Re: <u>WorldCom, Inc., HO-09440</u>

Revised Statement Pursuant to Section 21(a)(1) of the Securities Exchange Act of 1934

1. This **revised** 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. **The Company is relying on the independent investigation already underway to determine all the relevant facts and will take further action as appropriate upon conclusion of the investigation. The Company has not conducted in-depth interviews of present or former directors, officers, or employees.** 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.

<u>Preparation of the Company's 2001 and 2002 Financial Statements</u>

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. **Mr. Sullivan reported to Bernard J. Ebbers, Chief Executive Officer of the Company until April 29, 2002, when Mr. Ebbers resigned and was succeeded as CEO by John W. Sidgmore.** 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. **The Company's directors, including Mr. Ebbers and Mr. Sullivan, also sign the annual Form 10-K filing.**

2A. During 2001 to the present, the members of the Audit Committee of the Company's Board of Directors were: Max Bobbitt, Chairman, James Allen, Judith Areen, and Francesco Galesi, all of whom are independent directors.

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.

3A. **On February 6, 2002, the Audit Committee met with Andersen to discuss Andersen's audit of the Company's consolidated results of operations and financial position as of and for the year ended December 31, 2001. Andersen's presentation (Exhibit 1 to this Statement) noted, among other things: (a) there were no significant or unusual transactions, or material transactions in controversial or emerging areas for which there was a lack of authoritative guidance or consensus, (b) Andersen had assessed the Company's key accounting practices to determine whether management had adequate controls to prevent a material error in the financial statements as a result of a failure to properly record data in the general ledger, (c) it was Andersen's assessment that the Company's processes for line cost accruals and for capitalization of assets in Plant, Property & Equipment accounts were effective, (d) it was Andersen's assessment that the Company's process for formulating judgments and estimates for accrued line costs was effective, noting that line costs (see paragraph 5 below) as a percentage of revenue had remained flat at 41.9% on a YTD basis. During the meeting, Andersen advised in response to specific questions by the Committee that Andersen had no disagreements with management and that there were no accounting positions taken by the Company with which Andersen was not comfortable.**

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 Line Cost 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. **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. 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. **According to a memorandum prepared by Ms. Cooper (Exhibit 2 to this Statement), 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 2002 numbers. However, Ms. Cooper continued the audit. According to the June 12 memorandum, Mr. Sullivan indicated the line cost transfers began in the third quarter of 2001, and that previously these costs had been expensed. Ms. Cooper furnished a copy of the June 12 memorandum to Company management subsequent to the June 25, 2002 meeting with the SEC staff (see paragraph 22 below). The Company has provided the**

memorandum to the Department of Justice, the SEC, and the independent investigator.

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. 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. **According to a memorandum prepared by Ms. Cooper (Exhibit 3 to this Statement), Ms. Cooper stated during this discussion that she believed the Audit Committee should be apprised of the facts known to date. Mr. Bobbitt and Mr. Malone of KPMG believed it was premature to raise the issue at the Audit Committee meeting on June 14, 2002, because Internal Audit was still in the middle of the audit and support had not yet been obtained. It was agreed that Internal Audit would carry on with the audit as planned on Monday morning (June 17). Ms. Cooper's personal attorney furnished a copy of this memorandum to Company management on July 1, 2002. The Company has given the memorandum to the Department of Justice, the SEC, and the independent investigator.**

7A. On or about June 13, 2002, Mr. Sullivan indicated to Mr. Sidgmore that the SG&A and capital expenditure reduction measures planned for the second quarter of 2002 may not have the desired impact on net income due to writedowns that were planned for the quarter.

7B. On June 14, 2002, at a regularly scheduled Board meeting, Mr. Sullivan noted that the financial report for second quarter 2002 would be complex, including the previously announced $15 to $20 billion goodwill impairment charge, severance charges, and charges for cancelled capital projects, discontinued operations, and other items. Mr. Sullivan indicated that he would continue to examine the Company's line cost commitments.

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. **On either June 17 or June 18, Mr. Myers indicated that large transfers were made in 2001 and the first quarter of 2002 and that there was no directly applicable accounting support for the transfers.** 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.

<u>The Audit Committee's Review</u>

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 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 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. **Bert C. Roberts, Jr., Chairman of the Board of the Company, was advised of the situation later that day.**

15. The June 20 Audit Committee meeting was attended by Mr. Bobbitt, Ms. Areen, 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. **He stated that beginning in 1999 the Company had spent billions to expand its systems and had incurred costs pursuant to long-term contracts for unused capacity. Based on the principle of matching costs and revenues, it was Mr. Sullivan's intent that certain costs not be expensed until the Company realized matching revenue. However, revenues had not grown. He added that accounting for line costs required significant judgments to be made, and that the line cost transfers were not made in order to allow the Company to meet earnings projections. Mr. Sullivan said that he made the transfers pursuant to high-level**

estimates based on quarterly line cost reports. 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. Sullivan stated that he had originated the request for Ms. Cooper's review, but that he had asked Ms. Cooper to hold off on her report to allow him to address the situation.** Mr. Malone disagreed that 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. **Internal Audit was instructed to continue its investigation.**

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. Sullivan confirmed that the capitalization of line costs extended back into the first quarter of 2001.** 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 **(Exhibit 4 to this statement)** 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. **Mr. Rodgers and Mr. Howell indicated that they had not seen Mr. Sullivan's memorandum, but that it had been read to them and they did not accept it as compliant with GAAP.** 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. **Mr. Sullivan indicated that the line costs were long-term contracts entered into in connection with the Company's investment in its network and in anticipation of gaining customers that ultimately were not gained.** 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**d**: **July 8**, 2002**.**