02 MAG. 1511

Approved: Bonnie Jonas/D.B.A./E.T.B.
BONNIE JONAS
DAVID B. ANDERS
EVAN T. BARR
Assistant United States Attorneys

Before: HONORABLE JAMES C. FRANCIS, IV
United States Magistrate Judge
Southern District of New York

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UNITED STATES OF AMERICA, :

- v - :

SCOTT D. SULLIVAN and :
DAVID F. MYERS,
:
Defendants.
:
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SEALED COMPLAINT

Violation of
18 U.S.C. §§ 371 & 2;
15 U.S.C. §§ 78j(b), 78ff
and 78m(b)(5)

COUNTY OF OFFENSE:
NEW YORK

SOUTHERN DISTRICT OF NEW YORK, ss.:

PAUL J. HIGGINS, being duly sworn, deposes and says that he is a Special Agent with the Federal Bureau of Investigation ("FBI") and charges as follows:

Conspiracy to Commit Securities Fraud

1. From in or about early 2001 through in or about June 2002, in the Southern District of New York and elsewhere, SCOTT D. SULLIVAN and DAVID F. MYERS, the defendants, and others known and unknown, unlawfully, willfully, and knowingly did combine, conspire, confederate, and agree together and with each other to commit offenses against the United States, namely, (a) to commit fraud in connection with the purchase and sale of securities issued by WorldCom, Inc., in violation of Title 15, United States Code, Sections 78j(b) and 78ff, and Title 17, Code of Federal Regulations, Section 240.10b-5; (b) to make and cause to be made false and misleading statements of material fact in applications, reports, and documents required to be filed under the Securities Exchange Act of 1934 (the "Act") and the rules and regulations thereunder, in violation of Title 15, United States Code, Section 78ff; (c) to make and cause to be made false and misleading statements to WorldCom, Inc.'s auditors, in violation of Title 15, United States Code, Section 78ff and Title 17, Code of Federal Regulations, Section 240.13b2-2; and (d) to falsify books, records, and accounts of WorldCom, Inc., in violation of Title 15, United States Code, Sections 78m(b)(2)(A), 78m(b)(5) and 78ff, and Title 17, Code of Federal Regulations, Section 240.13b2-1.

Objects of the Conspiracy

Fraud In Connection With The Purchase Or Sale Of Securities

2. It was a part and an object of the conspiracy that SCOTT D. SULLIVAN and DAVID F. MYERS, the defendants, and others known and unknown, unlawfully, willfully, and knowingly, directly and indirectly, by use of the means and instrumentalities of interstate commerce, the mails, and the facilities of national securities exchanges, would and did use and employ manipulative and deceptive devices and contrivances in connection with the purchase and sale of securities issued by WorldCom, Inc., in violation of Title 17, Code of Federal Regulations, Section 240.10b-5, by (a) employing devices, schemes, and artifices to defraud; (b) making and causing WorldCom, Inc. to make untrue statements of material facts and omitting to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and (c) engaging in acts, practices, and courses of business which operated and would operate as a fraud and deceit upon the purchasers and sellers of WorldCom, Inc. securities, in violation of Title 15, United States Code, Sections 78j(b) and 78ff.

False Statements In Annual And Quarterly SEC Reports

3. It was further a part and an object of the conspiracy that SCOTT D. SULLIVAN and DAVID F. MYERS, the defendants, and others known and unknown, unlawfully, willfully, and knowingly, in applications, reports, and documents required to be filed under the Act and the rules and regulations thereunder, would and did make and cause to be made statements which were false and misleading with respect to material facts, in violation of Title 15, United States Code, Section 78ff.

False Statements to Auditors

4. It was further a part and an object of the conspiracy that SCOTT D. SULLIVAN and DAVID F. MYERS, the defendants, being directors and officers of WorldCom, Inc., an issuer with a class of securities registered pursuant to Section 12 of the Act, and others known and unknown, unlawfully, willfully, and knowingly, would and did, directly and indirectly: (a) make and cause to be made materially false and misleading statements; and (b) omit to state, and cause others to omit to state, material facts necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading to accountants in connection with: (i) audits and examinations of the Financial Statements of WorldCom, Inc.; and (ii) the preparation and filing of documents and reports required to be filed with the SEC pursuant to rules and

regulations enacted by the SEC, in violation of Title 17, Code of Federal Regulations, Section 240.13b2-2 and Title 15, United States Code, Section 78ff.

False Books and Records

5. It was further a part and an object of the conspiracy that SCOTT D. SULLIVAN and DAVID F. MYERS, the defendants, and others known and unknown, unlawfully, willfully, and knowingly would and did, directly and indirectly, falsify and cause to be falsified books, records, and accounts subject to Section 13(b)(2) of the Act, namely books, records, and accounts of WorldCom, Inc., an issuer with a class of securities registered pursuant to the Act, which WorldCom, Inc. was required to make and keep in reasonable detail, accurately and fairly reflecting the transactions and dispositions of the assets of WorldCom, Inc., in violation of Title 15, United States Code, Sections 78m(b)(2)(A), 78m(b)(5) and 78ff, and Title 17, Code of Federal Regulations, Section 240.13b2-1.

Overt Acts

6. In furtherance of the conspiracy and to effect its illegal objects, SCOTT D. SULLIVAN and DAVID F. MYERS, the defendants, and their co-conspirators, committed the following overt acts, among others, in the Southern District of New York and elsewhere:

a. In or about April 2001, at SULLIVAN's direction, MYERS directed employees of the General Accounting department at WorldCom, Inc. ("WorldCom") to transfer approximately $771 million in "line cost" expenses to various Property, Plant & Equipment ("PP&E") accounts in WorldCom's general ledger.

b. In or about July 2001, at SULLIVAN's direction, MYERS directed employees of the General Accounting department at WorldCom to transfer approximately $560 million in "line cost" expenses to various PP&E accounts in WorldCom's general ledger.

c. In or about October 2001, at SULLIVAN's direction, MYERS directed employees of the General Accounting department at WorldCom to transfer approximately $743 million in "line cost" expenses to various PP&E accounts in WorldCom's general ledger.

d. In or about February 2002, at SULLIVAN's direction, MYERS directed employees of the General Accounting department at WorldCom to transfer approximately $941 million in "line cost" expenses to various PP&E accounts in WorldCom's general ledger.

e. On or about March 13, 2002, SULLIVAN signed WorldCom's Form 10-K Annual Report for the Year Ending December 31, 2001.

f. On or about March 13, 2002, SULLIVAN and MYERS caused WorldCom's 2001 Form 10-K to be filed with the United States Securities and Exchange Commission from New York, New York.

g. In or about April 2002, at SULLIVAN's direction, MYERS directed employees of the General Accounting department at WorldCom to transfer approximately $818 million in "line cost" expenses to various PP&E accounts in WorldCom's general ledger.

h. On or about June 11, 2002, SULLIVAN requested that WorldCom's Vice President for Internal Audit defer an audit of WorldCom's capital expenditure accounts.

(Title 18, United States Code, Section 371.)

COUNT TWO

(Securities Fraud)

7. From in or about 2001, up to and including in or about June 2002, in the Southern District of New York and elsewhere, SCOTT D. SULLIVAN and DAVID F. MYERS, the defendants, unlawfully, willfully and knowingly, directly and indirectly, by the use of means and instrumentalities of interstate commerce, and of the mails, and of facilities of national securities exchanges, would and did use and employ, in connection with the purchase and sale of securities, namely WorldCom, Inc. common stock, manipulative and deceptive devices and contrivances in violation of Title 17, Code of Federal Regulations, Section 240.10b-5 by: (a) employing devices, schemes and artifices to defraud; (b) making untrue statements of material fact and omitting to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; and (c) engaging in acts, practices and courses of business which operated and would operate as a fraud and deceit upon purchasers and sellers of WorldCom, Inc. common stock.

(Title 15, United States Code, Sections 78j(b) and 78ff; Title 17, Code of Federal Regulations, Section 240.10b-5; Title 18, United States Code, Section 2).

COUNTS THREE THROUGH SEVEN

(False Filings With The SEC)

8. On or about the dates listed below, in the Southern District of New York and elsewhere, SCOTT D. SULLIVAN and DAVID F. MYERS, the defendants, unlawfully, willfully, and knowingly, made and caused to be made statements in reports and documents required to be filed with the SEC under the Act and the rules and regulations promulgated thereunder, which statements were false and misleading with respect to material facts, to wit, SULLIVAN and MYERS submitted in New York, New York the filings listed below to the United States Securities and Exchange Commission:

COUNT	FILING	APPROXIMATE DATE OF FILING
THREE	Form 10-Q for WorldCom, Inc., for the First Quarter of 2001	5/15/01
FOUR	Form 10-Q for WorldCom, Inc., for the Second Quarter of 2001	8/14/01
FIVE	Form 10-Q for WorldCom, Inc., for the Third Quarter of 2001	11/14/01
SIX	Form 10-K for WorldCom, Inc., for the Year Ending December 31, 2001	3/13/02
SEVEN	Form 10-Q for WorldCom, Inc., for the First Quarter of 2002	5/15/02

(Title 15, United States Code, Sections 78m(a) and 78ff; Title 17, Code of Federal Regulations, Section 240.13a-1; and Title 18, United States Code, Section 2).

The bases for my knowledge and for the foregoing charges, are, in part, as follows:

9. I am a Special Agent of the Federal Bureau of Investigation (the "FBI"), and have been so employed for approximately 13 years. For approximately the past five years, I have been assigned to squads responsible primarily for the investigation of offenses involving violations of the federal securities and commodities laws, including accounting fraud. Throughout my career as an FBI agent, I have participated in numerous investigations of such offenses, including offenses involving accounting fraud. I received a Bachelor of Science degree in Accounting in 1985 and received a CPA license from the State of New York in 1988. From 1985 through 1989, before

joining the FBI, I practiced public accounting at a public accounting firm.

10. The information contained in this Affidavit is based upon my personal knowledge, as well as information obtained during this investigation from other sources, including: (a) other FBI agents, representatives of the United States Securities and Exchange Commission (the "SEC"), and other personnel involved in this investigation; (b) statements made or reported by various witnesses with personal knowledge of relevant facts; and (c) my review of corporate documents and business records obtained during the course of this investigation, as well as summaries and analyses of such documents and records that have been prepared by others. Because this Affidavit is submitted for the limited purpose of establishing probable cause to arrest SCOTT D. SULLIVAN and DAVID F. MYERS, the defendants, I have not set forth each and every fact I have learned in connection with this investigation. Where conversations and events are referred to herein, they are related in substance and in part. Where figures and calculations are set forth herein, they are approximate.

Relevant Parties and Entities

11. Based on my review of WorldCom's 2001 Annual Report on Form 10-K (the "2001 10-K"), WorldCom's Statement filed with the SEC pursuant to Section 21(a)(1) of the Act (the "Section 21(a)(1) Statement"), other publicly-available filings by WorldCom with the SEC, and other information obtained from WorldCom, I am aware of the following:

a. WorldCom is a corporation organized under the laws of the State of Georgia with its headquarters in Clinton, Mississippi. At all times relevant to this Complaint, WorldCom's common stock was listed on the NASDAQ National Market System, an electronic market system administered by the National Association of Securities Dealers ("NASD"), under the symbol "WCOM." As of May 31, 2002, WorldCom's largest institutional shareholders included Bernstein Investment Research and Management, Oppenheimer Capital, Merrill Lynch Investment Managers, and College Retirement Equities Fund, all of which maintain offices in New York, New York.

b. From in or about 1989 until on or about May 16, 2002, Arthur Andersen LLP ("Arthur Andersen") served as WorldCom's independent external auditors. Beginning on or about May 16, 2002, KPMG LLP ("KPMG") served as WorldCom's independent external auditors.

c. From in or about December 1994 until on or about June 25, 2002, SCOTT D. SULLIVAN, the defendant, served, at various times, as WorldCom's Chief Financial Officer, Treasurer and Secretary. WorldCom's 2001 10-K and its Form 10-Q for the first quarter of 2002, both of which were filed with the SEC and which included WorldCom's financial statements for those periods, were prepared under SULLIVAN's direction and bear his signature. SULLIVAN received a CPA license in or about 1985.

d. From in or about August 1995 through on or about June 25, 2002, DAVID F. MYERS, the defendant, served, at various times, as Senior Vice President and Controller of WorldCom. MYERS reported to SULLIVAN and assisted in the preparation of WorldCom's 2001 and the first quarter of 2002 financial statements.

Relevant Accounting Principles

12. Based on my review of certain relevant accounting literature and based on my training and experience, including my prior work in investigations involving accounting fraud, I am aware of the following:

a. Public companies, such as WorldCom, typically report the financial results of their operations in financial statements that include both an Income Statement and a Balance Sheet. A company's Income Statement reports, among other things, revenue recognized, expenses incurred, and income earned during a stated period of time -- usually for a fiscal quarter or a fiscal year. Within an Income Statement, expenses are generally subtracted from revenues to calculate income. A company's Balance Sheet reports, among other things, the assets and liabilities of a company at a point in time, usually the end of the company's fiscal quarter or fiscal year.

b. When companies spend money or incur costs, those expenditures can be accounted for in a number of ways. Some types of expenditures, most commonly those incurred by a company in its normal operations, are treated as current or operating expenses. Examples include recurring costs such as salaries and wages, insurance, equipment rental, electricity, and maintenance contracts. In brief, almost all routine expenditures that a company makes are operating expenses. Other types of expenditures, most commonly those which result in the acquisition of or improvement to the company's assets, are treated as capital expenditures. Examples include purchases of real estate, manufacturing equipment, and computer equipment. Operating expenses and capital expenditures generally receive different accounting treatment. Operating expenses are generally reported on a company's Income Statement and subtracted from revenues, in the period in which the expense is incurred or paid, to derive net income. Capital expenditures, by contrast, are not subtracted from revenues and are not generally reflected on the Income Statement. Instead, capital expenditures are reflected as assets on a company's Balance Sheet and, depending on the nature of the asset and its expected useful life, are subject to depreciation.[1]

c. If a company transfers or reclassifies a given expenditure from an operating expense to a capital expenditure, that transfer will have the following effects in the reporting period for which the transfer is made: (a) the company's operating expenses will be reduced and the company's net income will be increased by the amount reclassified or transferred; and (b) the value of the company's capital assets will increase by the amount reclassified.

<u>WorldCom's Networks and Third-Party Access Fees</u>

13. Based on my review of the WorldCom public filings described above, I am aware of the following:

a. WorldCom provides a broad range of communications services to United States and foreign-based businesses and consumers. WorldCom provides, among other things, data transmission services, Internet-related services, commercial voice services, international communication services, long distance service, and other telecommunication services.

b. WorldCom has generally employed what it refers to as an "on-net" business strategy, which is based on maintaining the ability to provide service through its own facilities. To carry out its "on-net" business strategy, WorldCom maintains extensive network facilities to connect metropolitan centers and various regions throughout the world. To serve customers that are not directly connected to its networks, WorldCom pays fees to use or lease so called "off-net" facilities and connections from other telecommunication companies.

c. The various fees that WorldCom must pay to use or lease facilities belonging to third-parties are generally referred to by WorldCom in its internal reports, publicly filed financial reports, and elsewhere as "line costs" or "telco" expenses.

14. Based upon my interview of WorldCom's Vice President for Internal Audit (the "VP-IA") and my interviews of members of the WorldCom engagement team from Arthur Andersen, I

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[1] When capital assets are depreciated, a portion of the asset's value is written off over a number of accounting periods. The portion of the asset's value that is depreciated for a given period is reflected as a current expense in each period and deducted from revenues on the Income Statement.

learned that, prior to the first quarter of 2001, WorldCom did not capitalize "line costs."

WorldCom's Expanded Reliance on Third-Party Leases

15. I have spoken with WorldCom's Vice President for Telco/Line Cost Accounting & Planning (the "VP-LCAP"), who informed me of the following, in substance and in part:

a. In or about 1999, WorldCom entered into a large number of long-term lease agreements with various third-party carriers to gain access to out-of-network facilities. WorldCom secured these leases in anticipation that a proliferation of various Internet-related business ventures likely would increase the demand for WorldCom services in the near future, although such demand did not then exist.

b. Many of the these leases required WorldCom to pay a fixed sum to the third-party carrier over the full term of the lease regardless of whether WorldCom actually made use of all or part of the capacity of the leased facility.

The Scheme to Defraud

16. Based on my training and experience, I am aware that, at all times relevant to this Complaint, many public companies provide "guidance" to the public regarding their anticipated earnings for upcoming reporting periods. Relying in part on the company's "guidance," many professional securities analysts then disseminate to the public their own estimates of the company's expected performance. These "earnings estimates" or "analysts expectations" are closely followed by investors. Typically, if a company announces earnings that fail to meet or exceed analysts' expectations, the price of the company's securities will decline.

17. Based on company records and an interview with WorldCom's Vice President of Investor Relations ("VP-IR"), I am aware of the following:

a. At all times relevant to this Complaint, numerous analysts of major Wall Street investment firms followed WorldCom's performance and published estimates regarding its expected earnings.

b. These analysts considered, among other things, WorldCom's EBITDA ("Earnings Before Interest, Taxes, Depreciation, and Amortization"), earnings per share, net income, and capital expenditures, to gauge WorldCom's performance and predict WorldCom's expected earnings.

18. I have spoken with the VP-IA, other employees of WorldCom's Internal Audit department, WorldCom's Director of Property Accounting (the "DPA"), and the VP-LCAP, who have informed me of the following, in substance and in part:

a. Beginning at least in or about July 2000, WorldCom's expenses as a percentage of its total revenue began to increase, resulting in a decline in the rate of growth of WorldCom's earnings. This decline created a substantial risk that, unless WorldCom's performance improved, its earnings would fail to meet analysts' expectations. Thereafter, SCOTT D. SULLIVAN, the defendant, and others known and unknown, devised a scheme to hide WorldCom's increasing expenses by causing substantial portions of WorldCom's line costs to be transferred from WorldCom's income statement into its capital expenditure accounts. This transfer allowed WorldCom to defer recognizing a substantial portion of its current operating expenses, thereby allowing WorldCom to report higher earnings.

b. To implement this scheme, SULLIVAN instructed DAVID F. MYERS, the defendant, to direct employees of WorldCom's general accounting department to make various journal entries necessary to transfer certain line costs from WorldCom's income statement to capital expenditure accounts on WorldCom's balance sheet.

c. In furtherance of this plan, MYERS instructed certain subordinates, including the Director of General Accounting (the "DGA"), the Director of Management Reporting (the "DMR"), and the Director of Legal Entity Accounting (the "DLEA") to make journal entries transferring certain line costs from expense accounts in WorldCom's general ledger to certain general ledger accounts for capital expenditures. As a result of these transfers, billions of dollars of WorldCom's current expenses were transferred from expenses on its Income Statement to assets on its Balance Sheet. Contrary to WorldCom's usual practices and prevailing accounting industry norms, no documentary support existed for any of these entries, which reclassified certain line costs as capital expenditures.

d. Beginning at the end of the first quarter of 2001 and continuing through the first quarter of 2002, the DGA, the DMR and the DLEA executed the instructions of MYERS by making certain journal entries in the general ledger to transfer, in total, approximately $3.8 billion from line cost expense accounts to capital expenditure accounts. MYERS' instructions were generally communicated, and the journal entries affecting the transfers were generally made, after WorldCom's field offices' books were closed for each quarter.

e. In or about April 2001, the DLEA telephoned the DPA and instructed him to adjust the schedules he maintained for certain Property, Plant & Equipment capital expenditure accounts ("PP&E Roll-Forward") by increasing certain capital accounts for "prepaid capacity." The DLEA advised the DPA that these entries had been ordered by SULLIVAN and MYERS. Correspondingly, a subordinate of the DLEA made journal entries in WorldCom's general ledger, transferring approximately $771 million from certain line cost expense accounts to certain PP&E capital expenditure accounts.

f. In or about July 2001, the DLEA called the DPA and again instructed him to adjust the PP&E Roll-Forward by increasing certain capital accounts for "prepaid capacity." The DLEA again advised the DPA that these entries had been ordered by SULLIVAN and MYERS. Correspondingly, the DMR made journal entries in WorldCom's general ledger that effectively transferred approximately $560 million from certain line cost expense accounts to certain PP&E capital expenditure accounts.

g. In or about October 2001, the DLEA called the DPA and again instructed him to adjust the PP&E Roll-Forward by increasing certain capital accounts for "prepaid capacity." The DLEA again advised the DPA that these entries had been ordered by SULLIVAN and MYERS. Correspondingly, a subordinate of the DMR made journal entries in WorldCom's general ledger that effectively transferred approximately $743 million from certain line cost expense accounts to certain PP&E capital expenditure accounts.

h. In or about February 2002, the DLEA called the DPA and again instructed him to adjust the PP&E Roll-Forward by increasing certain capital accounts for "prepaid capacity." The DLEA again advised the DPA that these entries had been ordered by SULLIVAN and MYERS. Correspondingly, the DMR made journal entries in WorldCom's general ledger that effectively transferred approximately $941 million from certain line cost expense accounts to certain PP&E capital expenditure accounts.

i. In or about April 2002, the DLEA called the DPA and again instructed him to adjust the PP&E Roll-Forward by increasing certain capital accounts for "prepaid capacity." The DLEA again advised the DPA that these entries had been ordered by SULLIVAN and MYERS. Correspondingly, the DMR made journal entries in WorldCom's general ledger that effectively transferred approximately $818 million from certain line cost expense accounts to certain PP&E capital expenditure accounts.

19. I have recently interviewed the DPA regarding the adjustments described above that the DLEA instructed him to make, and learned the following:

a. In the normal course of closing the books for each quarterly reporting period, the DPA and his subordinates prepared the PP&E Roll-Forward based on documents and information provided from WorldCom field operations reflecting actual business activity.

b. With respect to each of the adjustments described in paragraph 18 above, the DPA received no supporting documentation whatsoever, despite his requests to the DLEA for such support. Moreover, the DPA was directed to make these adjustments after the field offices' books had been closed for each quarter.

c. The DPA expressed concerns to the DLEA regarding the propriety of these adjustments.

20. Based upon my conversations with members of WorldCom's Internal Audit department, who have reviewed WorldCom's general ledger and journal entries, and my review of summary analyses they have prepared, the chart set forth below fairly summarizes the quarterly transfers from certain current expense line cost accounts to certain PP&E capital expenditure accounts between April 2001 and April 2002. Figures expressed in the chart are rounded to the nearest million.

WorldCom General Ledger Account Adjustments
(expressed in millions)

	Income Statement				Balance Sheet					
	Line Cost Expense Accounts				Asset Accounts					
	Interstate Originating	Special Access Summary	Special Access Local	Total Credits	Other Assets-Non Current	Transmission Equipment	Communications Equipment	Furniture, Fixtures & Other	Construction in Progress	Total Debits
Q1-2001	$ 671	$ 100		$ 771	$ 629				$ 142	$ 771
Q2-2001	$ 480	$ 80		$ 560					$ 560	$ 560
Q3-2001	$ 578	$ 90	$ 75	$ 743		$ 343	$ 400			$ 743
Q4-2001	$ 539	$ 317	$ 85	$ 941		$ 539	$ 317	$ 85		$ 941
Q1-2002	$ 575	$ 163	$ 80	$ 818		$ 818				$ 818
Grand Totals				$ 3,833						$ 3,833

21. I have spoken to members of the WorldCom engagement team from Arthur Andersen, who participated in annual audits and quarterly reviews of WorldCom and who have advised me of the following, in substance and in part:

a. Neither SCOTT D. SULLIVAN nor DAVID F. MYERS, the defendants, nor anyone else from WorldCom, disclosed to members of the Arthur Andersen engagement team, during the course of the engagement, that WorldCom had begun to capitalize third-party line costs.

b. Neither SCOTT D. SULLIVAN nor DAVID F. MYERS, the defendants, nor anyone else from WorldCom, disclosed to members of the Arthur Andersen engagement team, during the course of the engagement, any of the journal entries summarized in paragraph 18 above.

c. Neither SCOTT D. SULLIVAN nor DAVID F. MYERS, the defendants, nor anyone else from WorldCom, provided to members of the Arthur Andersen engagement team, during the course of the engagement, a list of "top-side" entries -- entries made at the corporate level -- such as the transfers described in paragraph 18 above, as Arthur Andersen had requested.

d. Neither SCOTT D. SULLIVAN nor DAVID F. MYERS, the defendants, nor anyone else from WorldCom, disclosed to members of the Arthur Andersen engagement team, during the course of the engagement, that WorldCom had changed its accounting practices for certain line costs, namely that certain line costs had been capitalized rather than treated as an expense, even though Arthur Andersen had asked SULLIVAN and MYERS whether WorldCom had implemented any changes in accounting practices.

22. Other FBI agents have spoken to a partner at KPMG, who currently works in KPMG's practice advisory group and who is familiar with the accounting entries described above, which were implemented at the direction of SCOTT D. SULLIVAN and DAVID F. MYERS, the defendants. The KPMG partner advised them, in substance and in part, that there was no basis in accounting principles to capitalize such line costs as described in paragraph 18 above. According to this KPMG partner, the accounting treatment of line costs described above was not in accordance with General Accepted Accounting Principles ("GAAP").

23. I have spoken with SEC investigators who have confirmed from a review of the relevant WorldCom filings for the first quarter of 2001 through the first quarter of 2002 that WorldCom did not publicly disclose the decision to capitalize line costs in its SEC filings, or in any other publicly-issued statement known to the SEC.

24. I have reviewed WorldCom's 2001 Form 10-K, in which WorldCom reported to the investing public that its line costs expressed as a percentage of overall company revenues remained consistent over a three year period, namely 41.0% for 1999; 39.6% for 2000, and 41.9% for 2001, when, in truth and in

fact, line costs as a percentage of overall company revenue for 2001 was approximately 50%.

25. I have spoken with a representative of Merrill Communications LLC ("Merrill"), a filing agent that assists companies in electronically filing periodic reports with the SEC. The Merrill representative stated that, at all times relevant to this Complaint, WorldCom's quarterly and year-end financial statements were transmitted to Merrill's office in New York, New York and were thereafter transmitted electronically by a Merrill subcontractor, located in New York, New York, to the SEC and were filed electronically with the SEC.

<u>The Discovery of the Line Cost Transfers</u>

26. I have spoken with the VP-IA and various staff members of the Internal Audit department. The VP-IA advised me that from May through July 2002, she and various members of her staff conducted an internal review of certain of WorldCom's capital expenditures and journal entries in WorldCom's general ledger. During the course of that internal audit, the VP-IA and members of her staff reviewed numerous internal WorldCom business records and interviewed a number of WorldCom officers and employees. After discovering a number of the journal entries described in paragraph 18, above, the VP-IA and a member of her staff questioned both SCOTT D. SULLIVAN and DAVID MYERS, the defendants. The VP-IA and a member of her staff have advised me of the following concerning those interviews:

a. On or about June 11, 2002, when questioned about the journal entries referred to in paragraph 18 above, SCOTT D. SULLIVAN, the defendant, stated, in substance and in part, that those journal entries related to "prepaid capacity" and that they represented costs associated with underutilized or unused leased lines, which had been capitalized. SULLIVAN further stated, in substance and in part, that beginning in or about 2001, while revenues had declined, the costs associated with these leases were fixed, creating what SULLIVAN considered to be a "matching problem." SULLIVAN further stated, in substance and in part, that the practice of capitalizing line costs began in the third quarter of 2001; that prior to the third quarter of 2001, these costs had been accounted for as current expenses. SULLIVAN further stated, in substance and in part, that these costs were directly related to the amounts paid for line leases. SULLIVAN further stated, in substance and in part, that WorldCom expected to take a restructuring charge in the second quarter of 2002 related to the "prepaid capacity" entries for the third quarter of 2001 through the first quarter of 2002. Going forward, according to SULLIVAN, the company would no longer capitalize "prepaid capacity." SULLIVAN further requested that the VP-IA delay her audit of capital expenditures until the third quarter of 2002, and thereafter audit the second quarter 2002 numbers.

b. On or about June 17, 2002, when questioned about the journal entries referred to in paragraph 18 above, DAVID F. MYERS, the defendant, stated, in substance and in part, that beginning in or about 2001, WorldCom's management determined that the company's cost structure had become too high and that the "field" had been asked to lower the cost structure of the network. MYERS further stated, in substance and in part, that WorldCom could not continue with the cost structure at the current levels and that if the cost structure did not change, the company "might as well shut the doors." MYERS further stated, in substance and in part, that he could construct support for the journal entries that had been made to transfer line costs to capital expenditures, but he was not going to do that. MYERS further stated, in substance and in part, that the amounts were booked based on what the margins [i.e., ratio of line costs to revenues] had been historically and that there were no accounting principles supporting these entries. MYERS further stated, in substance and in part, that he had felt uncomfortable with the entries since the first time they were booked; that WorldCom probably should not have capitalized the line costs but that once it was done for the first time, it was difficult to stop. MYERS further stated, in substance and in part, that he hoped this conduct would not have to be explained to the SEC.

27. Other FBI agents have spoken with the WorldCom KPMG Engagement Partner, who advised them of the following, in substance and in part:

a. On or about June 18, 2002, DAVID F. MYERS, the defendant, stated, in substance and in part, that WorldCom had capitalized some excess line costs but there was no supporting documentation for the adjustments. MYERS further explained that he and other members of the company's senior management were aware that historically, WorldCom's line cost margins [i.e. ratio of costs to revenues] had been approximately 40 percent. MYERS further stated, in substance and in part, that because of overcapacity in the system, expenses for leases were going up and therefore "they" had decided to capitalize some of the excess capacity to make the margins fit in with past experience. MYERS acknowledged, in substance and in part, that he was aware that this approach had no basis in accounting principles.

b. On or about June 19, 2002, SCOTT D. SULLIVAN, the defendant, stated, in substance and in part, that WorldCom had entered into a series of long-term lease agreements with other telephone companies to guarantee access to additional line capacity to enable them to meet anticipated future demand. SULLIVAN stated, in substance and in part, that revenues had not grown as expected to fill this capacity. SULLIVAN stated, in substance and in part, that he therefore decided to capitalize the excess leased capacity, on the theory that the costs associated with securing the long-term leases should be "matched" with revenues generated in the future. SULLIVAN acknowledged, in substance and in part, that he had not consulted with Arthur Andersen regarding the decision to capitalize line costs.

28. According to the KPMG Engagement Partner, on June 20, 2002, at a meeting of the WorldCom Audit Committee, representatives of Arthur Andersen indicated that they disagreed with the explanation provided by SCOTT D. SULLIVAN, the defendant, regarding the propriety of capitalizing line costs and accordingly would withdraw their 2001 audit report and their first quarter of 2002 review. The KPMG Engagement Partner stated, in substance and in part, that KPMG agreed with Arthur Andersen based on the fact that (a) methodologically, SULLIVAN's accounting did not comply with GAAP; (b) there was no supporting documentation for the "prepaid capacity" entries; and (c) the accounting method described by SULLIVAN and DAVID F. MYERS, the defendant, had not been disclosed to Arthur Andersen or to the public.

29. In a press release issued on June 25, 2002, WorldCom announced that "[a]s a result of an internal audit of the company's capital expenditure accounting, it was determined that certain transfers from line cost expenses to capital accounts" during 2001 and the first quarter of 2002 "were not made in accordance with [GAAP]." The press release stated that the amount of these transfers was $3.055 billion for 2001 and $797 million for the first quarter of 2002. The press release further stated, in substance and in part, that absent these approximately $3.8 billion in transfers, the Company's reported EBITDA would have been reduced to $6.339 billion for 2001 and $1.368 billion for the first quarter of 2002, with the result that the Company would have reported a net loss for 2001 and for the first quarter of 2002.

30. On June 25, 2002, prior to the release of the June 25, 2002 press release, WorldCom's common stock closed at a price of $.83. As of July 1, 2002, WorldCom's common stock closed at a price of $.06. Based upon WorldCom's publicly reported outstanding common stock as of February 28, 2002, the drop in market price resulted in total approximate losses of more than $2 billion in value for WorldCom's outstanding approximate 2.9 billion shares.

31. On or about July 21, 2002, WorldCom filed for bankruptcy protection pursuant to Chapter 11 of the Bankruptcy Code. On or about July 30, 2002, the NASD de-listed WorldCom's common stock from the NASDAQ National Market System.

WHEREFORE, deponent prays that the above-named defendants be arrested and imprisoned or bailed as the case may be.

Paul J. Higgins

PAUL J. HIGGINS
Special Agent
Federal Bureau of Investigation

Sworn to before me this JUL 31 2002
day of , 2002 .

S/ James C. Francis IV

UNITED STATES MAGISTRATE JUDGE

JAMES C. FRANCIS IV
UNITED STATES MAGISTRATE JUDGE
SOUTHERN DISTRICT OF NEW YORK