information to respond to our request. I hope WorldCom's executives and directors will quickly consent to making public the information we requested about their participation in IPOs underwritten by Salomon," added Congressman Shays.

When the House Financial Services Committee held the first congressional hearing on the disturbing accounting problems at WorldCom on July 8, Congressmen Kanjorski and Shays asked Salomon Smith Barney analyst Jack Grubman whether senior WorldCom executives had been allocated lucrative IPO shares during the "dot com" craze. Obtaining scarce IPO shares during the late 1990s was equivalent to receiving a windfall profit. Mr. Grubman responded that he could not recall whether Salomon had allocated IPO shares to WorldCom's leaders. Subsequently, the legislators wrote to Mr. Grubman and requested the information by the close of business on July 11. They received a reply late yesterday evening.

In response to their letter, the Salomon attorney acknowledges that the company is "ready and willing to provide" the information requested. She additionally notes that Salomon is preparing to produce similar information for the National Association of Securities Dealers (NASD), which regulates brokers and dealers, these types of transactions, and the way they are managed. The NASD also has an exemption under federal privacy laws to receive such materials.

"The NASD is in an excellent position to determine the propriety of Salomon's IPO allocation policies and whether these practices contributed to any conflicts of interest," noted Congressman Kanjorski. "In particular, I hope that the NASD will examine whether Salomon tied its WorldCom investment banking business to its allocation of IPO shares to the telecommunications company's executives."

-more-

Congressman Shays said, "After the hearing, the *Wall Street Journal* reported that WorldCom CEO Bernie Ebbers was among the investors who purchased IPO shares. In indicating that Salomon has 'nearly completed the process of gathering information' responsive to our inquiry, the investment bank implies that other WorldCom decisionmakers may have also participated in underwritten IPOs."

The *Wall Street Journal* reported on July 10 that Bernie Ebbers was among those investors who purchased shares of Rhythms NetConnections at the IPO or thereafter, which Salomon Smith Barney helped to underwrite. The article notes that the price of stock in Rhythms Net soared 229 percent on the first day of trading.

Congressman Kanjorski noted, "The Salomon letter also confirms that the company's policies favor wealthy individuals like WorldCom's leaders with access to 'friends and family' IPO allocations. As a result, WorldCom's middle-income, hard-working 'Friends and Family' customers who lacked such special access could not participate in this monetary windfall. As we examine the lessons of the Internet bubble, I hope that all investment banks will reevaluate their policies to improve fairness in the allocation of IPO shares in the future."

Congressman Shays concluded, "I look forward to receiving a full and accurate accounting from Salomon Smith Barney as quickly as possible. Such a response will help us understand how we can prevent future failures in corporate accountability like at WorldCom."

-End-

NOTE: Citigroup's Salomon Smith Barney's letter to Congressmen Kanjorski and Shays (two pages total) is attached.

Congress of the United States

Washington, DC 20515

July 8, 2002

Mr. Jack B. Grubman
Managing Director
U.S. Equity Research Division
Salomon Smith Barney
New York, New York 10013

Dear Mr. Grubman:

We are seeking additional information about the relation between your firm, Salomon Smith Barney, on the one hand, and senior executives at MCI WorldCom, Inc., on the other hand. Specifically, and in furtherance of our questions at today's hearing of the House Financial Services Committee, we request that you forward the information that we request as soon as possible, but in any event by the close of business on Thursday, July 11, 2002.

1. Has Salomon Smith Barney permitted Mr. Bernard Ebbers or any other current or former officer, director, executive or employee of MCI WorldCom to purchase or otherwise acquire any shares or any other security in any initial public offering (IPO) that Salomon Smith Barney underwrote, or otherwise had access to, at any time in the past five years?

2. If so, please list the IPO; the MCI WorldCom officer, director, executive or employee who acquired the IPO shares; the number of shares that the MCI WorldCom executive bought or acquired; the date of the sale; and the acquisition price.

Please respond to our request consistent with all applicable law and regulation by faxing your material to our Washington offices at (202) 225-0764 and (202) 225-9629. We intend to include the responses that you provide in the Committee's record of today's hearing.

Sincerely,

Paul E. Kanjorski
Member of Congress

Christopher Shays
Member of Congress

PRINTED ON RECYCLED PAPER

Thursday June 27, 9:00 pm Eastern Time

ACCOUNT-ABILITY: WorldCom May Not Turn Eyes From Ebitda

By: Christine Nuzum, Of DOW JONES NEWSWIRES

NEW YORK -(Dow Jones)- WorldCom Inc. (NasdaqNM: WCOM - News) 's (WCOME) multibillion-dollar accounting fraud has hurt industries associated with a somewhat controversial metric known as Ebitda, but some experts say the measure will continue to be widely used to assess financial performance.

"I don't think it loses credibility," said Robert Willens, a tax and accounting analyst at Lehman Brothers. "I still think it's a useful number and I don't see people getting away from it as much as being sure they understand the components of it."

The use of Ebitda, or earnings before interest, taxes, depreciation and amortization, to assess stocks took off in the late 1980's and early 1990's after a few years of merger mania, according to Pat McConnell, an accounting analyst at Bear Stearns. It is used to measure the financial health of companies in capital-intensive industries, such as cable and telecommunications, where capital investment reduces profit to little or nothing. It also shows the amount of earnings available to support and pay off debt, making it a useful tool for measuring a company's susceptibility for being acquired, said Willens.

Detractors of Ebitda warn that it diverts attention from a company's profits and losses, which are in the end, what make or lose money for investors. Investment luminary Warren Buffett is a particularly prominent opponent of the widespread reliance on Ebitda.

However, WorldCom's accounting gimmick masked a loss with a phantom profit, although the sum of the inflation was greater for the company's Ebitda. The company's free cash flow was not affected by its fraudulent accounting, but using another tactic could rejigger that metric as well, said McConnell.

"If management is willing to engage in fraud, there is no financial statement that can't be manipulated," she said.

Analysts agree that WorldCom's fraud will further intensify the scrutiny of all financial metrics, including Ebitda, that has already heightened in the wake of other corporate scandals, such as Enron Corp.

Willens points out that the WorldCom fiasco may lend new weight to the cash flow statement, which generally receives less attention than the balance sheet or income statement. WorldCom's impropriety, which also affected the income statement, shifted cash from operating cash flow, which is highly scrutinized, to the less prominent area of cash from investing or cash from financing, said Willens.

-Christine Nuzum; Dow Jones Newswires; 201-938-5172

THE WALL STREET JOURNAL.

RAYBURN REFERENCE

© 2002 Dow Jones & Company, Inc. All Rights Reserved

TUESDAY, JULY 2, 2002 - VOL. CCXL NO. 2 - ★★★★ $1.00

POLITICAL CAPITAL

By ALAN MURRAY

Inflated Profits In Corporate Books Is Half the Story

SO NOW WE KNOW: In the last decade, leading American corporations have teamed up with unscrupulous (or incompetent) accountants to mislead shareholders about how much money they make. But that is only half the story.

At the same time, many of those same companies have teamed up with the same accountants to mislead the Internal Revenue Service about how *little* money they make. The result is a huge and growing gap—call it the credibility gap—between book income and taxable income. If the efforts at accounting overhaul now under way are to be successful, they will need to close that yawning gap ... from both ends.

Consider the case of WorldCom. Between 1996 and 2000, the company reported $16 billion in earnings to its shareholders. But to the tax man, it reported less than a billion dollars of taxable income. The truth undoubtedly lies somewhere in between. Enron has a similar story. To its shareholders, it reported profit of $1.8 billion between 1996 and 2000. But it told the IRS that it lost a billion dollars during the same period, according to calculations by Robert McIntyre of the labor-backed group, Citizens for Tax Justice. A study of more than 17,000 publicly traded firms by Gil Manzon of Boston College and George Plesko of MIT confirms that the gap widened for all of corporate America through the 1990s.

The games that allow companies to achieve such anomalous results are often the brainchildren of clever accountants and investment bankers. One particularly egregious tactic used by Enron was the now infamous "MIPS"—a security invented by Goldman Sachs that counted as debt on the company's tax return, but equity on its public books. Regardless of whether MIPS technically complied with the law, it was a sham. And any honest accountant or tax lawyer who works at one of the big accounting firms will tell you such tactics have become increasingly common, and increasingly outrageous, in the last decade. Indeed, fierce arguments have occasionally broken out at those firms between publicly minded tax experts who still feel some obligation to abide by the spirit of the tax laws, and profit-minded partners eager to find clever new ways to exploit every loophole in the law.

Lying to the IRS doesn't generate the same public outrage as lying to shareholders. In some quarters of the country, it is almost seen as a patriotic act. Americans have a peculiar ability to view the public's finances as separate from their own. During the savings and loan crisis a decade ago, for instance, a talk show host asked a guest whether taxpayers should foot the bill for the savings and loan mess. "No, no, no," the guest replied without hesitation. "The government should pay."

BUT IT'S INCREASINGLY clear that lying to shareholders and lying to the IRS are just opposite sides of the same coin. Accounting is no longer a way to provide an accurate and unified view of a company's finances. Instead, it has become a means to an end. For the public books, the goal is to achieve smooth and steady earnings growth that will lift the value of the company's stock (and the value of executives' stock options.) For the IRS, the goal is the exact opposite—keeping income, and thus taxes, to a minimum. The fact that accountants have become so good at serving both ends is the clearest evidence of the corruption of their profession.

So what's to be done? Well, for starters, publicly traded companies should be required to make tax returns public. That kind of information may not be much use to the average investor. But conscientious stock analysts—surely there are some out there?—could spend their time analyzing the gaps between book and tax income, attempting to find truth in between. Some critics will complain that publicizing tax returns violates the privacy of corporations. But just how much privacy are public companies entitled to? At the moment, it seems they have too much.

And over time, Congress and the Securities and Exchange Commission should work to bring the two measures of income into closer alignment. That won't be easy, and it goes against congressional instincts. Congress shares much of the blame for the existing credibility gap, having adopted tax loopholes over the years in response to lobbying from accountants, investment banks and corporations.

But a unified definition of income for both book and tax purposes would go a long way toward alleviating the current problems. No matter how much money Congress pours into the SEC, or how strong an accounting oversight board it creates, corporations will always have the resources and ability to outwit regulators ... as long as they have the incentive. Reuniting book and tax income would take away some of that incentive. If a company wants to overstate its income, it would have to pay more taxes as a result. And if it wanted to reduce taxes, it would have to moderate its income claims.

The result could be more honest accounting.

Alan Murray is Washington Bureau Chief of CNBC and co-host of Capital Report, which airs Tuesday through Friday at 7 p.m.

THE CHAIRMAN

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

May 21, 2002

The Honorable Brad Sherman
Committee on Financial Services
U.S. House of Representatives
1524 Longworth House Office Building
Washington, D.C. 20515

Dear Congressman Sherman:

During my testimony before the House Financial Services Committee on March 20, 2002, you requested that I submit for the record an estimate of the increase in Commission resources that would be required to increase the level of financial statement reviews. You asked that a cost estimate be provided for annual reviews at three levels of effort covering the top 500, 1000 and 2000 firms. As I noted during the hearings, it is impractical for Congress to attempt to provide the Commission with sufficient resources to do a comprehensive review of the top 500, 1000 or 2000 companies. Apart from the enormous cost of such a process, there is ultimately no assurance that the additional expenditures would ensure the quality of audits or financial reporting.

As I noted in my testimony, the Administration's request for fiscal year 2002 supplemental funding includes $20 million to finance 100 new positions for the Commission. Our plan would be to allocate 30 positions to the Division of Corporation Finance to expand, improve and expedite our review of periodic filings. Our Division of Corporation Finance has undertaken to monitor the annual reports submitted by all Fortune 500 companies that file periodic reports with the Commission in 2002. This new initiative, which we announced in December, significantly expands the Division's review of financial and non-financial disclosures made by public companies. The additional funds would allow the Division to perform full reviews of more public companies' annual filings.

Thank you for your support of the Commission's programs. Should you have additional questions, I would be pleased to be of assistance.

Yours truly,

Harvey L. Pitt

Harvey L. Pitt

ARNOLD & PORTER

Irvin B. Nathan
Irvin_Nathan@aporter.com
202.942.5070
202.942.5999 Fax
555 Twelfth Street, NW
Washington, DC 20004-1206

July 8, 2002

VIA FAX AND HAND DELIVERY

The Honorable Michael G. Oxley
Chairman
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515-6050

Re: Subpoena to Scott D. Sullivan

Dear Chairman Oxley:

On behalf of our client, Scott D. Sullivan, former Chief Financial Officer of WorldCom, Inc., who has been subpoenaed to appear before the Committee today, we hereby inform the Committee, as we had informed your staff last week: Mr. Sullivan, reluctantly and contrary to his desire to testify, will follow the advice of counsel and respectfully decline to testify, based upon his rights under the Fifth Amendment to the U.S. Constitution. In connection with Mr. Sullivan's decision to invoke his Constitutional privilege, we respectfully make the following requests.

First, we request the Committee to draw no adverse inference based on Mr. Sullivan's invocation of his Fifth Amendment Constitutional rights and not to engage in a rush to judgment about the complex financial and accounting issues involved. As you know, the U.S. Supreme Court has repeatedly observed that one of the basic functions of the Fifth Amendment is to protect the innocent. We understand investors, employees, and the public may be inclined to seek particular individuals to blame for a company's financial woes. However, we note that, with respect to the telecommunications industry generally, and WorldCom in particular, the substantial decline in stock prices occurred long before WorldCom's recent announcement that it would restate certain of its financial statements. The decline in stock prices appears to have stemmed from a broad array of economic, competitive, and legal issues that were far beyond the control of any particular individual. Moreover, the accounting issues raised by WorldCom's restatement involve complex judgments, based on a variety of factors. While Mr. Sullivan is interested in explaining the factors considered and the judgments made, at this early time in an emerging series of proceedings, including two federal grand jury investigations, we, out of an abundance of caution, have advised him to assert his rights under the Fifth Amendment.

Second, in light of Mr. Sullivan's decision, and as previously requested of your staff, we ask that you accept this letter from counsel in lieu of Mr. Sullivan's appearance at the hearing. No legitimate purpose is served in making him appear in person to assert his rights in a setting that could significantly prejudice Mr. Sullivan in other forums at a later time. In an analogous situation, standard practice in federal grand jury proceedings is generally to accept the representation of counsel of a target's intention to assert his rights under the Fifth Amendment and to excuse the individual from appearing in person. *See* U.S. Attys' Man. 9-11.154. Such practice recognizes that when an individual intends to assert a valid Fifth Amendment privilege, no proper purpose is served by parading that individual in front of others to prejudice him in the eyes of those who must make judgments about his past conduct. Similarly, there is no valid reason here to require Mr. Sullivan to invoke his Fifth Amendment rights personally in a public setting and potentially prejudice him in the minds of those who may sit in judgment of him in the future.

Third, if you determine it is necessary for Mr. Sullivan to assert his Constitutional rights in person before the Committee, we respectfully request you excuse him promptly after he makes it clear he intends to assert such rights with respect to any questions that relate to your investigation of WorldCom. Indeed, it is generally viewed as an abuse of a witness's Constitutional rights to require him to continue asserting the privilege repeatedly in response to questions in areas that he has indicated will not be answered. *See* John C. Grabow, *Congressional Investigations, Law and Practice* § 4.2[a], p. 126. In this connection, we note an opinion of the District of Columbia Bar, which stated that, in the context of a congressional hearing, it is unethical for a D.C.-licensed lawyer to continue to propound questions to an individual when, as a result of asserting the Fifth Amendment, it is clear that there will be no answers forthcoming. *See* District of Columbia Legal Ethics Committee, Opinion No. 31 (March 29, 1977).

We have also been advised by the Committee's staff that it is the present plan to require Mr. Sullivan to remain at the witness table while others testify about events at WorldCom. Based upon statements in the press by individuals, who are expected to testify at the hearing, it appears at least some of the witnesses, perhaps for self-serving reasons, will level accusations at Mr. Sullivan. Because his counsel will be unable to cross examine witnesses, and because of his assertion of his Constitutional rights, Mr. Sullivan would be unable to defend himself in such a situation. To require him to sit at the witness table and remain mute while such charges are made under these circumstances would seriously prejudice Mr. Sullivan's rights and call into question the fundamental fairness of the Committee's investigation.

Therefore, if the Committee insists that adverse testimony concerning Mr. Sullivan be taken in his presence, then we respectfully request, pursuant to Rule XI

ARNOLD & PORTER

of the Rules of the U.S. House of Representatives, that all such testimony be taken in executive session outside of the presence of television cameras and the press. The Rule is clearly designed to protect individuals from public testimony which is likely to "defame, degrade, or incriminate" them. The Rule recognizes that in a public House committee hearing, such an individual will have no opportunity to defend himself and could thereafter be seriously prejudiced in future proceedings. Precisely such prejudice will result if Mr. Sullivan is seen remaining silent while accusations, however unjustified, are hurled at him in a situation where, because of his valid assertion of his Constitutional rights, he will be unable to respond. We emphasize that we are not asking that Mr. Sullivan's assertion of his Fifth Amendment privilege be taken in executive session, and we are not asking that all testimony of others about his actions be taken in executive session. We are only asking that if the Committee insists on combining the two events in one panel session prior to his being excused, that, consistent with the letter and spirit of the House Rules and fundamental fairness, the adverse testimony be taken in executive session.

Mr. Sullivan and his counsel support your efforts to understand the complex facts relating to WorldCom and any relevant corporate management, governance, disclosure and accounting issues that inform the work of the Committee in developing legislation and overseeing the work of federal regulators. However, parallel inquiries that could subject individuals to potential criminal exposure require that we advise Mr. Sullivan to invoke his Constitutional rights under the Fifth Amendment. We ask that (i) you respect his assertion of his Constitutional right; (ii) you accept this letter in lieu of his appearance at the hearing and (iii) you take the other steps requested in this letter to insure the fairness of the hearing and the avoidance of undue prejudice to any individual. We hope to be able to assist you at a later time.

We appreciate your consideration. I am available to discuss our requests further with you at your earliest convenience. Please feel free to call me at (202) 942-5070 or my partner Marti Cochran at (202) 942-5228.

Sincerely,

Irvin B. Nathan
Counsel to Scott D. Sullivan

cc: The Honorable John J. LaFalce

ANDERSEN

WORLDCOM

2001 Audit Plan and Proposed Fee Arrangements

June 6, 2001

Confidential Treatment
Requested by WorldCom

Members of the Audit Committee:

On the next few pages we have synopsized our proposed 2001 audit plan and proposed fee arrangements for WorldCom, WorldCom Group and MCI Group. In forming the plan and developing the fee proposal we have discussed with executive and senior operating management the significant business risks facing the Company, considered the results of recent audits and used our own judgment to assess the significance and likelihood of financial statement misstatement. We believe our audit plan responds to the traditional risk areas faced by the Company while emphasizing emerging risk areas such as new lines of business and unique transactions. We value the Committee's input to the audit plan and proposed fees and welcome the opportunity to address your questions or concerns.

We have enclosed an overview of our audit process to assist the Committee in understanding the context in which the plan and fee were developed and the method of its execution. We look forward to presenting the plan to the Committee at the June 6th meeting.

If you have any questions before the meeting we would welcome the opportunity to address those individualty.

Very truly yours,

ARTHUR ANDERSEN LLP

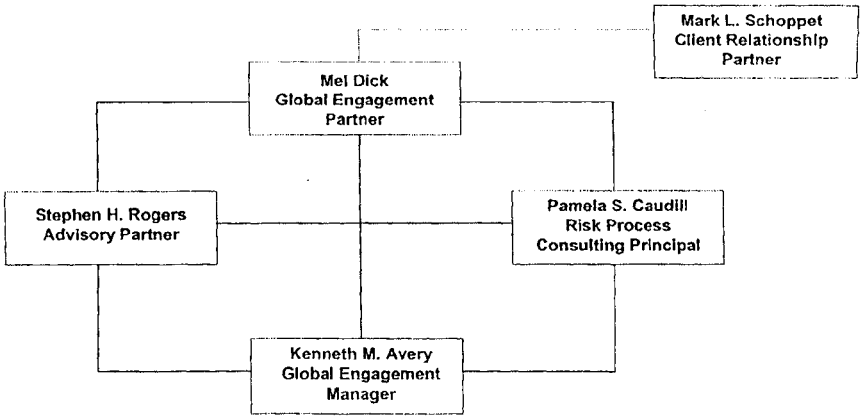
Mel Dick

Melvin Dick

Confidential Treatment
Requested by WorldCom

1WCOM/COFS:00346

WorldCom Client Service Team



Confidential Treatment
Requested by WorldCom

Client Service Team, *continued*

Melvin A. Dick
Global Engagement Partner

Mel is an experienced partner who is responsible for Andersen's Global Technology, Media and Communications (TMC) audit, tax and consulting services. Mel has previously served as Andersen's global wireless communications leader. Mel has spent the majority of his career working with diverse telecommunications companies. Mel was the lead engagement partner for US West from 1987 through 1996, and Level 3 Communications from 1998 through 2000. Mel has also served as engagement partner for MediaOne Group, US West New Vector and Teletech.

Stephen H. Rogers
Advisory Partner

Steve is the managing partner of the Atlanta office, as well as the managing partner of Southeast region of which Jackson is a part. He is one of the four principal partners for operations of Andersen in the United States and one of the 12 partners responsible for operations of Andersen worldwide. Steve has served clients for more than 29 years in various industries, including manufacturing, technology, and telecommunications.

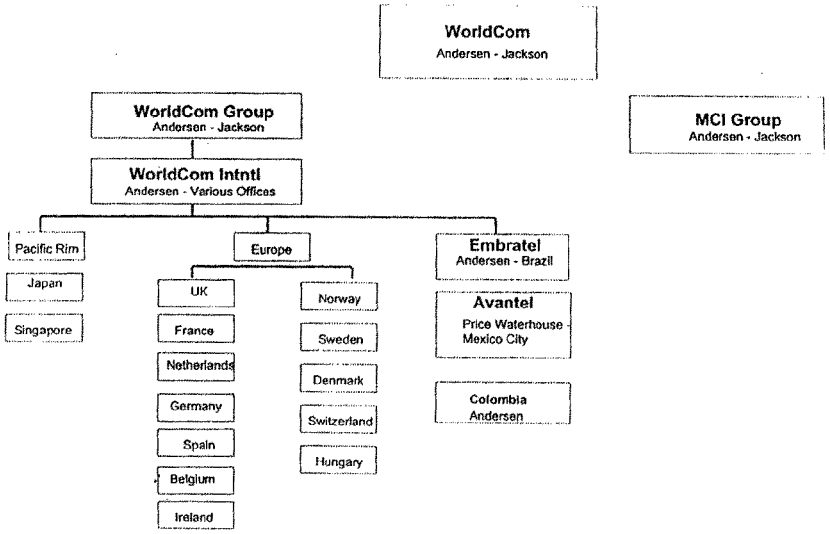
Mark L. Schoppet
Client Relationship Partner

Mark has 20 years of experience in the telecommunications profession and served as the engagement partner for WorldCom from 1994 through 2000. He is a member of our Firmwide Telecommunications Industry Team and has dedicated his career to the telecommunications industry.

Client Service Team, *continued*

Pamela S. Caudill Risk Process Consulting Principal	Pam leads the Mid-South technology Risk Consulting practice and has more than 26 years of experience with Andersen. She has assisted with the development and execution of the technology related audit plan for the past 7 years at WorldCom. Throughout her career she has provided assistance to many multinational clients including Fedex and International Paper among others.
Kenneth M. Avery Global Audit Manager	Kenny is a senior audit manager in the Jackson office and has been with the firm 11 years. He has served as the audit engagement manager for WorldCom for the past 3 years and has extensive experience in serving global companies.

Coordination of Consolidated WorldCom Audit



Confidential Treatment
Requested by WorldCom

1WCOM/COFS:00350

Summary of Audit Process

- The results of our assessment of the Company's control processes allow us to determine the extent of any remaining risks.
- Where residual audit risk exists, detective procedures are designed and executed to reduce the risk to an acceptable level. Detective procedures consist mainly of:
  - Inspection and vouching of business data to source documents
  - Reperformance of computations
  - Corroboration of business data with 3rd parties
  - Performance of analytical procedures to assess reasonableness of business outputs

Confidential Treatment Requested by WorldCom

1WCOM/COFS:00351

Audit Materiality Used

- Based on our discussions with management and understanding of the business, we identified the significant risks related to the Company's key accounting principles and practices, judgments and estimates and transaction processes.
- In identifying "significant" risks, we consider their potential materiality to the Company's and related group's financial statements.
  - In general, materiality is defined as an amount equal to approximately 5% of anticipated pre-tax income, or approximately $285 million in the case of WorldCom.
  - In order to identify misstatements that could aggregate to a material amount, we will design our work to detect misstatements of $14.0 million (pre-tax) on a consolidated basis (Approximates $9.0 million for the WorldCom group and $5.0 million for the MCI group).

Confidential Treatment
Requested by WorldCom

Process Effectiveness Assessment - Key judgment and Estimate Processes

- We will review the process for formulating each key judgment and estimate in order to assess its effectiveness in preventing a material misstatement in the financial statements.
- In forming our assessment of each process, we will consider the following:
  - is management using the proper data to formulate the particular judgment or estimate (e.g., historical bad debt rates, historical data, trends, etc.)?
  - does the Company have controls in place to ensure that the data utilized has integrity?
  - is management using the data in the proper way (i.e., rendering an appropriate conclusion)?
- In assessing the effectiveness of each process in preventing a material misstatement in the financial statements, we will utilize the following scale:
  - ● Process is effective
  - ○ Process is effective, however certain process improvement opportunities were identified
  - ● Process is ineffective

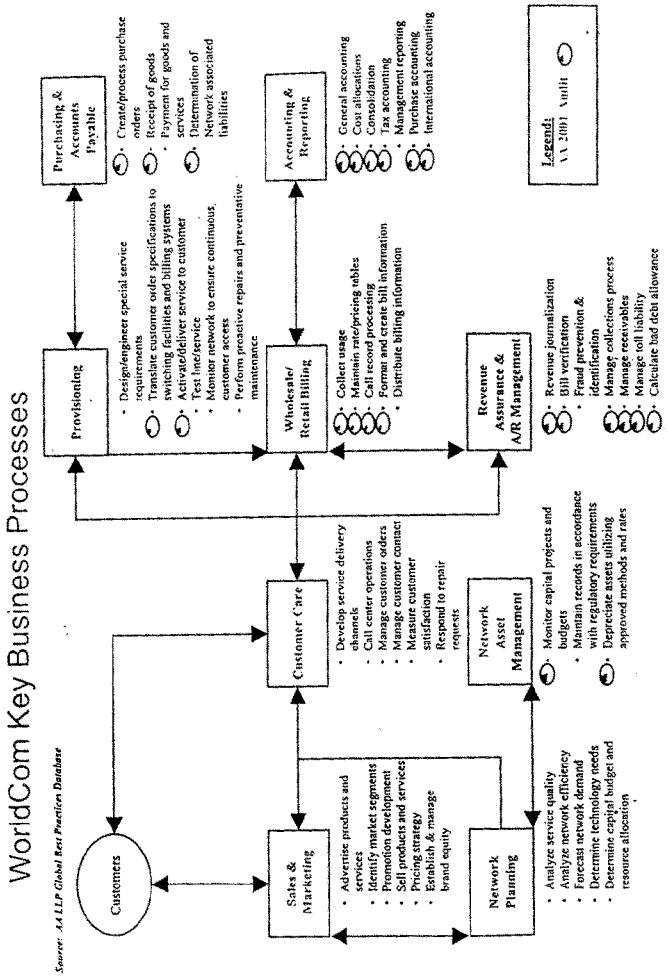
Confidential Treatment Requested by WorldCom

Process Effectiveness Assessment - Transaction Processes

- We will review the key transaction processes in order to assess their effectiveness in preventing a material misstatement in the financial statements.
- In forming our assessment of each process, we will determine whether management has adequate controls to prevent a material error in the financial statements as a result of a failure to properly:
  - capture transactions
  - process data
  - record data in the general ledger
- In assessing the effectiveness of each process in preventing a material misstatement in the financial statements, we will utilize the following scale:
  - ● Process is effective
  - ○ Process is effective, however certain process improvement opportunities were identified
  - ● Process is ineffective

Confidential Treatment Requested by WorldCom

WCOM/COFS-00354



Confidential Treatment
Requested by WorldCom

Overall Business Reality of WorldCom

- Access, info system integrity, Infrastructure & Relevance
- Change Readiness
- Communications
- Competitor
- Compliance
- Customer Satisfaction
- Efficiency
- Human Resources
- Organizational Structure
- Performance Gap
- Performance Incentives
- Performance Measurements
- Pricing
- Product Development
- Service Order Fulfillment
- Service Failure

Confidential Treatment
Requested by WorldCom

WCOM/COFS:00356

WorldCom Key - Accounting Principles and Practices

- Accrued Liabilities - Line Costs
- Affiliated Transactions
- Capitalization of Internal Use Software
- Income Taxes
- PP & E - Proper Capitalization of Assets
- Long-Term Asset Valuation
- Revenue Recognition
- Earnings Per Share
- Special Charges
- Allowance for Doubtful Accounts
- Other Current Liabilities
- Comprehensive Income
- Consolidation
- Segment Disclosures
- Valuation of Assets - Foreign Currency Translation

Confidential Treatment
Requested by WorldCom

WorldCom Key - Judgments and Estimates

- **Income Tax Reserves**
- Legal Reserves and Contingent Liabilities
- **Asset Depreciable Lives**
- Accrued Line Costs
- **Impairment of Long-Lived Assets**
- Annual Effective Tax Rate in Interim Reporting
- **Related Party Transactions**
- Settlements - Unbilled Amounts
- **Unrecorded Liabilities**
- Unbilled Revenue
- **Allowance for Doubtful Accounts**
- Cost versus Equity method accounting for investments

Confidential Treatment
Requested by WorldCom

1WCOM/COFS:00358

WorldCom Key - Critical Processes

- Process Accounts Payable
- Bill the Customer
- Journalization of Revenue
- Collection of Accounts Receivable
- PP&E - Capital Expenditures - Initiation of Work Order
- PP&E - Retirements, Inactive, Dispositions
- Network Development and Maintenance
- Customer Care and Retention
- Process Payroll
- Deliver Services to the Customer
- Strategic Planning
- Perform Account Reconciliations
- Revenue Cycle
- Expenditure Cycle
- Property Cycle
- Accounting and Financial Reporting

Confidential Treatment
Requested by WorldCom

1WCOM/COFS:00359

WorldCom Key - Financial Reporting Processes

- Consolidation
- Post-Closing Adjustments and Reclassifications
- Preparation of Financial Statements
- Process Finance and Accounting Transactions
- General Ledger
- Management Reports
- SEC Filings
- Conversion of Data to Accounting and Management Information

Confidential Treatment Requested by WorldCom

1WCOM/COFS:00360

Confidential Treatment
Requested by WorldCom

2001 Proposed Fees and Expenses

We understand your need to control administrative costs of all types, including professional fees. We are committed to delivering the best possible service of the highest quality at a reasonable fee, both now and in the future. We plan to conduct the audit with experienced resources. Our engagement team will ensure that the appropriate focus and analytical skills are brought to bear on the 2001 audit. We also believe your investment in the right level of expertise is crucial to the success of WorldCom.

	2001 Proposed	2000	1999
Audit of WorldCom, WorldCom Group and MCI Group	$ 2,000,000	$ 2,000,000	$ 1,825,000

The above fee proposal does not include out-of-pocket expenses that will be incurred during the course of the audit work. We anticipate that out-of-pocket expenses will not exceed $120,000.

WCOM/COFS:00361

Confidential Treatment
Requested by WorldCom

2001 Proposed Fees and Expenses, *continued*

We understand during the course of the next year you will need assistance in certain accounting-related matters. Our billing for such assistance will be based on hours incurred, based on the following rates, plus out-of-pocket expenses:

Partner	$	305
Senior Manger		240
Manager		185
Experienced Senior		160
Senior		150
Staff		95

IWCOM/COFS-00362

ANDERSEN

Report to the Audit Committee
Year Ended December 31, 2001

February 6, 2002

1WCOM/COFS:00188

Note: This presentation is intended solely for the information and use of management and the Audit Committee of the Board of Directors of WorldCom, Inc. and is not intended to be used by anyone other than those specified parties.

February 4, 2002

Audit Committee of the Board of Directors WorldCom, Inc.

Clinton, Mississippi

Members of the Audit Committee:

Over the next few days we will be completing our audit procedures on WorldCom, Inc.'s consolidated results of operations and financial position, as well as, WorldCom Group and MCI Group as of and for the year ended December 31, 2001. At the February 6th meeting we will be prepared to discuss with the Committee the results of our audit procedures and respond to any questions. In addition, we will discuss with the Committee certain matters, including our independence as external auditors of the Company, which is required by professional standards and the Securities and Exchange Commission.

We will be prepared to respond to questions from the Committee and management about the enclosed materials on February 6th. Of course, we will be pleased to address any questions you have prior to that time. We look forward to meeting with you next week.

Very truly yours,

ARTHUR ANDERSEN LLP

Melvin Dick

Purpose of Our Report

- Summarize our audit approach and audit results for the year ended December 31, 2001
- Discuss our views regarding WorldCom's key accounting principles and practices, transaction processes and judgments and estimates used in the preparation of the WorldCom, Inc., WorldCom Group and MCI Group financial statements
- Communicate matters required by professional standards
- Provide an opportunity for the Audit Committee to ask questions of us as part of discharging their due diligence responsibility

Overall Summary of Results

- WorldCom, Inc. and WorldCom Group and MCI Group balance sheets and income statements are fairly presented in accordance with accounting principles generally accepted in the United States.
- Work is in progress on review of financial statement disclosures and other information to be included in the WorldCom, Inc. Annual Report and SEC filings.

Required Communications to the Audit Committee – Quality of the Company's Financial Reporting

Significant Accounting Policies

- There were no significant changes in accounting policies in the current year.
- We noted no significant or unusual transactions, or material transactions in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

Management Judgments and Accounting Estimates

- Accounting estimates are an integral part of the financial statements prepared by management and are based upon management's current judgments. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments.
- We are satisfied as to the reasonableness of management's current judgments regarding such estimates in the context of the financial statements taken as a whole, based on our knowledge of management's process for making such judgments, inquiries of management and others regarding such matters, and other audit procedures applied during our engagement.
- Those items representing particularly sensitive accounting estimates are discussed in the following slides.

WorldCom Key - Accounting Principles and Practices

- Revenue Recognition
- Affiliated Transactions
- Capitalization of Internal Use Software
- Income Taxes
- PP & E - Proper Capitalization of Assets
- Pensions
- Long-Term Asset Valuation
- Securitization of Receivables
- Earnings Per Share
- Comprehensive Income
- Segment Disclosure
- Valuation of Assets - Foreign Currency Translation
- New Accounting Standards
- Business Combinations
- Stock Options

WorldCom Key - Accounting Principles and Practices

Area	Assessment
• Revenue Recognition	[redacted]
• Affiliated Transactions	
• Capitalization of Internal Use Software	
• Income Taxes	
• PP & E - Proper Capitalization of Assets	
• Pensions	
• Long-Term Asset Valuation	
• Securitization of Receivables	
• Earnings Per Share	
• Comprehensive Income	
• Segment Disclosure	
• Valuation of Assets - Foreign Currency Translation	
• New Accounting Standards	
• Business Combinations	
• Stock Options	

Process Effectiveness Assessment - Transaction Processes

- We have held updated discussions with members of management and performed testing related to key transaction processes in order to assess their effectiveness in preventing a material misstatement in the financial statements and to determine whether or not any significant changes have occurred.
- In forming our assessment of each process, we determined whether management has adequate controls to prevent a material error in the financial statements as a result of a failure to properly:
  - capture transactions
  - process data
  - record data in the general ledger
- In assessing the effectiveness of each process in preventing a material misstatement in the financial statements, we have utilized the following scale:
  - ● Process is effective
  - ○ Process is effective, however certain process improvement opportunities were identified
  - ● Process is ineffective

WorldCom Key - Transaction Processing Areas

Area	Assessment
• Revenues – Revenue Assurance – Revenue Adjustments – Customer Setup – Management reports	
• Line Costs – Line Cost Accrual – Line Cost Disputes – Line Cost Allocation Report	
• Property Plant & Equipment – Capitalization of Assets – Capitalization of Internal Use Software	
• Financial Reporting Process – Consolidation – Post-closing adjustments – Preparation of financial statements – in process – SEC filings – in process	

Process Effectiveness Assessment - Key judgment and Estimate Processes

- We have reviewed management's process for formulating each key judgment and estimate in order to assess its effectiveness in preventing a material misstatement in the financial statements. We have updated these procedures on a quarterly basis through discussion and analytical reviews and through our preliminary and final testing.
- In forming our assessment of each process, we considered the following:
  - is management using the proper data to formulate the particular judgment or estimate (e.g., historical bad debt rates, historical data, trends, etc.)?
  - does the Company have controls in place to ensure that the data utilized has integrity?
  - is management using the data in the proper way (i.e., rendering an appropriate conclusion)?
- In assessing the effectiveness of each process in preventing a material misstatement in the financial statements, we utilized the following scale:
  - ● Process is effective
  - ○ Process is effective, however certain process improvement opportunities were identified
  - ● Process is ineffective

WorldCom Key - Judgments and Estimates

Area	Assessment
• Allowance for Doubtful Accounts	[redacted]
• Accrued Line Costs	
• Line Cost Disputes	
• Purchase Accounting	
• Income Tax Reserves	
• Legal Reserves and Contingent Liabilities	
• Asset Depreciable Lives	
• Impairment of Long-Lived Assets	

WorldCom Judgment and Estimate Processes

Judgment or Estimate	Description	Process Changes	Discussion and Other	Assessment	Residual Audit Risk
Allowance for Doubtful Accounts	The Company maintains reserves designed to cover amounts in accounts receivable which will not be collected.	None	Initial reserves are provided based upon a historical average of net write-offs in relation to billings; additional amounts are provided for conservatism or alternatively via specific reserves. Various analytical measures are employed to assess the adequacy of the reserve. The Company performs a "look-back" test which compares reserves to subsequent net write-offs to determine the accuracy of the reserve estimation process.		None Noted

WorldCom Judgment and Estimate Processes

Judgment or Estimate	Description	Process Changes	Discussion and Other	Assessment	Residual Audit Risk
Line Cost Accrual	Line costs represent charges from LECs for leased lines or traffic termination. Line costs as a percentage of revenues have remained flat at 41.9% on a YTD basis. Line costs are allocated between the WorldCom Group and MCI Group based on minutes of use and revenues.	None	Accruals are based on metered traffic as determined by WorldCom. Disputed amounts are reserved for separately see discussion below.		None
Line Cost Disputes	Generally, WorldCom accrues 100% of LEC billed amounts prior to dispute resolution.	None	LEC under billing dispute amounts are maintained for a period of 12 months and are reversed on a monthly basis.		None

WorldCom Judgment and Estimate Processes

Judgment or Estimate	Description	Process Changes	Discussion and Other	Assessment	Residual Audit Risk
Purchase Accounting	In conjunction with the Company's numerous purchase transactions the Company has recorded goodwill and intangible balances of approximately $46 billion. This amount, included in intangibles, represents the largest single asset on the balance sheet and represents excess of purchase price over net assets acquired coupled with unfavorable commitments pursuant to APB 16.	None	In the current year, the Company recorded approximately $5 billion of goodwill additions related primarily to the Intermedia transaction. We worked with the Company to ensure that these additions were recorded properly with respect to authoritative accounting literature.		None
	Goodwill is divided between the tracked entities based on the respective fair values at date of acquisition.				
	The Company is conducting impairment reviews of all intangible assets and expects to complete this assessment in accordance with the provisions of SFAS No. 142.		Consistent with the provisions of SFAS No. 142, the Company anticipates disclosing an impairment charge range in conjunction with the 2001 Form 10-K.		

WorldCom Judgment and Estimate Process

Judgment or Estimate	Description	Process Changes	Discussion and Other	Assessment	Residual Audit Risk
ncome Tax Reserves	Reserves are established as necessary for any tax audit exposures.	None	The Company evaluates the need for reserves related to any tax exposures for U.S. federal, foreign, state and local, property, excise, and sales and uses taxes.		None
Legal Reserve and Contingent Liabilities	Reserves are established as necessary for legal and regulatory matters.	None	The Company monitors the statues of pending and threatened legal and regulatory matters and provides reserves and/or disclosures based on the expected outcome.		None
Asset Depreciable Lives and Impairment	The Company's largest tangible assets relate to the network. Changes in technology over the past years requires management to periodically analyze assigned depreciable lives to determine their appropriateness.	None	We completed a benchmark study with industry standards and found that the Company's lives compared favorably with that of the industry averages.		None

1WCOM/COFS:00202

Required Communications to the Audit Committee

Audit Adjustments

- We will provide a list of all audit adjustments and discuss both recorded and passed adjustments at the Committee meeting.

Disagreements with Management

- There were no disagreements with management on financial, accounting and reporting matters which, if not satisfactorily resolved, would have been material to the financial statements or which might cause a modification of our auditors' report.

Irregularities or Illegal Acts

- We are not aware of any irregularities or illegal acts committed by the Company or its employees.

Consultation by Management with Other Accountants

- We are not aware of any consultations by management with other independent public accountants during the year about auditing or accounting matters.

Difficulties Encountered in Performing the Audit

- We encountered no significant difficulties in performing our audit procedures to date.

Major Issues Discussed with Management Prior to Appointment

- No major issues were discussed with management in connection with our appointment as auditors, including the application of generally accepted accounting principles or generally accepted auditing standards.

1WCOM/COFS:00203

Required Communications to the Audit Committee

Communications Regarding Internal Controls

- Our review of internal controls was made for the purpose of determining the required scope of our audit procedures, not to render a separate opinion regarding the Company's internal control structure.
- There were no material weaknesses in internal controls noted in our testing and evaluation.

Auditor's Responsibility for Other Information in Documents Containing Audited Financial Statements

- We will review the non-financial information included in the Form 10-K (including management's discussion and analysis of financial condition and results of operations) for consistency with information contained in the audited financial statements.

Communications Regarding Auditor Independence

- We are not aware of any issues related to Arthur Andersen's independence that occurred during the Company's fiscal year through the date of this meeting other than those disclosed in the attached letter, which also describes the scope of our services provided during fiscal 2001.

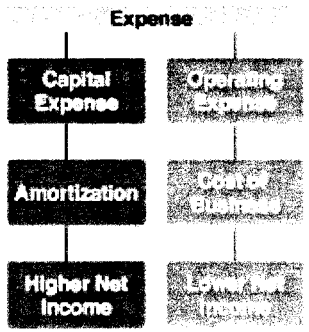
IWCOM/COFS:00204

CREATIVE ACCOUNTING

By booking certain costs as a capital expense, WorldCom was able to boost its bottom line. A look at how the company conducted such accounting in 2001.

WorldCom's accounting

1. Accounts $3.1 billion in 'line costs,' including telecom access and transport charges, as capital expenditure.
2. Plans to amortize $3.1 billion over a period of time, possibly as much as 10 years.
3. Reports net income of $1.38 billion for 2001.



Generally accepted accounting principles

1. The $3.1 billion 'line-cost' expense is booked as an operating expense.
2. The entire $3.1 billion would have been counted as a cost of business for that quarter.
3. Net income for 2001 would have been a loss, amount to be determined.

NEWS

Federal Communications Commission
445 12th Street, S.W.
Washington, D. C. 20554

News media Information 202 / 418-0500
Fax-On-Demand 202 / 418-2830
TTY 202/418-2555
Internet: http://www.fcc.gov
ftp.fcc.gov

This is an unofficial announcement of Commission action. Release of the full text of a Commission order constitutes official action. See MCI v. FCC, 515 F 2d 385 (D.C. Circ 1974).

FOR IMMEDIATE RELEASE
June 26, 2002

Contact: David Fiske
(202) 418-0513

Statement by FCC Chairman Michael K. Powell:

I am deeply concerned by the WorldCom developments, and the impact it could have on consumers and other providers in the industry. We are closely monitoring the situation and are doing everything possible to ensure and protect both the stability of the telecommunications network and the quality of service to consumers.

To better assess the continuing troubles in the telecommunications industry, I will travel to New York on Friday to meet with a variety of telephone industry officials, analysts and debt-rating agencies to gain a first-hand understanding of the recent developments that continue to challenge the telecom industry. Through this exchange, I hope to assure the financial markets that the FCC is committed to doing whatever it can to assist in the recovery of the sector and strengthen the public trust in this vital segment of our economy.

- FCC -

SALOMON SMITH BARNEY

See final page for important disclosures

Target Price Change ☐
Estimate Change ☑
Rating Change ☑

WorldCom Group (WCOM)

WCOM: Lower Est/More Urgency of Recap Cause Downgrade to 4S from 3S

4S *(Underperform, Speculative)*
Mkt Cap: $3,814.9 mil.

June 21, 2002

TELECOMMUNICATIONS SERVICES

Jack B. Grubman
+1-212-816-2877
jack.b.grubman@ssmb.com

Sheri McMahon
+1-212-816-3193
sherlyn.m.mcmahon@ssmb.com

Cheryl Cua
212-816-3371

United States

SUMMARY

- We are lowering our rating on WorldCom to 4S (Underperform/Speculative Risk) from 3S (Neutral/Speculative Risk) since we are lowering our WCOM Group 2002 EBITDA estimate to $6.7B down from our previous estimate of $7.0B (which is the low end of WCOM's guidance of $7-$7.5B in EBITDA). We therefore believe there is a risk of WCOM lowering guidance, again. Our WCOM Inc. 2002 EBITDA estimate goes to $8.2B down from $8.5.
- Since our last Call Note on 5/22/02 1) we are lowering estimates 2) Enterprise spending looks to be getting worse not better 3) WCOM's debt rating has been cut 4) there is a subtle wrinkle in our assumption of the new $5 bil. credit facility currently being negotiated & 5) the urgency for a recapitilization which would significantly dilute equity holders has increased, in our opinion.
- Our $1 price target implies a 3.9x FV/EBITDA roughly in-line with FON and twice where the AT&T stub is trading (2.2x).

FUNDAMENTALS

P/E (12/02E)	9.4x
P/E (12/03E)	17.4x
TEV/EBITDA (12/02E)	4.0x
TEV/EBITDA (12/03E)	4.1x
Book Value/Share (12/02E)	$2.32
Price/Book Value	0.5x
Dividend/Yield (12/02E)	NA/NA
Revenue (12/02E)	$31,330.0 mil.
Proj. Long-Term EPS Growth	2%
ROE (12/02E)	NA
Long-Term Debt to Capital(a)	80.6%

(a) Data as of most recent quarter

SHARE DATA

Price (6/21/02)	$1.22
52-Week Range	$15.88-$1.24
Shares Outstanding(a)	3,127.0 mil.
Convertible	No

RECOMMENDATION

Current Rating	4S
Prior Rating	3S
Current Target Price	$1.00
Previous Target Price	$2.00

EARNINGS PER SHARE

FY ends		1Q	2Q	3Q	4Q	Full Year
12/01A	Actual	$0.30A	$0.28A	$0.24A	$0.20A	$1.02A
12/02E	Current	$0.09A	$0.03E	$0.02E	$0.01E	$0.13E
	Previous	$0.09A	$0.08E	$0.05E	$0.05E	$0.24E
12/03E	Current	NA	NA	NA	NA	$0.07E
	Previous	NA	NA	NA	NA	$0.19E
12/04E	Current	NA	NA	NA	NA	NA
	Previous	NA	NA	NA	NA	NA

First Call Consensus EPS: 12/02E $0.36; 12/03E $0.39; 12/04E $0.37
We are using tangible bk value/share and we factor out goodwill from total capitalization.

OPINION

The reason we are now going to a 4S as opposed to our prior 3S is because of several factors that have come about since we have published our last WCOM note on May 22. We did highlight the risk of recapitalization in our previous note, which would be dilutive to equity holders.

Subsequent to 5/22/02, we believe that there is growing evidence that enterprise spending is not getting any better in 2Q'02. In fact, the fundamentals in the Enterprise space might even be slipping. Our colleague, Heather Bellini, who follows Application Software, has recently lowered her 2Q'02 estimates for many of her companies (see note as of 6/13/02) due in part to tough selling conditions throughout 2Q. In addition, we have seen technology company

pre-announcements in 2Q'02. In addition, Sprint pre-announced that its 2Q revenues would be at the low end of previous guidance and the CPI long distance figures for May came in roughly flat with April's low levels. All of this leads us to believe that the macro conditions for enterprises are softening, and we believe WCOM's credit conditions probably exacerbate the economic situation for WCOM. Thus, we believe that WCOM Group revenues are likely to decline by at least $100 million on a sequential basis. As a result, we believe that WCOM Group's 2002 EBITDA could be as low as $6.7 billion, down from the $7 billion we had previously been expecting. Our previous revenue estimate for WCOM Group was $20.2 billion well below the low-end of guidance of $21 billion. Our revised revenue estimate is $19.6 billion.

Secondly, since our May 22 note, Moody's and S&P downgraded WCOM to single B levels, which we found surprising. However, the ratings downgrades still need to be factored into the analysis for WCOM's overall fair value equity.

We now believe that the $5 billion credit facility is inclusive of the $2.65 billion facility that is currently due in 2003 and the $1.6 billion that is due 2006. We previously expected WCOM to repay the $2.65 billion facility in the near/term and obtain a brand-new secured facility of $5-$6 billion which would be due in 2005 or 2006, as we mentioned in our 5/9/02 First Call Note "WCOM: Follow Up Note After Constructive Conference Call". The difference in our understanding of the facility may or may not be relevant depending on the negotiations with the banks holding the $2.65 billion loan (whether or not they will agree to a maturity date further in the future beyond 2003 when the loan is now due), but nonetheless it is a subtle nuance in our understanding of the new $5 billion credit facility. WorldCom has announced that the lead banks have committed $450 million to the deal, meaning that it needs to raise $300 million for a total of $750 million. In addition WorldCom's press release states that its negotiations with its banks on the new $5 billion credit facility continue to go well. The new $750 million mentioned on 5/17/02 plus the previously drawn down $2.65 billion facility plus the undrawn $1.6 billion facility due in 2006 add up to $5 billion.

Again, while we recognize that the bank credit market is fluid and near-term or a year from now, the facility could be extended, nonetheless, this development suggests somewhat less long-term access to liquidity than we had previously been assuming.

From the WCOM Inc. perspective, a total 2002 EBITDA is likely to be roughly $8-8.2 billion, down from the previous $8.5 billion estimate. The upshot of all this is that a reasonable price target should be $1, which would still be almost 4x EBITDA for WCOM Inc., or almost double what the T stub is trading at. A more immediate issue for the stock (as we cited in our May 22 note) is that it is increasingly clear that WCOM will need to do a recap, where equity will not be defended in order for WCOM to get de-leveraged.

The bottom line on a potential recap is that we believe that with WCOM's debt trading where it is, $30 billion total face value for WorldCom Inc., and with depressed multiples in the industry, we are hardpressed to get much more than a $1 equity value. Given the lower debt rating and business getting worse not better for a wide variety of companies dependent on enterprise spending, we believe WCOM's stock will continue to be under pressure. With their leverage ratio of 3.4x and their debt maturities strung out, WCOM does not have to do anything immediately, and could operate their business as usual but that may not be best for the stock price. If WCOM does not do anything to improve their balance sheet then the equity will stay depressed given the debt load and the industry multiples. If they do something to address the leverage via a recapitalization, it will be very dilutive to current shareholders.

NET/NET

We downgraded the stock to 3H on April 22, when WCOM lowered guidance. We have had an S risk rating for since May 9th. The reasons we are going to 4 now are factors that have developed since our last note of May 22: 1) we believe 2Q02 was a weak quarter for

enterprise spending overall 2) WCOM has a lower debt rating than everyone anticipated, 3) an increasing need to recapitalize, and 4) the subtle change in our assumption of the $5 billion credit facility. Thus, we feel a 4S rating is more appropriate even though we have had a 3S rating for almost 2 months.

IMPORTANT DISCLOSURES

Salomon Smith Barney or its affiliates has received compensation for investment banking services provided within the past 12 months from WorldCom Group.

Salomon Smith Barney or its affiliates is a market maker in the publicly traded equity securities of WorldCom Group.

The # symbol signifies that within the past 12 months, Salomon Smith Barney ("SSB"), including its parent, subsidiaries, and/or its affiliates ("the Firm"), has acted as manager or co-manager of a public offering of this company.

Guide To Investment Ratings: RATING is a guide to the expected total return over the next 12-18 months. The total return required for a given rating depends on the degree of risk (see below) in a stock. The higher the risk, the higher the required return. A Buy (1) rating indicates an expected total return ranging from +15% or greater for a low-risk stock to +30% or greater for a speculative stock. Outperform (2) indicates an expected total return ranging from +5% to +15% for a low-risk stock to +10% to +30% for a speculative stock. Neutral (3) indicates an expected total return ranging from -5% to +5% for a low-risk stock to -10% to +10% for a speculative stock. Underperform (4) indicates an expected total return ranging from -5% to -15% for a low-risk stock to -10% to -20% for a speculative stock. Sell (5) indicates an expected total return ranging from -15% or worse for a low-risk stock to -20% or worse for a speculative stock. RISK takes into account predictability of earnings and dividends, financial leverage, and stock price volatility, among other factors. L (Low Risk): predictable earnings and dividends, appropriate for conservative investors. M (Medium Risk): moderately predictable earnings and dividends, appropriate for average equity investors. H (High Risk): earnings and dividends are less predictable, appropriate for aggressive investors. S (Speculative): very low predictability of fundamentals and a high degree of volatility, appropriate only for investors/traders with diversified portfolios that can withstand material losses. V (Venture): indicates a stock with venture capital characteristics that is appropriate for sophisticated investors with a high tolerance for risk and broadly diversified investment portfolios.

Securities recommended, offered, or sold by SSB: (i) are not insured by the Federal Deposit Insurance Corporation; (ii) are not deposits or other obligations of any insured depository institution (including Citibank); and (iii) are subject to investment risks, including the possible loss of the principal amount invested. Although information has been obtained from and is based upon sources SSB believes to be reliable, we do not guarantee its accuracy and it may be incomplete or condensed. All opinions and estimates constitute SSB's judgment as of the date of the report and are subject to change without notice. This report is for informational purposes only and is not intended as an offer or solicitation for the purchase or sale of a security.

Investing in non-U.S. securities, including ADRs, may entail certain risks. The securities of non-U.S. issuers may not be registered with, nor be subject to the reporting requirements of the U.S. Securities and Exchange Commission. There may be limited information available on foreign securities. Foreign companies are generally not subject to uniform audit and reporting standards, practices and requirements comparable to those in the U.S. Securities of some foreign companies may be less liquid and their prices more volatile than securities of comparable U.S. companies. In addition, exchange rate movements may have an adverse effect on the value of an investment in a foreign stock and its corresponding dividend payment for U.S. investors. Net dividends to ADR investors are estimated, using withholding tax rates conventions, deemed accurate, but investors are urged to consult their tax advisor for exact dividend computations. Investors who have received the report from the Firm may be prohibited in certain states from purchasing securities mentioned in this report from the Firm. Please ask your Financial Consultant for additional details.

This report is distributed in the United Kingdom by Salomon Brothers International Limited. This material is directed exclusively at market professional and institutional investor customers and is not for distribution to private customers, as defined by the rules of the Financial Services Authority, who should not rely on this material. Moreover, any investment or service to which the material may relate will not be made available to such private customers. This material may relate to investments or services of a person outside of the United Kingdom or to other matters which are not regulated by the Financial Services Authority and further details as to where this may be the case are available upon request in respect of this material. If this publication is being made available in certain provinces of Canada by Salomon Smith Barney Canada Inc. ("SSB Canada"), SSB Canada has approved this publication. This report was prepared by SSB and, if distributed in Japan by Nikko Salomon Smith Barney Limited, is being so distributed under license. This report is made available in Australia through Salomon Smith Barney Australia Securities Pty Ltd (ABN 64 003 114 832), a Licensed Securities Dealer, and in New Zealand through Salomon Smith Barney New Zealand Limited, a member firm of the New Zealand Stock Exchange. This report does not take into account the investment objectives, financial situation or particular needs of any particular person. Investors should obtain advice based on their own individual circumstances before making an investment decision. Salomon Smith Barney Securities (Proprietary) Limited is incorporated in the Republic of South Africa (company registration number 2000/025868/07) and its registered office is at Citibank Plaza, 145 West Street (corner Maude Street), Sandown, Sandton, 2196, Republic of South Africa. The investments and services contained herein are not available to private customers in South Africa. This publication is made available in Singapore through Salomon Smith Barney Singapore Pte Ltd, a licensed Dealer and Investment Advisor. For purposes of this report, "SSB" includes the aforementioned companies.

Salomon Smith Barney is a registered service mark of Salomon Smith Barney Inc. Schroders is a trademark of Schroders Holdings plc and is used under license. Nikko is a service mark of Nikko Cordial Corporation. © Salomon Smith Barney Inc., 2002. All rights reserved. Any unauthorized use, duplication, redistribution or disclosure is prohibited by law and will result in prosecution.

ADDITIONAL INFORMATION IS AVAILABLE UPON REQUEST

SALOMON SMITH BARNEY

A member of citigroup

Corporate Bond Research June 24, 2002

High Yield Notes

WorldCom, Inc. (WCOM)

Senior Debt Rating: B1/B+

Waldman, Robert A. (212) 816-8716
robert.waldman@citigroup.com

Mitchell, Jr., Henry (212) 816-8794
henry.mitchell.jr@citigroup.com

Davey, Justin (212) 816-1106
justin.davey@citigroup.com

Haym, Louis H. (212) 816-0968
louis.h.haym@citigroup.com

Clarification on WCOM Report

Opinion

We want to clarify a couple of statements to the bond market made in a recent research report by Jack Grubman on WorldCom, Inc. (WCOM) (B1/B+) dated June 21, 2002.

First, bondholders should not be alarmed by Grubman's characterization on the state of WCOM's bank negotiations. His statement was a clarification for equity investors. The state of WCOM's bank negotiations is already known by bondholders who have been following the negotiations closely. Nothing has changed. To reiterate, the proposed $5 billion senior secured bank facility is expected to be negotiated as follows:

1) An existing $1.6 billion term loan due 2006, which is undrawn;

2) An existing $2.65 billion 364-day facility, currently drawn and which WCOM is currently in negotiations with its banks to extend the term beyond 2003; and

3) New money of $750 million, of which approximately $400 million has already been committed by WCOM's lead banks

We would like to emphasize that the proposed facility, as detailed above, has been the expectation for bondholders for quite some time. The report to the equity market was meant to provide an update to a group of investors who have not followed the bank negotiations as closely.

Second, one of the major points of the report is that Grubman is concerned about a possible recapitalization that would dilute equity investors in order to address leverage issues. With this in mind, we agree that WCOM can stay the course and survive as a long-term viable entity without a Chapter 11 restructuring. Chapter 11 is not a strategic alternative for WCOM due to the risk of potential churn on WCOM's key corporate and government customers. Chapter 11 restructurings are best served by entities that do not have any alternative and whose customer base is not meaningful. When Grubman talks about recapitalization, it does not imply Chapter 11. What Grubman was referring to was some form of equity dilutive initiative whose purpose would be to reduce leverage on the balance sheet, which does make sense once the bank negotiations have been completed.

U.S. Securities and Exchange Commission

Re: WorldCom, Inc., HO-09440

Sworn Statement Pursuant to Section 21(a)(1) of the Securities Exchange Act of 1934

1. This statement is submitted by WorldCom, Inc. (the "Company") in response to the Commission's June 26, 2002 Order (the "Order") directing the Company to describe in detail the facts and circumstances underlying the events described in and leading to the Company's June 25, 2002 press release (the "Release") regarding its intention to restate its 2001 and first quarter 2002 financial statements. The information provided in this Statement reflects the Company's best understanding as of this date. However, in light of the Company's prompt determination, disclosed in the Release, that a full investigation of the circumstances giving rise to the need for the restatement should be performed by a party independent of the Company (see paragraph 20 below), which investigation commenced on June 24, 2002, and the short amount of time available, the Company's own review of those circumstances necessarily has been limited. Thus, the majority of the information set forth in this Statement is based on the Company's information and belief and does not reflect information as to which the undersigned has personal knowledge. This Statement is not intended to be exhaustive but rather a summary of key events.

Preparation of the Company's 2001 and 2002 Financial Statements

2. The Company's financial statements for 2001 and for the first quarter of 2002 were prepared under the direction of Scott D. Sullivan, the Company's Chief Financial Officer and Secretary. David F. Myers, Senior Vice President and Controller of the Company, reported to Mr. Sullivan and assisted in the preparation of these financial statements. The Company's SEC filings during this period were prepared under the direction of, and signed by, Mr. Sullivan.

3. Prior to May 16, 2002, Andersen LLP ("Andersen") was the Company's external auditor. Andersen audited the Company's 2001 financial statements and reviewed the Company's first quarter 2002 financial statements. During this period, Andersen's engagement partner on the Company's audits was Mel Dick. Andersen gave an unqualified opinion on the Company's 2001 financial statements following its audit.

4. On May 16, 2002, KPMG LLP was appointed as the Company's external auditors. KPMG assigned Farrell Malone as the engagement partner on this audit.

Discovery of the Transfers

5. During May 2002, Cynthia Cooper, Vice President - Internal Audit, began

an investigation of certain of the Company's capital expenditures and capital accounts. Ms. Cooper determined that a number of questionable transfers had been made into the Company's capital accounts during 2001 and the first quarter of 2002. The transfers involved a portion of the costs associated with network services and facilities provided by third parties, designated "line costs" by the Company, that previously had been treated as expenses in the Company's financial statements. Ms. Cooper discussed these entries with Mr. Sullivan and with Mr. Myers.

6. On or about June 12, 2002, Ms. Cooper and Glyn Smith, another member of the Company's Internal Audit staff who had assisted Ms. Cooper's investigation, contacted Max E. Bobbitt, Chairman of the Audit Committee of the Board of Directors of the Company, and discussed the line cost transfers. Thereafter, Mr. Bobbitt asked Ms. Cooper to contact Mr. Malone, and the three spoke later that day.

7. On or about June 13, 2002, Ms. Cooper met with Mr. Bobbitt and Mr. Malone in Clinton, Miss. to discuss her investigation. It was agreed that the transfers required further discussion with Mr. Sullivan and Mr. Myers.

8. On or about June 17, 2002, Ms. Cooper and Mr. Smith interviewed Mr. Myers in Clinton, Miss. Ms. Cooper briefed Mr. Malone and then they jointly called Mr. Bobbitt. The three agreed that Mr. Malone should interview Mr. Sullivan and Mr. Myers as soon as possible.

9. On or about June 18, 2002, Mr. Malone interviewed Mr. Myers in Clinton, Miss. regarding the transfers and then briefed Mr. Bobbitt. Thereafter, it was agreed that Mr. Malone, Ms. Cooper, Mr. Bobbitt, and Mr. Smith would travel to Washington, D.C. and that Mr. Malone would interview Mr. Sullivan there.

10. On or about June 19, 2002, Mr. Bobbitt contacted Judith Areen, another member of the Audit Committee, and briefed her on the situation. Mr. Bobbitt and Ms. Areen contacted outside counsel for the Audit Committee, Simpson Thacher & Bartlett, to inform them that KPMG was looking into accounting issues for the period commencing during 2001 and the first quarter of 2002 and to seek legal advice.

11. On or about June 19, 2002, Mr. Malone interviewed Mr. Sullivan in Washington, D.C. regarding the transfers and then briefed Mr. Bobbitt.

The Audit Committee's Review

12. On or about June 20, 2002, Mr. Bobbitt met with Mr. Sullivan and advised him that the Audit Committee was reviewing the propriety of transferring line costs to capital accounts.

13. On June 20, 2002, Ms. Areen and Mr. Bobbitt consulted with Simpson Thacher & Bartlett. It was agreed that Mr. Bobbitt would schedule an Audit Committee meeting in Washington, D.C. that afternoon.

14. On June 20, 2002, Mr. Bobbitt also notified John W. Sidgmore, Chief Executive Officer of the Company, of the Audit Committee's review. Mr. Bobbitt asked that Mr. Sidgmore brief Michael H. Salsbury, General Counsel

of the Company, on the situation and that both of them attend the Audit Committee's meeting later that day. Upon learning of the situation, Mr. Salsbury caused a notice to be sent to Mr. Sullivan and persons who reported to him, including Mr. Myers, to preserve all documents and records relating to the capitalization of line costs by the Company.

15. The June 20 Audit Committee meeting was attended by Mr. Bobbitt, Ms. Areen, and Francesco Galesi, members of the Committee, by Mr. Sullivan and Mr. Myers, by Ms. Cooper and Mr. Smith, by Mr. Malone and Stanley Kroll of KPMG, by Mr. Sidgmore, Mr. Salsbury, and Ronald R. Beaumont, Chief Operating Officer of the Company, and by attorneys from Simpson Thacher & Bartlett. Mr. Malone described the circumstances underlying the transfer of line costs to the Company's capital accounts at the end of each of the second, third, and fourth quarters of 2001 and the first quarter of 2002. Mr. Malone stated that the transfers, in his view, did not comply with generally accepted accounting principles (GAAP), and, in particular, Mr. Malone noted the absence of documentation supporting the transfers. Mr. Sullivan presented his reasoning regarding the appropriateness of the transfers in light of economic conditions in 2001 and early 2002. Mr. Sullivan stated that there may have been a transfer of line costs to capital accounts in the first quarter of 2001 as well. He requested additional time to support and document the transfers. Mr. Sullivan also indicated that in light of the decline in the Company's revenues in the first quarter of 2002, he believed the transfers no longer could be supported and had planned an appropriate writedown of the Company's capital accounts in the second quarter of 2002. Mr. Malone disagreed that such a writedown could be taken in the second quarter of 2002. Later in the meeting, Mr. Malone indicated that KPMG had not reached a final conclusion as to restatement. It was agreed that the Audit Committee would reconvene at 5 p.m. on June 24, 2002, to make a final determination on these issues.

16. On the afternoon of June 21, 2002, Mr. Sidgmore met with the Board of WorldCom, attorneys from Simpson Thacher & Bartlett and from Weil, Gotshal & Manges LLP (additional outside counsel for the Company) to brief them on the issues being reviewed by the Audit Committee. Mr. Salsbury advised that if it were concluded that the transfers were inappropriate and that as a result the Company's financial statements for 2001 and the first quarter of 2002 would have to be restated, a full investigation of the facts and circumstances underlying the transfers would have to be conducted. To ensure completeness and accuracy, a committee of the Board rather than the Company's management would need to arrange and direct an independent investigation.

17. On or about June 21, 2002, Mr. Bobbitt contacted Steve Rodgers of Andersen, and on or about June 22, 2002, Mr. Bobbitt contacted Mark Schoppet, a former Andersen partner who had been the audit engagement partner in connection with Andersen's audit of the Company's financial statements for 2000 and prior years, and briefed them on the situation. Ken Avery, another former Andersen partner who had been involved in audits of the Company's financial statements, also was contacted.

18. During June 21-24, 2002, Mr. Sullivan prepared a short memorandum outlining his position on the transfers. On or about June 24, 2002, Mr. Sullivan met with Mr. Schoppet and Mr. Avery to discuss why he believed the transfers had been appropriate and why a writedown should be

permitted in the second quarter of 2002, rather than a restatement. Mr. Malone also attended this meeting.

19. On June 24, 2002, the Audit Committee conducted an expanded Audit Committee meeting with senior management and a number of additional directors, attorneys from Simpson Thacher & Bartlett, attorneys from Weil, Gotshal & Manges LLP, and representatives from KPMG. Mr. Rodgers and Richard Howell attended the meeting by telephone on behalf of Andersen. Andersen informed the Company that in light of the transfers of line costs during 2001 and the first quarter of 2002, Andersen's opinion regarding the Company's 2001 financial statements no longer could be relied upon. They stated that Andersen had not known of the transfers, but declined to respond to questions regarding how Andersen's audit activities could have failed to discover the transfers. While noting that KPMG had neither audited nor formally reviewed any of the financial statements in question, Mr. Malone and Teresa Iannaconi of KPMG observed that they agreed with Andersen's conclusion that the transfers in question could not be supported by GAAP. In light of the positions of Andersen and KPMG, the Committee concluded that they should report to the Board that a restatement of the Company's financial statements for 2001 and first quarter 2002 would be necessary. The amounts of the transfers by quarter were $771 million in the first quarter of 2001, $610 million in the second quarter of 2001, $743 million in the third quarter of 2001, $931 million in the fourth quarter of 2001, and $797 million in the first quarter of 2002. A full Board meeting was scheduled for the morning of June 25, 2002. Mr. Sullivan and Mr. Myers were advised that if they did not resign from their positions with the Company before the Board meeting, they would be terminated.

20. Later on June 24, 2002, the Audit Committee met with William McLucas of Wilmer, Cutler & Pickering and retained him to investigate the facts and circumstances leading up to the Company's misstatement of its financial results in 2001 and in the first quarter of 2002 in the amount and manner subsequently announced by the Company in the Release. The investigation is underway and is expected to continue for approximately eight to twelve weeks.

The Company's Recent Actions

21. At the Board's June 25, 2002 meeting, following a report by the Audit Committee, the Board determined to (i) restate the Company's financial statements for 2001 and first quarter 2002 and request KPMG to undertake a full audit of the Company's 2001 financial statements, (ii) inform the SEC of the Board's decision and the events leading up to it, (iii) terminate Mr. Sullivan without severance, (iv) accept the resignation of Mr. Myers without severance, and (v) after meeting with the SEC, publicly announce the Board's actions.

22. After the Board meeting, the Company requested a meeting with the staff of the SEC as promptly as possible. The meeting occurred at 3:30 p.m. on June 25, 2002. During the meeting, the SEC staff was given an overview of the information set forth in this Statement, to the extent it was then known by the Company.

23. As promptly as practicable after meeting with SEC staff, the Company issued the Release.

24. The Audit Committee is reviewing the Company's financial records for 2001, 2000, and 1999 and has requested KPMG's assistance in this review. In particular, questions have been raised regarding certain material reversals of reserve accounts during 2000 and 1999. No conclusion has been reached regarding these entries. If, after review, the Company believes additional actions are required, it will make an announcement promptly.

Affirmed as accurate:

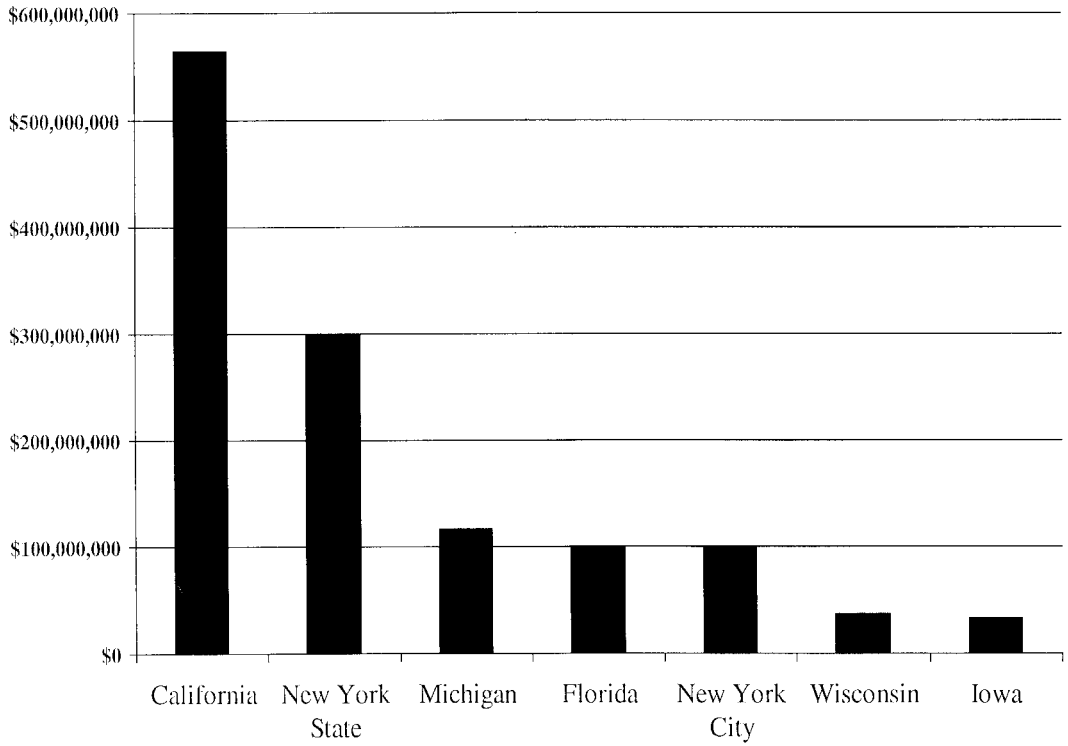
WorldCom, Inc.

/s/ Michael H. Salsbury
By: Michael H. Salsbury
General Counsel

Date: June 30, 2002

http://www.sec.gov/news/wcreponse.htm

State and Local Pension Plans (WorldCom Losses)



Insider Sales (1996 To Now)

Name and Title	Shares Sold	Proceeds
Lawrence C. Tucker	3,171,789	$ 110,799,074
John W. Sidgmore (CEO)	2,601,430	$ 87,364,381
Walter Scott Jr.	4,995,367	$ 79,522,097
Scott D. Sullivan (EX - CFO)	1,388,816	$ 44,183,360
Robert D. Bradbury	2,340,720	$ 39,426,538
Francesco Galesi	3,517,004	$ 29,176,146
James Quell Crowe	1,463,800	$ 24,655,910
Bert C. Roberts (Chairman)	422,526	$ 22,766,074
Gerald H. Taylor	538,069	$ 21,811,915
John A. Porter	1,055,915	$ 19,042,558
James C. Allen	140,495	$ 4,500,000
Carl J. Aycock	859,791	$ 4,490,900
Richard R. Jaros	137,997	$ 2,842,863
Max E. Bobbitt	34,343	$ 1,821,875
Clifford L. Alexander Jr.	11,613	$ 691,892

MINUTES OF THE
REGULAR MEETING OF THE AUDIT COMMITTEE
OF THE BOARD OF DIRECTORS OF WORLDCOM, INC.
February 6, 2002

A Regular Meeting of the Audit Committee of the Board of Directors of WorldCom, Inc. (the "Company") was held on Wednesday, February 6, 2002 at 4:00 p.m. (CST) via conference call at 500 Clinton Center Drive, Clinton, MS.

The meeting was called to order by Mr. Max Bobbitt, Chairman of the Audit Committee.

Members Present

Mr. Max Bobbitt, Mr. Francesco Galesi, Mr. Jim Allen, and Ms. Judy Areen were conferenced in as members of the Audit Committee. Also conferenced in was Mr. Mark Schoppet on behalf of Andersen. Mr. Melvin Dick and Mr. Ken Avery were present in Clinton on behalf of Andersen. Also in attendance in Clinton were Mr. Scott Sullivan, Mr. David Myers, and Mr. Reginald Bernard of WorldCom.

Andersen Discussion Items

The purpose of the meeting was for Andersen to discuss the results of their audit procedures related to the audit of WorldCom's consolidated results of operations and financial position as well as WorldCom Group and MCI Group as of and for the year ended December 31, 2001. There were no Internal Audit items on the agenda.

Mr. Bobbitt introduced everyone being conferenced in and Mr. Sullivan introduced everyone in Clinton and turned the meeting over to Mr. Dick. Mr. Dick determined that everyone had copies of the independence Letter, a listing of passed reclassification entries, the proxy statement disclosure on fees, and a report to the audit committee. Mr. Avery then discussed the following items:

1. **Proxy Statement Disclosure on Fees**: Mr. Avery stated that Andersen performed approximately $5.5 million in audit and audit-related services, $6.6 million in tax services and $4.7 million in other consulting services. Mr. Bobbitt inquired about the nature of the Wireless Process Review and Mr. Sullivan responded that the nature of Andersen's work covered the billing cycle from beginning to end including customer service and the billing systems and that the Wireless bills are now going out on time. Mr. Bobbitt also inquired about the nature of the amount included as EDS arbitration and other. Mr. Sullivan stated that the work performed by Andersen was pre-litigation work that resulted in EDS paying the Company a significant portion of the amount in dispute. Ms. Areen asked whether the Company was in line with the ratio of audit to non-audit services performed by Andersen. Mr. Sullivan replied that the ratio may be out of line when it comes to tax services but that the Company is in line overall. There is no IT consulting service or internal audit work done by Andersen. Mr. Avery then walked through the Report to the Audit Committee.

2. **Report to the Audit Committee**: Mr. Avery noted that Arthur Andersen had completed substantially all of the audit procedures necessary to express an opinion on the financial statements as of December 31, 2001. However, the review and testing of the Annual Report on Form 10-K is ongoing. Mr. Avery stated that he would discuss the issues related to the current status of the audit

and would update the Committee on any additional items prior to the filing of the Annual Report on Form 10-K. Mr. Avery stated that:

- There were no significant changes in accounting policy.
- There were no significant or unusual transactions or material transactions in controversial or emerging areas for which there are a lack of authoritative accounting guidance or consensus.
- Andersen was satisfied as to the reasonableness of management's current judgments regarding material estimates in the context of the financial statements taken as a whole.
- The Company's key transaction processing areas are operating effectively.
- Passed Audit Reclassifications were deemed not material and will be disclosed in the footnotes to the financials.
- Andersen did not have any disagreements with Management.
- Andersen was not aware of any irregularities or illegal acts committed by the Company or its employees.
- Andersen was not aware of any consultations by management with other independent public accountants during the year about auditing or accounting matters.
- There were no significant difficulties encountered during the audit.
- There were no major issues discussed with management prior to Andersen being appointed as auditors.
- There were no material weaknesses in internal controls noted in the testing and evaluation associated with the financial statement audit.
- Andersen provided a separate letter that described the scope of all services provided during fiscal 2001 and confirmed their independence within the meaning of SEC and Independence Standard Board rules.

Mr. Sullivan inquired whether Andersen had looked at the composite useful life of the Company's property, plant and equipment. Mr. Avery stated that the Company was included in a blind survey and that the asset lives were in line with peers with the exception of fiber which had a longer life than those of the peer group. Mr. Avery agreed to provide Mr. Sullivan a copy of the study.

Mr. Allen asked if there were any disagreements with Management. Mr. Avery stated that there were none. Mr. Allen also asked if there were any accounting positions taken by the Company that Andersen was not comfortable with. Mr. Avery stated that Andersen was comfortable with the Company's accounting. Mr. Allen asked if there were any debt covenant violations and Mr. Avery responded that there are no violations. Mr. Sullivan added that the Company is not near any of the thresholds on the bank facility and that the bonds do not have any triggers.

Mr. Bobbitt inquired about the timing and size of a charge to earnings for intangible assets. Mr. Sullivan responded that the Company would be taking a $15-$20 billion charge in the 2nd Qtr. Ernst and Young is finalizing their study supporting the charge. Andersen was further questioned about whether they were comfortable with the Company's accounting in light of an article that appeared in the New York Times. Mr. Dick replied that Andersen is comfortable with the accounting.

Mr. Bobbitt inquired about the allocation of expenses between MCI and WorldCom. Mr. Sullivan stated that the allocation has not changed since it was put in place. Mr. Sullivan further stated that there may be some justification for a future change based on declining revenues and transport costs.

Mr. Allen asked whether the Company should continue to pay dividend on MCIT and whether the tracking stock should be brought back in. Mr. Sullivan stated that the Company is not at that point. Mr. Sullivan further stated that the Wholesale business should bottom out and that the consumer business will continue to suffer due to decreases in the number of calls, minutes and wireless substitution.

Mr. Avery concluded the Andersen discussion items by stating that Andersen is comfortable with the Company's classification of its CEO loan as of December 31, 2001. In addition, Mr. Avery stated that Andersen is working with the international accounting organization to implement changes that will result in better reporting.

4Q01 Results

Mr. Sullivan then went over the 4Q01 results for both MCI and WCOM. Overall the Company grew 7.0% on a reported basis. The Company grew 5% without Intermedia and Digex. The Company grew 8.5% without Intermedia, Digex and excluding the Emerging Markets sector, which is under serious pressure.

Mr. Bobbitt asked whether guidance for 2002 revenue growth would be revised and Mr. Sullivan responded that it would be revised to mid-single digit growth.

Mr. Sullivan summarized by saying that the Company's balance sheet is strong, cash flow broke even during the 4th quarter, SG&A is being cut wherever possible and debt maturities are relatively light over the next 2 years.

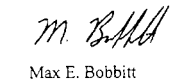
Executive Session

Mr. Myers, Mr. Sullivan and Mr. Bernard exited the meeting and the Audit Committee then spoke with Mr. Schoppet, Mr. Dick and Mr. Avery.

Mr. Sullivan was asked to re-enter the meeting as the Andersen representatives exited. The Audit Committee then spoke with Mr. Sullivan.

The meeting was adjourned at 5:45 p.m. (CST) on this the 6th day of February 2002.

Submitted by:



Max E. Bobbitt
Chairman

MINUTES OF THE
REGULAR MEETING OF THE AUDIT COMMITTEE
OF THE BOARD OF DIRECTORS OF WORLDCOM, INC.
March 6, 2002

A Regular Meeting of the Audit Committee of the Board of Directors of WorldCom, Inc. (the "Company") was held on Wednesday, March 6, 2002 at 4:00 p.m. (EST) at the WorldCom office located at 1133 19th St NW in Washington, conference room # 1204.

Mr. Max Bobbitt, Chairman of the Audit Committee, called the meeting to order.

Members Present

Audit Committee: Mr. Max Bobbitt, Mr. Francesco Galesi, and Mr. Jim Allen were present. Ms. Judith Areen joined the meeting via conference.

Andersen: Mr. Melvin Dick and Mr. Kenny Avery were present.

WorldCom: Mr. Scott Sullivan and Ms. Cynthia Cooper were present. Ms. Stephanie Scott joined the meeting via conference.

Minutes Approved

Mr. Bobbitt asked if there were any changes to the September 10, 2001 or February 6, 2002 minutes. Mr. Jim Allen noted one correction to the minutes. Mr. Bobbitt stated that pending that correction, the minutes would be approved as submitted. A motion was made and accepted to approve the revised minutes.

Mr. Sullivan stated that Ms. Scott would discuss the 10-K draft previously provided to them. Ms. Scott asked if there were any comments related to the 10-K draft. Mr. Bobbitt stated that the Company's security interest in the collateral supporting the CEO loan would be perfected in 30 days. Ms. Areen inquired whether an 8-K would be required and whether the Audit Committee should make its motion to the Board subject to any new information arising from the ongoing review of the CEO loan.

After a discussion period, Mr. Bobbitt made a motion that the Audit Committee recommend to the Board of Directors that the audited financial statements be included in the Company's annual report on Form 10-K for the year ended December 31, 2001, to be filed with the Securities and Exchange Commission. The motion was unanimously approved.

Ms. Scott excused herself from the remainder of the Audit Committee Meeting after concluding discussion of her agenda items.

Mr. Bobbitt asked Mr. Avery to discuss any Andersen items on the agenda.

Confidential Treatment
Requested by WorldCom

Andersen Discussion Items

Mr. Avery discussed items in the Andersen presentation – Audit Committee Quality of Earnings Discussion, Year Ended December 31, 2001 as follows:

- Mr. Avery noted that pursuant to existing rules and the Committee's charter – Committee

members are required to discuss the quality, not just acceptability, of the Company's accounting principles and underlying estimates in the financial statements. To assist the Committee members with this requirement, Andersen has developed a framework to facilitate discussion.

- Mr. Avery discussed issues, which the Audit Committee should consider related to substance, verifiability, clarity, consistency, comparability, earnings persistence, and disaggregated information. See issues detailed in the March 6, 2002 Audit Committee Package.

Mr. Jim Allen stated that the members of the Audit Committee had to rely on Andersen and Management to provide them with relevant information.

Ms. Judith Areen stated that she had a copy of the questions that Warren Buffet recently suggested Audit Committee Members ask the Company's public accountants. Ms. Areen asked if Andersen were solely responsible for preparing the company's financial statements would they be prepared in the same manner selected by Management. Mr. Avery responded yes.

Mr. Allen stated that he had asked Mr. Avery a question in the prior Audit Committee Meeting related to debt covenants and did not feel comfortable that Andersen had completed the debt covenant work based on the answer that Mr. Avery provided. Mr. Dick stated that the debt covenant work had been completed and that the Company was in compliance with all covenants.

Mr. Bobbitt then asked Ms. Cooper to discuss the Internal Audit items outlined in the agenda.

Internal Audit Discussion Items

First,
Staffing Changes:

- Ms. Cooper presented an organization chart and discussed staffing changes and stated that one auditor had recently resigned to accept another position and that at least two additional employees would be severenced with the upcoming reduction in force.

- Mr. Jim Allen asked if the Company should consider increasing the audit staff. Mr. Sullivan stated that the Finance organization was not included in the previous severance since his organization had not grown, but that Finance would be impacted with the upcoming severance.

- Mr. Sullivan indicated that Mr. Ebbers had proposed a 50% reduction in internal audit compensation expense but that the final decision was to limit the reduction to 10%. He indicated that preparation of the Executive Report as well as the Commissions Audit is consuming significant audit resources. Ms. Cooper stated that moving the preparation of the Executive Report into Ron Beaumont's organization would allow four persons who are dedicated part time to completion of the report to work full time on audit.

- Mr. Sullivan asked if Mr. Ebbers would be comfortable with moving the report. Ms. Cooper indicated that Mr. Ebbers stated that he was comfortable with moving the report as long as he continued to receive the same level of reporting monthly.

- Mr. Bobbitt asked Ms. Cooper to work with Mr. Beaumont to migrate report preparation by April 1st.

Confidential Treatment
Requested by WorldCom

2002 Proposed Internal Audit Plan: Ms. Cooper stated that:

- She was submitting the 2002 Proposed Internal Audit Plan (Plan) for Audit Committee approval.
- Internal Audit solicited feedback from Senior and Executive Management across the Company in developing the Plan, and Mr. Sullivan and Mr. Ebbers had reviewed and approved the Plan.
- The Plan may change during the year based on new areas of risk identified and special requests from Executive Management.
- The time required to complete the Commissions audit, migrate the Executive Report compilation to Ron Beaumont's organization, and special requests from Executive Management will impact completion of the 2002 Plan.
- As in prior years, the scope of internal audit work focuses heavily on operational effectiveness and efficiency, systems and internal controls.
- There are a significant number of follow-up audits included in the Plan intended to help ensure that key recommendations are implemented.

Ms. Cooper asked whether Andersen or the Audit Committee proposed any changes to the scope of internal audit work or the audits listed on the 2002 Plan. No changes were proposed and Mr. Bobbitt stated that the 2002 Plan was approved as submitted.

2001 Audits Completed: Ms. Cooper stated that 37 projects have been completed since January 1, 2001. The number of audits completed has decreased due to resources focused on the Commissions audit.

Executive Summaries for Key Audit Reports: Ms. Cooper reviewed the summary of key issues and recommendations outlined in section 5 of the March 6, 2002 Audit Committee Binder, and stated that copies of the full audit reports are available.

Ms. Cooper discussed Internal Audit's work in the following areas: Commissions, Web Hosting Revenue Integrity, Switch Access, EDS IT Outsourcing, Wireless General Controls, Domestic Line Cost, Capital Spending, Executive Report, International – Revenue Realization, International - Asia Pac Fraud Investigation, and International - Switched Voice Payment and Dispute Process.

Commissions: Ms. Cooper discussed the key issues and recommendations outlined in the Audit Committee Binder related to Commissions including the key causes and circumstances surrounding each commission overpayment, and stated that:

- She was updating them on the commissions fraud audit work that was reported on in the September 10, 2001 Audit Committee meeting.
- Since the Wall Street Journal article, Internal Audit has received numerous calls and letters alleging sales employee fraud and is in the process of investigating.
- Audit has identified key internal controls related to systems, processes and procedures that should to be implemented to prevent future occurrences of sales employee fraud and commission

overpayments.

- Audit is holding meetings with various groups across the Company to help facilitate implementation of the key internal controls identified. Several key controls have already been implemented. Examples include migrating to a single commission system and implementing system controls to disallow payment on non-majors revenue location codes.

- Testing and quantifications are still in progress and will be reported at the next Audit Committee meeting. A significant portion of the overpayments has never been paid out and is fully recoverable from sales employee banks since commissions are capped each month.

- Some of the commission overpayments identified were driven by Sales employee fraud while other commission overpayments were a result of missing internal controls or system deficiencies.

- Of the accounts associated with commission overpayments, the only account that had a known revenue impact was OMNI. Two OMNI circuits were closed to billing and billed approximately $14 million over 10 months. The circuits were subsequently cancelled. The revenue impact was a timing issue as the full $14 million was credited.

Mr. Jim Allen asked if the Company had given any thought to rethinking the commission plans and methods/reasons for payment. Mr. Sullivan stated that Ron Beaumont was working to simplify and consolidate many of the plans and that commission payments will be dramatically reduced in 2002.

Mr. Bobbit excused himself from the Audit Committee Meeting to attend another Committee meeting.

Wireless General Controls: Ms. Cooper discussed the issues and recommendations outlined in the Audit Committee Binder and stated that:

- This review is the second of two audits completed in Wireless. The first audit released in May 2001 discussed the significant delays in customer billing and number of customer calls to Customer Service which were blocked and delayed. Ms. Cooper stated that Jon Stupka indicates the billing is now current, however there are still problems with blocked and delayed customer calls.

- The Wireless audit focused on reviewing the adequacy of systems and operational internal controls to minimize subscription fraud and no pay customers impeding collectibility. Controls supporting wireless order activation are not adequate and should be strengthened as quickly as possible to reduce intake of fraudulent and no pay customers. Delayed billing, subscription fraud and lack of key controls within Wireless have impacted collectibility.

- Network Services reporting to Ron Beaumont and Wireless Operations Review Staff reporting to Mr. Stupka have performed detailed testing which indicates bad debt losses due to delayed billing, inadequate controls, and direct sales channel subscription fraud.

- Mr. Stupka's testing focuses primarily on no pay customers. Network Services testing focuses on subscription fraud. The group has reported significant direct sales subscription fraud based on testing incoming orders for the Dallas Center and individual cases that they have investigated.

- Network Services coordinates with Legal and Human Resources to investigate reported cases of suspected wireless subscription fraud. Their testing resulted in 72 terminations and four

Confidential Treatment
Requested by WorldCom

prosecutions in 2000 and 15 terminations and three prosecutions in 2001.

- Sales rep misrepresentation and subscription fraud relating to the following have resulted in terminations and prosecutions: accounts set up with stolen identities (person billed for cellular service that someone else is using), stolen equipment, credit bypasses, second and third lines credit approved for a legitimate customer are activated for a non-legitimate customer (three phone credit approval policy).

Ms. Cooper noted that Mr. Stupka provided the written status included in the Audit Committee Package and that several key points everyone should review include:

- The accounts receivable balance and increased accounts receivable exposure due to delayed billing, subscription fraud and no pay customers
- Charts related to credits, fraud, accounts receivable and bad debt
- Ms. Cooper stated that Mr. Stupka indicates that while he has implemented some key controls outlined in the status, there is still a great deal of work to be done; and that as controls improve, Management will have visibility into the true profitability of the unit

Mr. Jim Allen asked Mr. Sullivan whether or not the Company had compared operating efficiency to other carriers. Mr. Sullivan stated that Wireless is one of the most significant problem areas for the Company today and that the Company should not be in the business. Mr. Sullivan stated that the margins are tight. Ms. Cooper stated that Mr. Stupka's analysis shows a 5% industry margin assuming that a Company bills accurately and timely and has strong collection efforts.

Next,
Ms. Judith Areen asked that Andersen be excused from the meeting so that the Audit Committee could have a discussion with Management. Mr. Melvin Dick and Mr. Kenny Avery excused themselves.

Mr. Francesco Galesi, Ms. Judith Areen, Mr. Jim Allen, Mr. Scott Sullivan and Ms. Cynthia Cooper continued with discussions.

The meeting was adjourned at approximately 5:00 p.m. (EST) on this the 6th day of March 2002.

Submitted by:

Max E. Bobbitt
Chairman

Confidential Treatment
Requested by WorldCom

PRIVILEGED

DRAFT

MINUTES OF THE SPECIAL MEETING

OF THE BOARD OF DIRECTORS OF

WORLDCOM, INC.

April 29, 2002

Pursuant to notice, a special meeting of the Board of Directors of WorldCom, Inc. (the "Company") was held on April 29, 2002, at approximately 4 p.m. (EDT). The meeting was conducted by means of telephonic conference such that each director could hear the statements of other directors. Board members participating in the meeting were:

James. C. Allen	Stiles A. Kellett, Jr.
Judith Areen	Gordon S. Macklin
Carl J. Aycock	Bert C. Roberts, Jr.
Max E. Bobbitt	John W. Sidgmore
Francesco Galesi	Scott D. Sullivan

Also participating in the call by invitation were Michael Salsbury (acting as secretary for the meeting) and Richard I. Beattie and Philip T. Ruegger of the law firm of Simpson Thacher & Bartlett.

Mr. Roberts called the meeting to order and asked whether the Compensation Committee had any report to make. Mr. Kellett stated that the Committee had discussed changes in the compensation for Messrs. Beaumont, Huyard, and Sullivan but believed it would not be appropriate to make any proposal to the Board without CEO input. Mr. Kellett hoped to be able to make a proposal regarding executive retention and compensation shortly.

President and CEO. Mr. Roberts then turned to the issues surrounding the President and CEO, Mr. Ebbers. Mr. Ruegger reported that on the evening of Friday, April 26, 2002, the independent directors of the Company had met and voted to request Mr. Ebbers's resignation from the Company. These directors also had proposed a severance arrangement to Mr. Ebbers that Mr. Ruegger described. Mr. Ebbers had requested certain amendments to the arrangements that Mr. Ruegger then described. The Board then discussed the proposed arrangements and the changes requested by Mr. Ebbers, as well as a successor to Mr. Ebbers as President and CEO.

Confidential Treatment
Requested by WorldCom

Upon motion of Mr. Kellett, seconded by Mr. Allen, the Board unanimously accepted the resignation of Mr. Ebbers as President and CEO of the Company and as a director of the Company and approved the Separation Agreement and Promissory Note with Mr. Ebbers in the form attached as Exhibits 1 and 2 to these minutes.

Upon motion of Mr. Macklin, seconded by Mr. Galesi, the Board unanimously elected Mr. Sidgmore as President and CEO of the Company.

CEO Report. Mr. Sidgmore then proposed the following organizational changes: (a) Ronald R. Beaumont would become Chief Operating Officer of Worldcom, Inc., reporting to Mr. Sidgmore, (b) Wayne Huyard, Chief Operating Officer of the MCI Group, would continue in that capacity reporting to Mr. Beaumont, (c) Mr. Sullivan would become Executive Vice President of the Company in addition to continuing in his role as Chief Financial Officer, reporting to Mr. Sidgmore, and (d) Mr. Salsbury would continue in his role as General Counsel of the Company, reporting to Mr. Sidgmore. Upon motion of Mr. Kellett, seconded by Mr. Galesi, the board unanimously ratified and approved these organizational changes.

Board Schedule. Mr. Roberts proposed that the Board have a telephonic meeting during the week of May 6, 2002, upon notice by the Chairman, to discuss a plan for postponing the annual meeting of shareholders scheduled for May 23, 2002 to permit circulation of amended proxy materials. Mr. Roberts asked Mr. Salsbury to be prepared to suggest a plan at this Board meeting. Mr. Roberts also proposed that the board have an in-person meeting on May 23, 2002, in Washington, D.C. Without objection, this meeting schedule was agreed.

CFO Report. Mr. Sullivan discussed the current status of the Company's bank loan facilities and the depressed trading prices of certain of the Company's bonds. The bond prices presented an opportunity to retire some of the Company's financial obligations at a substantial savings. Mr. Sullivan responded to questions from the Board on his report. Upon motion of Mr. Galesi, seconded by Mr. Allen, the Board unanimously authorized Messrs. Sidgmore and Sullivan to purchase up to $2 billion of the Company's bonds if, in their opinion, such purchases were in the best interest of the Company taking into account current market conditions and the Company's financial position.

Chairman of the Board. Mr. Sidgmore then asked Mr. Roberts to depart from the meeting and assumed the Chair. Mr. Sidgmore described to the Board the reasons why he believed it was essential for Mr. Roberts to assume a more active role in the management of the Company. Mr. Sidgmore proposed that the Board continue Mr. Roberts's current compensation arrangements but add a payment arrangement after Mr. Roberts's eventual retirement from the Company similar to that approved for Mr. Ebbers.

Following discussion, upon motion of Mr. Bobbitt, seconded by Mr. Aycock, the Board unanimously approved (a) Mr. Roberts continuing as Chairman of the Board and participating in the management of the Company as requested by Mr. Sidgmore, and (b) a

retirement benefits package like that approved for Mr. Ebbers, but with an annual retirement stipend of $1 million (in addition to Mr. Roberts's pre-existing pension rights).

The meeting was adjourned at approximately 5 p.m. (EDT).

Confidential Treatment
Requested by WorldCom

MINUTES OF THE SPECIAL MEETING

OF THE BOARD OF DIRECTORS OF

WORLDCOM, INC.

May 21, 2002

Pursuant to notice, a special meeting of the Board of Directors of WorldCom, Inc. (the"Company") was held on May 21, 2002, at approximately 4:30 p.m. (EDT) in the Company's offices at 1133 Nineteenth Street, N.W., Washington, D.C. Board members present for the meeting were:

Max E. Bobbitt	John W. Sidgmore
Bert C. Roberts, Jr.	Scott D. Sullivan

James C. Allen, Carl J. Aycock, Judith Areen, Francesco Galesi, Stiles A. Kellett, Jr., and Gordon S. Macklin participated by means of telephonic conference call such that they could hear, and be heard by, persons participating in the meeting. Also participating in the meeting by invitation were Lawrence C. Tucker, Advisory Director, via telephonic conference call, and Ronald R. Beaumont, Wayne E. Huyard, and Michael Salsbury (acting as secretary for the meeting). Mr. Roberts called the meeting to order.

Conversion of MCI Group Shares. Mr. Salsbury outlined a proposal to convert the outstanding shares of MCI group common stock into WorldCom group common stock pursuant to the Company's Articles of Incorporation. The conversion would occur on July 12, 2002. The previously declared dividend on MCI group shares, would be paid by the Company on July 15, 2002 to holders of record of MCI group stock on June 30, 2002. Messrs. Sidgmore and Sullivan explained that this proposal would yield a cash savings to the Company in excess of $280 million per year, significant operating efficiencies, and flexibility in dealing with various lines of business. Mr. Beaumont outlined the steps that would be taken to re-assure MCI group employees of their importance to the Company. After discussion, upon motion by Mr. Bobbitt, seconded by Mr. Macklin, the following resolutions were unanimously adopted:

> WHEREAS, the Second Amended and Restated Articles of Incorporation, as amended (the "Articles") of WorldCom, Inc. (the "Company") provide for two series of common stock with the following designations: (i) WorldCom, Inc.—WorldCom Group Common Stock (the "WorldCom Stock") and (ii) WorldCom, Inc.—MCI Group Common Stock (the "MCI Stock");
>
> WHEREAS, shares of the WorldCom Stock and the MCI Stock are currently outstanding and the Board has determined that it would be in the

Confidential Treatment
Requested by WorldCom

best interests of the Company and its shareholders to have only one series of the Company's common stock issued and outstanding;

WHEREAS, pursuant to the Articles, the Board may at any time declare that each outstanding share of MCI Stock shall be converted (the "Conversion") into shares of WorldCom Stock in the manner and on the terms provided in the Articles, including Section 4F of Section A, Article 4 thereof with respect to shares of MCI Stock issuable upon the conversion of Convertible Securities (as defined in the Articles);

WHEREAS, the Articles provide that the effective date for the Conversion (the "Conversion Date") shall be fixed by the Board and set forth in the notice of the Conversion (the "Conversion Notice"); and

WHEREAS, the Conversion Notice must be given not later than the 35th Trading Day (as defined in the Articles) prior to the Conversion Date;

NOW, THEREFORE, BE IT RESOLVED, that the Board of Directors hereby authorizes and approves the Conversion and further declares that the Conversion shall occur on the Conversion Date;

FURTHER RESOLVED, that the Board hereby fixes the Conversion Date as July 12, 2002;

FURTHER RESOLVED, that, on the Conversion Date, and in accordance with and pursuant to the Articles, each outstanding share of MCI Stock shall be converted into a number of fully paid and nonassessable shares of WorldCom Stock equal to 110% of the ratio, rounded to the nearest 1/10,000, of the average Market Value (as defined in the Articles) of one share of MCI Stock over the 20 consecutive Trading Days ending on May 15, 2002 to the average Market Value of one share of WorldCom Stock over the same period;

FURTHER RESOLVED, that the issuance of shares of WorldCom Stock in the Conversion in exchange for the shares of MCI Stock surrendered therefore is hereby approved and authorized, that the consideration to be received in exchange for such shares of WorldCom Stock is adequate and that such shares of WorldCom Stock shall, upon issuance in accordance with the terms of the Conversion, be validly issued, fully paid and non-assessable;

FURTHER RESOLVED, that the officers of the Company are hereby authorized and directed to cause, on May 22, 2002, the Conversion Notice to be prepared and given, in accordance with the requirements of the Articles, to each holder of record at the close of business on May 21,

Confidential Treatment
Requested by WorldCom

2002 of shares of MCI Stock or Convertible Securities that are convertible into or exchangeable or exercisable for shares of MCI Stock; and

FURTHER RESOLVED, that the officers of the Company be and are hereby authorized and empowered to take such other actions as they may deem appropriate or necessary in order to carry out the intent of the above resolutions and, in connection therewith, are authorized and empowered to execute and deliver any documents or other instruments as they deem appropriate or necessary to effectuate the foregoing.

The meeting was adjourned at approximately 5 p.m.

Confidential Treatment
Requested by WorldCom

MINUTES OF THE QUARTERLY MEETING

OF THE BOARD OF DIRECTORS OF

WORLDCOM, INC.

May 23, 2002

Pursuant to notice, a quarterly meeting of the Board of Directors of WorldCom, Inc. (the "Company") convened on May 23, 2002, at approximately 9:30 a.m. Eastern Daylight Time in the Company's offices at 1133 Nineteenth Street, N.W., Washington, D.C. The following Board members were present, constituting all the Directors:

James C. Allen	Stiles A. Kellett, Jr.
Judith Areen	Gordon S. Macklin
Carl J. Aycock	Bert C. Roberts, Jr.
Max E. Bobbitt	John W. Sidgmore
Francesco Galesi	Scott D. Sullivan

Also present by invitation were Lawrence C. Tucker, Advisory Director, P. Bruce Borghardt, acting as secretary of the meeting, Ronald R. Beaumont, Wayne E. Huyard and Michael H. Salsbury.

Mr. Roberts called the meeting to order.

Approval of Minutes. Upon motion made by Mr. Allen and seconded by Mr. Macklin, the minutes of the Board's meetings held on May 7, 2002 and May 21, 2002, were unanimously approved as recorded.

Audit Committee Report. Mr. Bobbitt, Chairman of the Audit Committee, advised that the Committee met the day before with representatives of KPMG LLP, the Company's new auditors, and others. He informed the Board regarding KPMG's recently completed merger with Arthur Andersen's Jackson and Little Rock offices and the staffing by KPMG of the Company's account. Mr. Bobbitt also reported that Cynthia Cooper, Vice President of Internal Audit for the Company, had discussed with the Committee the internal audit report and review for this year. Ms. Areen added that Richard Beattie, with Simpson Thacher & Bartlett, participated telephonically during the Audit Committee meeting, which led to a discussion and approval by the Board of the availability of Mr. Beattie to advise the Board and its Committees, as desired.

Compensation and Stock Option Committee Report. Mr. Kellett, Chairman of the Committee, reported on the status of various compensation-related matters, including executive officer salaries and stock option grants to certain employees.

CEO Report. Mr. Sidgmore assessed the telecommunications environment and referenced input from analysts and other considerations which have led to a recommended course of action emphasizing stability and predictability. He reviewed the landscape in the industry, including comparisons to other inter-exchange carriers and to the RBOCs and certain trends, during which he and Mr. Sullivan made observations and responded to questions. Mr. Sidgmore then outlined a proposed plan for the Company designed to enhance liquidity and improve operating results. He described past and anticipated actions relating to financial matters, including the restructuring of the accounts receivable and bank credit facilities, the favorable reception to eliminating the tracking stock structure and various operational changes designed to generate additional cash and reduce expenditures/expenses. Next, Mr. Sidgmore provided a P&L analysis for WorldCom group, MCI group and WorldCom, Inc., giving historical information as well as original and updated outlooks. He also reported on recent inquiries or actions by, and discussions with, third parties. Throughout the discussion, others asked questions, made observations or recommendations and provided additional information.

Financial Report. Following a short break, Mr. Sullivan began a review of the first quarter highlights for WorldCom group, citing completion of the sale of an investment, the net debt decrease and the senior note redemption after the end of the quarter. He reported on the status of the accounts receivable and bank credit facilities, the terms associated therewith and the anticipated schedule and current expectations regarding the credit facilities. After responding to questions, Mr. Sullivan turned to a report on year-over-year growth statistics for WorldCom group, during which he described developments and strategies for dealing with certain challenges. He illustrated the impact of various factors on revenues, reviewed and provided explanations with respect to variances from guidance and addressed trends. Following a response to questions, during which Messrs. Beaumont and Sidgmore also made observations, Mr. Sullivan reviewed quarterly actual comparatives, revenue growth rates, the business rate-per-minute and capital expenditure trends. Next, Mr. Sullivan reported on first quarter highlights for the MCI group, noting solid cash flow, continued improvements in working capital and local services and payment of a dividend. He compared sequential actual results, observing certain trends that reflect stabilization, and illustrated the progress made in the consumer rate-per-minute, during which he along with Mr. Huyard responded to questions and made comments. Mr. Sullivan also reviewed first quarter statistics on a consolidated basis, including revenues, EBITDA, net income, cash flow, revenue mix compared to last year and revenue-per-employee. He then turned to balance sheet highlights, including credit ratios and balance sheet line items, followed by a review of the net debt schedule for the quarter reflecting a net debt reduction, free cash flow information and capital expenditure trends since 2000, including in relation to AT&T. Mr. Sullivan concluded with a report on April results, which along with prior information prompted questions to which Messrs. Sullivan and Beaumont responded.

WorldCom Group Report. Mr. Beaumont summarized the agenda for his presentation and described certain trends in the WorldCom group and the MCI group, identifying the causes associated therewith. He then turned to WorldCom group performance by product, line of business and geographical location, citing the areas of greatest challenge and certain comparisons. He addressed changes in operational revenue, noting the significance as to trends and favorable information. Next, Mr. Beaumont reported on revenue performance by size and type of customer; international sales; domestic sales, installation and disconnection trends; and

certain new or renewed contracts and the associated revenues. He reviewed additional performance trends during the year-to-date, historical results in relation to the operating plan and guidance for 2002, run-rate revenue forecast by sales channel and the SG&A forecast for the year. Mr. Beaumont also described the organizational structure, highlighting certain changes and plans, during which he and Mr. Sullivan addressed questions or comments and a request for periodic future progress reports. He provided additional information on matters previously summarized by Mr. Sidgmore, including strategic dispositions, as well as reductions in capital expenditures and SG&A expenses. Mr. Beaumont concluded with a summary of certain conditions in the marketplace, noting that the Company has not lost any major customers.

MCI Group Report. Following a short break to return with lunch, the meeting continued with a review by Mr. Huyard of the highlights for the MCI group during the first quarter, including statistics and observations in relation to the fourth quarter of 2001, stabilization in all areas but one, for which there is a solution to offset the previous decline associated with wireless substitution, and the actual results in relation to the plan for the quarter. Mr. Huyard then provided a comprehensive review of The Neighborhood built by MCI, during which he responded to questions or observations and distributed print materials and played a video associated with marketing activities. He also described the plans and goals going forward, noting the strong early results and favorable position of the Company which, along with other factors, give confidence in the likelihood of continued success.

Legal and Regulatory Report. Mr. Salsbury updated the Board on the status of a favorable settlement and continuing contract discussions with a third party. He identified certain unresolved matters, current requests and his opinion on the consequences associated therewith, during which Mr. Sidgmore reported on a recent meeting. Mr. Salsbury also provided information on another pending contract dispute. Next, he reviewed certain regulatory-related matters, including two recent Supreme Court decisions and a state proceeding favorable to the Company, with the likelihood of additional favorable pricing decisions in other states. Mr. Salsbury then reviewed the status of certain Section 271 decisions and related proceedings before turning to a report on reciprocal compensation, including the current rules, positions taken by others and recent discussions. He also reported on the status of certain pending broadband legislation, noting the implications for the Company and others. Mr. Salsbury concluded with a review of PAC matters, including a proposed reconstitution of the Company's political action committee Board. Upon motion by Mr. Aycock, seconded by Mr. Allen, the Board unanimously appointed as the sole members of the PAC Board Messrs. Beaumont, Huyard, Salsbury and Sullivan.

Chairman's Report. Mr. Roberts asked for suggestions on Board membership and committee composition. He also noted arrangements associated with the annual shareholders meeting, following which Mr. Salsbury advised of a recent action to enjoin the meeting. Mr. Roberts then identified the proposed Board meeting dates for the remainder of the year, which led to a discussion with further consideration to be given to possible changes in such dates in order to coincide more closely with scheduled earnings releases.

Adoption of Additional Resolutions. Upon motion made by Ms. Areen and seconded by Mr. Allen, the following resolutions were discussed and adopted unanimously:

Receivables Facility

WHEREAS, the Company and MCI WORLDCOM Receivables Corporation ("Receivables Corp.") are parties to a Second Amended and Restated Receivables Purchase Agreement dated October 24, 2001 with the Administrative Agent named therein and certain other banks and financial institutions (as amended to date, the "Existing Receivables Agreement");

WHEREAS, the Company has determined that it is in its best interest to amend and restate the Existing Receivables Agreement and certain of the other documents related thereto or contemplated or required thereby; and

WHEREAS, the Directors have been advised of and received information regarding the terms of the proposed amended receivables facility (the "Receivables Facility").

NOW, THEREFORE, BE IT RESOLVED, that the Third Amended and Restated Receivables Purchase Agreement and the other documents related thereto or contemplated or required thereby (collectively, the "Documents"), as the same may be changed or modified as herein permitted, be, and each is hereby, authorized, ratified and approved and that the transactions contemplated thereby and the Company's or its subsidiaries' performance thereunder be, and hereby are, authorized, ratified and approved.

RESOLVED FURTHER, that the officers of the Company including, but not limited to, John W. Sidgmore, Scott D. Sullivan, David F. Myers and Susan Mayer be, and each hereby is, authorized, empowered and directed to negotiate, execute and deliver, on behalf of the Company and its subsidiaries, the Documents in such form and substance as such officers may approve together with such changes in or modifications to the terms and provisions thereof as the officer executing the same shall, in such officer's discretion, deem necessary or advisable and in the best interest of the Company or its subsidiaries, including any renewals, extensions, modifications, restatements, amendments, supplements, waivers, increases or decreases to the amount of the Receivables Facility, and extensions or replacements thereof, and any such officer's signature, or such actions by such officer, shall be evidence that such officer did deem the same to be necessary or advisable and in the best interest of the Company or any such subsidiary.

RESOLVED FURTHER, that the Secretary and any Assistant Secretary of the Company be, and he is hereby, authorized, empowered and directed to certify and attest any documents which he may deem necessary or advisable to consummate the transactions contemplated by the Documents or to further assure the actions authorized hereby; provided that the corporate seal or attestation shall not be required for the validity of any particular document.

RESOLVED FURTHER, that the officers of the Company be, and each of them hereby is, authorized to pay all the expenses related to the Receivables Facility, including, but not limited to, accounting and legal fees and expenses.

RESOLVED FURTHER, that the officers be, and each of them hereby is, authorized to take any of the following actions on behalf of the Company and/or its subsidiaries, as the case may be, and any such actions heretofore taken are hereby ratified and affirmed in all respects: (i) negotiate, execute, deliver and/or file, in the name and on behalf of the Company and/or its subsidiaries, as the case may be, any and all agreements, documents, instruments, notices, fee letters, assignments, certificates, consents, promissory notes, filings and applications (including, but not limited to, any renewals, extensions, modifications, restatements, amendments, supplements, waivers, extensions or replacements to the Documents or any of the foregoing), and (ii) do such other things as may be required, or as may in their judgment be appropriate or advisable, in order to effectuate fully these resolutions and the consummation of the transactions contemplated thereby, and any such officer's signature, or such actions by such officer, shall be evidence that such officer did deem the same to be appropriate or advisable; provided that the corporate seal or attestation of any agreement or document by any officer of the Company or any of its subsidiaries shall not be required for the validity thereof.

Preferred Stock Dividends

WHEREAS, the Company has outstanding depositary shares ("Depositary Shares") each representing 1/100 of a share of the Series D junior convertible preferred stock, Series E junior convertible preferred stock or Series F junior convertible preferred stock (collectively, the "Preferred Stock");

WHEREAS, pursuant to the terms of each of the series of Preferred Stock, the holders thereof are entitled to receive, when, as and if declared by the Board of Directors of the Company, out of funds legally available therefor, cumulative dividends per share from the prior dividend payment date accruing at an annual rate of 7% (.07% per Depositary Share) of the liquidation preference per share, with the next dividend payment date being July 15, 2002 (the "Second Quarter Preferred Stock Dividend"); and

WHEREAS, the Board of Directors of the Company has determined it desirable to declare the Second Quarter Preferred Stock Dividend on each series of the Preferred Stock and that funds are legally available therefor.

NOW, THEREFORE, BE IT RESOLVED, that the Board of Directors hereby declares the Second Quarter Preferred Stock Dividend, which dividend shall be payable on July 15, 2002 by the issuance of Common Stock Units as defined in and determined in accordance with the terms of each series of Preferred

Stock, to the respective holders of record of each series of the Preferred Stock on July 1, 2002.

General Authorization

RESOLVED, that the officers of the Company and/or its subsidiaries be, and each of them hereby is, authorized to take any of the following actions on behalf of the Company and/or its subsidiaries, as the case may be, and any such actions heretofore taken by any of them are hereby ratified and affirmed in all respects: (i) negotiate, execute, deliver and/or file any and all of the agreements, documents and instruments referenced herein, and such other agreements, documents and instruments and assignments thereof as may be required or as such officers deem appropriate or advisable, or to cause the negotiation, execution and delivery thereof, in the name and on behalf of the Company and/or its subsidiaries, as the case may be, in such form and substance as such officers may approve, together with such changes and amendments to any of the terms and conditions thereof as such officers may approve, with the execution and delivery thereof on behalf of the Company and/or its subsidiaries, as the case may be, by or at the direction of such officers to constitute evidence of such approval, (ii) negotiate, execute, deliver and/or file, in the name and on behalf of the Company and/or its subsidiaries, as the case may be, any and all agreements, documents, certificates, consents, filings and applications relating to the resolutions adopted and matters ratified or approved at this meeting and the transactions contemplated thereby, and amendments to any of the foregoing, and to take such other actions as may be required or as such officers deem appropriate or advisable in connection therewith including, without limitation, voting any shares held by the Company and/or its subsidiaries, and (iii) doing such other things as may be required, or as may in their judgment be appropriate or advisable, in order to effectuate fully the resolutions adopted and matters ratified or approved at this meeting and the consummation of the transactions contemplated thereby.

There being no further business, the meeting was adjourned.

Respectfully submitted,

P. Bruce Borghardt, Acting Secretary

Exhibit 10.5

SEPARATION AGREEMENT
(BERNARD J. EBBERS)

SEPARATION AGREEMENT, dated as of April 29, 2002, between WORLDCOM, INC., a Georgia corporation (the "Company"), and BERNARD J. EBBERS (the "Executive").

SECTION 1. RESIGNATION. The Executive hereby resigns from all directorships, offices and positions with the Company and its subsidiaries, affiliates and employee benefit plans and trusts, effective April 29, 2002 (the "Termination Date"). The Executive will be appointed to serve the Company's board of directors as non-executive CHAIRMAN EMERITUS at the pleasure of the board, and also will serve as a consultant as described in Section 9.

SECTION 2. PENSION BENEFITS. Commencing as soon as practicable following May 1, 2002, and on each May 1 thereafter that occurs during the Executive's lifetime, the Company shall pay the Executive $1,500,000, in cash. Should the Executive be survived by the individual who is the Executive's spouse on the Termination Date, the Company shall pay such spouse $750,000 in cash on each May 1 after the Executive's death that occurs during such spouse's lifetime. These pension benefits are subject to complete discontinuance pursuant to Section 14.

SECTION 3. OTHER BENEFITS.

(a) The Company shall provide the Executive, at its expense (and subject to offset for Medicare coverage), with continued medical and life insurance benefits for the remainder of his lifetime at the level applicable generally to senior executives of the Company. The Executive also shall receive (without duplication) such amounts, if any, to which the Executive may be entitled as of the Termination Date pursuant to the terms of the employee benefit programs and compensation programs of the Company (other than severance programs).

(b) The Executive will have use of the Company aircraft for a maximum of 30 hours per calendar year, subject to reimbursement of the Company by the Executive on the same basis as is currently in effect with the Company for personal usage, in order to avoid imputed income.

(c) Subject to Section 6(b), the Executive may retain, at no additional cost to him, his current Company-issued desktop computer.

(d) The Executive may lease office space from the Company at its 515 Amite Street location on terms and conditions mutually agreeable to the parties.

SECTION 4. STOCK OPTIONS. Each outstanding option granted to the Executive to purchase WorldCom group common stock or MCI group common stock (collectively, "Company Stock") shall become fully vested and exercisable on the Termination Date, and each such option shall

remain exercisable until the fifth anniversary of the Termination Date (or, if earlier, the expiration of such option's original term), except to the extent the applicable option agreement cannot be amended

to permit such extension of the option's exercise period.

SECTION 5. LOANS. Simultaneously herewith, the Executive shall execute the letter agreement dated of even date herewith between the Executive and the Company (the "Letter Agreement") and the related promissory note (the "Promissory Note"). The Executive further acknowledges and agrees that his obligations under the letter agreement dated April 2, 2002 (the "April 2 Letter Agreement"), as modified by the Letter Agreement, shall continue to apply in full force and effect. The payments due from the Executive under the Promissory Note are subject to acceleration as described in Section 14.

SECTION 6. RESTRICTIVE COVENANTS.

(a) NON-COMPETITION. Executive acknowledges and recognizes the highly competitive nature of the businesses of the Company and its affiliates and accordingly agrees as follows:

(i) For a period of five years following the Termination Date (the "Restricted Period"), the Executive will not, whether on the Executive's own behalf or on behalf of or in conjunction with any person, firm, partnership, joint venture, association, corporation or other business organization, entity or enterprise whatsoever ("Person"), directly or indirectly:

(A) engage in any business which is in competition with the business of the Company or an affiliate, which shall include any business which is principally involved in the purchase, sale or other dealing in any property or the rendering of any service purchased, sold, dealt in or rendered by the Company or an affiliate as a material part of the business of the Company or an affiliate within the same geographic area in which the Company or an affiliate makes such purchases, sales or dealings or renders such services (a "Competitive Business");

(B) enter the employ of, or render any services to, any Person (or any division or controlled or controlling affiliate of any Person) in respect of any Competitive Business;

(C) acquire a financial interest in, or otherwise become actively involved with, any Competitive Business, directly or indirectly, as an individual, partner, shareholder, officer, director, principal, agent, trustee or consultant; or

(D) interfere with, or attempt to interfere with, business relationships (whether formed before, on or after the Termination Date) between the Company or any of its affiliates and customers, clients, suppliers or investors of the Company or its affiliates.

(ii) Notwithstanding anything to the contrary in this Agreement, Executive may directly or indirectly own, solely as an investment, securities of any Person which are publicly traded on a national or regional stock exchange or on the over-the-counter market if Executive (A) is not a controlling person of, or a member of a group which controls, such person and (B) does not, directly or indirectly, own 5% or more of any class of securities of such Person.

(iii) During the Restricted Period, Executive will not, whether on Executive's own behalf or on behalf of or in conjunction with any Person, directly or indirectly:

(A) solicit or encourage any employee of the Company or its affiliates to leave the employment of the Company or its affiliates; or

(B) hire any such employee who was employed by the Company or its affiliates as of the Termination Date, or, if later, within the six-month period prior to such date of hire; provided however, notwithstanding any other provision hereof, Executive may hire his current secretary, Debra Blackwell.

(iv) During the Restricted Period, Executive will not, directly or indirectly, solicit or encourage to cease to work with the Company or its affiliates any consultant then under contract with the Company or its affiliates.

(v) It is expressly understood and agreed that although the Executive and the Company consider the restrictions contained in this Section 6 to be reasonable, if a final determination is made by a court of competent jurisdiction or an arbitrator that the time or territory or any other restriction contained in this Agreement is an unenforceable restriction against the Executive, the provisions of this Agreement shall not be rendered void but shall be deemed amended to apply as to such maximum time and territory and to such maximum extent as such court or arbitrator may determine or indicate to be enforceable. Alternatively, if any such court of competent jurisdiction or arbitrator finds that any restriction contained in this Agreement is unenforceable, and such restriction cannot be amended so as to make it enforceable, such finding shall not affect the enforceability of any of the other restrictions contained herein.

(b) CONFIDENTIALITY.

(i) The Executive will not at any time use, divulge or convey any secret or confidential information, knowledge, or data of the Company or its affiliates, including information, knowledge or data of third parties as to which the Company or its affiliates is under an obligation of confidentiality (as, for example, information supplied to allow the Company to evaluate a potential acquisition), obtained by the Executive in the course of the Executive's activities as a director, officer or employee of the Company except where required to do so by a court of law, by a governmental agency having supervisory authority over the business of the Company or by any administrative or legislative body with apparent jurisdiction over the Executive to order the Executive to divulge, disclose or make accessible such information. Such information, knowledge or data includes, but is not limited to, secret or confidential matters (A) of a technical nature such as, but not limited to, methods, know-how, formulae, compositions, process, discoveries, machines, inventions, computer programs and similar items or research projects, (B) of a business nature such as, but not limited to, information about cost, purchasing, profits, market, sales or lists of customers, and (C) pertaining to future developments such as, but not limited to, research and development of future marketing or merchandising ("Confidential Information"). Such Confidential Information does not include information, knowledge or data that becomes publicly known other than through a breach of this Agreement by the Executive.

(ii) On and after the Termination Date the Executive shall (A) not use of any

Confidential Information or intellectual property owned or used by the Company, its subsidiaries or

affiliates, (B) immediately destroy, delete, or return to the Company, at the Company's option, all originals and copies in any form or medium in the Executive's possession or control (including any of the foregoing stored or located in the Executive's office, home, laptop or other computer, whether or not Company property) to the extent that they contain Confidential Information.

(c) NON-DISPARAGEMENT. The Company and its affiliates shall refrain from making any statements or comments of a defamatory or disparaging nature to any third party regarding the Executive, and the Executive shall refrain from making any statements or comments of a defamatory or disparaging nature to any third party regarding the Company, any of its affiliates, or any of their directors, officers, personnel, policies or product; provided, however, that it shall not be a violation of this Section 6(c) for either party to make truthful statements when required to do so by a court of law, by any governmental agency having supervisory authority over the party, or by any administrative or legislative body with apparent jurisdiction to order the party to divulge, disclose or make accessible such information.

SECTION 7. SPECIFIC PERFORMANCE. The Executive acknowledges and agrees that the Company's remedies at law for a breach or threatened breach of any of the provisions of Section 6 would be inadequate and the Company would suffer irreparable damages as a result of such breach or threatened breach. In recognition of this fact, the Executive agrees that, in the event of such a breach or threatened breach, in addition to any remedies at law, the Company, without posting any bond, shall be entitled to cease making any payments or providing any entitlement or benefit otherwise required by this Agreement (including without limitation the payments, entitlements and benefits otherwise provided pursuant to Sections 2, 3, 4 and 5), and, notwithstanding Section 22, shall be entitled to bring an action in any court of competent jurisdiction for the purpose of obtaining equitable relief in the form of specific performance, temporary restraining order, temporary or permanent injunction or any other equitable remedy which may then be available.

SECTION 8. COOPERATION. The Executive shall provide reasonable cooperation in connection with any action or proceeding which relates to the Company or any of its affiliates, including without limitation in connection with any litigation and disputes arising out of actions or inactions of the Company or any affiliate of which the Executive has knowledge or information. The Executive further agrees to cooperate with the Company in supplying data, information, and expertise within the Executive's special knowledge or competence and otherwise assist the Company in the protection of the interests of the Company and its affiliates. The Company shall reimburse the Executive for reasonable out-of-pocket expenses (such as hotel and travel expenses) incurred by the Executive in connection with such cooperation following its receipt of the Executive's appropriately itemized request.

SECTION 9. CONSULTATION. For a period of five years following the Termination Date, the Executive shall remain available to provide consulting services to the Company and its affiliates, in particular the Chief Executive Officer of the Company, on business matters from time to time at the Company's reasonable request. The Executive acknowledges that all such consulting services will be performed by the Executive as an independent contractor, and not as an employee, and that the Executive will not be eligible or entitled to participate, as a result of the performance of such consulting services, in any Company benefit or incentive program.

SECTION 10. INDEMNITY. The existing rights of the Executive and obligations of the Company

with regard to indemnification of the Executive that are not dependent upon Executive's continued employment or holding an office or directorship with the Company or an affiliate, and the indemnification rights under the Company's current by-laws, shall continue.

SECTION 11. RELEASE. The Executive acknowledges that certain payments provided for hereunder are in excess of the amounts that the Executive would otherwise be entitled to receive and that the Company had no obligation to enter into this Agreement. In consideration of the Company assuming these additional obligations and entering into this Agreement, and as a material inducement to the Executive to enter into this Agreement, the parties agree to execute (and not revoke) a release ("Release") substantially in the form attached hereto as EXHIBIT A. This Agreement is subject in all respects to Executive's execution (and non-revocation) of the Release.

SECTION 12. SEVERABILITY. In the event that any one or more of the provisions of this Agreement shall be or become invalid, illegal or unenforceable in any respect, the validity, legality and enforceability of the remaining provisions of this Agreement shall not be affected thereby.

SECTION 13. ASSIGNMENT. This Agreement, and all of Executive's rights and duties hereunder, shall not be assignable or delegable by Executive. Any purported assignment or delegation by Executive in violation of the foregoing shall be null and void AB INITIO and of no force and effect. This Agreement may be assigned by the Company to a person or entity which is a successor in interest to substantially all of the business operations of the Company. Upon such assignment, the rights and obligations of the Company hereunder shall become the rights and obligations of such successor person or entity.

SECTION 14. SET-OFF; BREACH. In the event of any breach of this Agreement by the Executive, the Company's obligation to pay any amounts to the Executive, whether under this Agreement or otherwise, and the Company's obligation to make the arrangements provided under this Agreement, net of any withholding obligations, shall be subject to set-off by or against, counterclaim or recoupment of, amounts owed by the Executive to the Company or its affiliates. Without limiting the generality of the foregoing, in the event of any breach of this Agreement by the Executive, any default by the Executive on any of the obligations contained in the Letter Agreement, the Promissory Note or the April 2 Letter Agreement, or the filing of voluntary or involuntary bankruptcy by the Executive, payment of the pension benefits described in Section 2 will be permanently discontinued and all outstanding amounts due to the Company by the Executive will be accelerated as provided in the Promissory Note.

SECTION 15. NO MITIGATION. Executive shall not be required to mitigate the amount of any payment provided for pursuant to this Agreement by seeking other employment, and the Executive shall not be required to pay the Company any amounts the Executive may receive from such alternative employment.

SECTION 16. SUCCESSORS; BINDING AGREEMENT. This Agreement shall inure to the benefit of and be binding upon personal or legal representatives, executors, administrators, successors, heirs, distributees, devisees and legatees.

SECTION 17. NOTICE. For purposes of this Agreement, notices and all other communications provided for in this Agreement shall be in writing and shall be deemed to have been duly given when delivered by hand or overnight courier or three days after it has been mailed by United

States registered mail, return receipt requested, postage prepaid, addressed to the respective addresses set forth below in this Agreement, or to such other address as either party may have furnished to the other in writing in accordance herewith, except that notice of change of address shall be effective only upon receipt.

Notice to the Company shall be addressed to:

WorldCom, Inc.
500 Clinton Center Drive
Clinton, MS 39056
Attn: General Counsel

With a copy to:
Kenneth C. Edgar, Jr., Esq.
Simpson Thacher & Bartlett
425 Lexington Avenue
New York, NY 10017

Notice to the Executive shall be addressed to:

Mr. Bernard J. Ebbers
2116 Highway 84 East
Oakhill Farm
Brookhaven, MS 39601

With a copy to:
Charles P. Adams, Jr., Esq.
Adams and Reese, LLP
P.O. Box 24297
Jackson, MS 39225-4297

SECTION 18. WITHHOLDING TAXES. The Company may withhold from any amounts payable under this Agreement such Federal, state and local taxes as may be required to be withheld pursuant to any applicable law or regulation.

SECTION 19. ENTIRE AGREEMENT/AMENDMENTS. This Agreement, the Release, the Letter Agreement and the Promissory Note contain the entire understanding of the parties with respect to the subject matter hereof; except that the obligations described in the April 2 Letter Agreement, as modified by the Letter Agreement, shall continue to apply in all respects. There are no restrictions, agreements, promises, warranties, covenants or undertakings between the parties with respect to the subject matter herein other than those expressly set forth herein and therein. This Agreement may not be amended except by written instrument signed by the parties hereto.

SECTION 20. NO WAIVER. The failure of a party to insist upon strict adherence to any term of this Agreement on any occasion shall not be considered a waiver of such party's rights or deprive such party of the right thereafter to insist upon strict adherence to that term or any other term of this Agreement.

SECTION 21. ARBITRATION. Except as set forth in Section 7, any dispute, controversy or claim arising out of or relating to this Agreement shall be settled exclusively by binding arbitration by a single arbitrator, conducted in the State of Mississippi in accordance with the rules of the American Arbitration Association then in effect. If the Executive and the Company are unable to mutually agree on the arbitrator, the arbitrator shall be chosen in accordance with the rules of the American Arbitration Association. Judgment may be entered on the arbitrator's award in any court in the State of Mississippi having jurisdiction.

SECTION 22. GOVERNING LAW; VENUE. This Agreement shall be governed by and construed in accordance with the laws of the State of Mississippi, without regard to conflicts of laws principles thereof. The Executive irrevocably submits to the non-exclusive jurisdiction of the courts of the State of Mississippi and the courts of the United States located in the State of Mississippi for the purpose of any action or proceeding arising out of or relating to this Agreement, and acknowledges that the designated FORA have a reasonable relation to this Agreement and the parties' relationship to one another.

SECTION 23. COUNTERPARTS. This Agreement may be signed in counterparts, each of which shall be an original, with the same effect as if the signatures thereto and hereto were upon the same instrument.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first written above.

WORLDCOM, INC.

/s/ John W. Sidgmore

By: John W. Sidgmore
President and
Chief Executive Officer

/s/ Bernard J. Ebbers

Bernard J. Ebbers

WORLDCOM TABLE OF EVENTS

Date	Company event	Company achievement	Stock Price
1985	Bernard Ebbers named CEO LDDS	Ebbers was early investor of discount long distance provider LDDS	
Aug 1989	LDDS Communications merges with Advantage to form WorldCom	WorldCom listed	$22.25
1994	Sullivan named CFO		$18.35
May 1995	LDDS/WorldCom pleads guilty to felony; fined $50K and $70K in restitution; LDDS changes name to WorldCom Inc., Ebbers named CEO	Reportedly Ebbers and CFO Cannada solicited employees' purchase of "picnic" tickets for 1991 re-election campaign of Miss. Public Utilities Commissioner	
Dec 1996	WorldCom merges with MFS Comm. Inc.; Lawrence Tucker added as director. Tucker's stock sales later reach $110M.	Merger adds $14 b value and brings in UUNet Internet;	$23.50
Jan 1998	WorldCom merges with Brooks Fiber		$29.50
Feb 2, 1998	WorldCom structures $1.2B deal with CompuServe and AOL		$37.90
Sept. 1998	WorldCom acquires MCI for $37B		$47.50
May 28, 1999	WorldCom acquires Skytel	Skytel brings 1.5 m subscribers and 1998 revenues of $518m	$57.50
Sept 1999	WorldCom acquires CAI Wireless	Company value reported to be $190B	$64.50
Oct.5,1999	Ebbers announces $129B merger with Sprint		$67.90
Nov18,1999	MCI WorldCom announces three for two (3/2) split.	Split effected as 50% dividend on 12/30	$60.96
July13,2000	Justice Dept. blocks WorldCom proposed $129B acquisition of Sprint		$49.18
Oct 5,2000	Ebbers sells 3m shares for $84M to pay off investment debts		$25.93
Jan 2001	Sullivan begins capitalization of operating expenses		$20.72
April 26,2001	WorldCom posts 38% drop in earnings		$19.74
July 2001	WorldCom buys Intermedia		$14

Jan.30,2002	WorldCom stock drops below $10 for first time since 1995		$9.85
Feb.8 2002	Ebbers takes out $366M loan to cover stock purchase		$8.18
March7, 2002	SEC requests documentation from WorldCom		$8.40
March 11, 2002	WorldCom publicly announces SEC inquiry listing accounting; loans to officers; tracking of analyst's earnings, and accounting for goodwill as concerns	WorldCom states in press release that company has complied with GAAP	$6.74
April 3,2002	WorldCom cuts 3,700 jobs		$6.51
April 22,2002	Jack Grubman downgrades stock from buy to neutral		$4.01
April 29,2002	Ebbers resigns, given $1.5m annual lifetime annuity; Sidgmore becomes CEO	Sidgmore served as Vice Chairman and COO since 1996	$2.47
May 9,2002	WorldCom bond rating lowered to junk status		$2.01
May 13,2002	Standard and Poor's removes WorldCom from S&P Index		$1.44
May15, 2002	Andersen LLP released as Company's external auditor	KPMG LLP appointed external auditor	$1.31
May 16, 2002	KPMG retained as external auditor		$1.31
May 22, 2002	KPMG meets with WorldCom audit committee and several Board members	Bobbit, Sullivan, Cooper, Scott, Beaumont, Myers and board member Areen present	$1.65
June 1, 2002	Melvin Dick resigns as Andersen engagement partner		
June 5, 2002	Internal audit V.P. Cynthia Cooper met newly retained KPMG engagement partner Malone and discussed accounting irregularities		$1.41
June 12, 2002	Internal audit committee V.P. Cooper informed Bobbitt of her investigation of "line- cost transfers."	Cooper began audit/investigation in May; discusses line cost with Myers; not shown documentation	$1.57

June 13, 2002	KPMG auditor Malone meets with Bobbitt and Cooper; Cooper states that she was not shown documentation to justify the line-cost transfers.		$1.65
June 14, 2002	Sullivan tells Board likelihood of upcoming write-down for FAS 142 adjustment	Audit Committee chair Bobbit, Cooper and KPMPG's Malone met with Sullivan earlier that morning. and discuss line-costs	$1.59
June 19, 2002	KPMG's Malone interviews Sullivan and Myers in Washington regarding accounting transfers; Sullivan does not support theory with documents; Malone briefs Bobbit	Board and Audit Committee Areen is briefed by Bobbit on issues, decides to bring in Simpson Thatcher and Bartlett as outside counsel.	$1.52
June 20, 2002	Sidgmore orders Sullivan to explain accounting irregularities	KPMG's Malone told Sullivan he could not find support for theory.	$1.37
June 21, 2002	Grubman downgrade opinion from "neutral" to "under-perform."	Grubman was paid $10 million in 2001; $25 million in bonus in 1998	$1.22
June 24, 2002	Expanded Audit Committee concludes "accounting transfers" unsupportable under GAAP;	.	$.91
June 26, 2002	WorldCom admits $4B accounting fraud; stock falls to $.20 in after hours trading; NASDAQ halts trading; SEC files fraud charges		$.20
June 29, 2002	WorldCom lays off 17,000 workers	2000 laid off in Washington DC area	
July 1, 2002	WorldCom files answer to SEC inquiry; Pitt labels response inadequate.	1,233,000,000 shares traded	$.06