Appendix E - UNIVERSITY HONORS PROGRAM
SENIOR PROJECT - APPROVAL

Name: JEFFREY ALEXANDER

College: BUSINESS Department: ACCOUNTING

Faculty Mentor: JACK KEGER

PROJECT TITLE: ETHICS IN ACCOUNTING ?

I have reviewed this completed senior honors thesis with this student and certify that it is a project commensurate with honors level undergraduate research in this field.

Signed: _____. Faculty Mentor

Date: 12-11-02

General Assessment - please provide a short paragraph that highlights the most significant features of the project.

Comments (Optional):

Ethics in Accounting?

Jeffrey Alexander

Senior Honors Project

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In the midst of all of the scandals in the accounting world over the past year and a half, believing that anything redeeming or purely good can be gleamed from the situation is hard to believe. As companies crumble, people lose their jobs and life-savings, and CEOs are being led away in handcuffs, the thought that anything worthwhile can be seen is the furthest from the minds of anyone involved or watching. This, however, is not the case. The following is a discussion of the circumstances that brought down the giant WorldCom, and the life lessons that can be extracted. It is an attempt to show that people can be basically good and that virtue is in the world, no matter what a person's views are.

The particulars about the events transpiring before the fall of WorldCom are taken from an article in the *Wall Street Journal* entitled "How Three Unlikely Sleuths Exposed Fraud at WorldCom." Apparently the fraud that eventually brought about WorldCom's bankruptcy permeated the company from the CEO down to many of the regular employees. Many people were unwilling to say no or expose the accounting irregularities even if they did not support them or worse knew they were illegal. This is a dangerous culture in American business. When *see no evil, hear no evil, speak no evil* becomes the corporate motto, employees and stakeholders can be taken for a ride. Fortunately, out of this mess comes one beacon of hope for a brighter, more stable future.

The whole situation sounds as if it comes from an action movie based solely on the actions of accountants. Three virtuous accountants in the internal audit department for WorldCom stumble across evidence that the global giant is lying to the public and is sending out inaccurate financial statements directly from the desk of a corrupt CEO. Following the trail of false entries and overcoming the blocking and misleading of coworkers, our heroes wind up with

proof that billions of dollars of profits never existed. They bring these falsities to the public, and the business is brought to its knees.

While this seems to simply be the bean counter's James Bond fantasy before WorldCom, it is the reality of the situation after the fact. Cynthia Cooper, the Vice President of Internal Audit for WorldCom, and two of her employees, Gene Morse and Glyn Smith, are the dashing seekers of truth within the structure of the evil empire of WorldCom. Their journey through the accounting system and paper trails of WorldCom began when Morse found no evidence to support a $500 million computer expense. This raised his eyebrow enough to show the expense to his boss, Cynthia Cooper who told him to keep searching. Their trip to uncover the truth sent them through the office of the CEO, through the subsidiaries of WorldCom, through the outside auditors for WorldCom, and straight to the audit committee for WorldCom and to the SEC. All told, $3.8 billion was found to be misallocated, countless individuals lost their jobs, including many executives, the company was dropped from NASDAQ, and the trio ended up revered by some and hated by others.

The most remarkable aspect of the entire story may not be the fact that the frauds occurred. Many people will be surprised that people within the organization cared enough about the truth to uncover it and bring it to the rest of the world. This is the reason for the necessity of this discussion. Throughout the course of history, most cultures have seemed to have a sense of rightness, a certain predominant ethical basis that most of its citizens followed. Philosophers and religious individuals have captured the essence of these ideas in their writings. In America today, a view that ethics is gone and that businessmen and women will do anything in their power to gain wealth and prestige exists. Some people may believe that every person who dons a suit or slips on business casual dress is Machiavelli incarnate. If this idea is correct, then businesses will

soon all crumble under the influence of these individuals as more of these illegal acts come out. If the idea is not correct, then the American public needs to educated to trust companies again to promote commerce and investment. So, this paper examines predominant ethical theories and shows how ethics may have motivated the choice of Cooper, Morse, and Smith to act responsibly.

The Ethical Quandaries

Obviously, the first question one might ask oneself in this situation is whether to pursue the truth behind the suspicious journal entries or not. A lot of factors need to be considered. Should a person sneak around at night trying to verify his or her suspicions? Should she go against the direct orders of her boss and the wishes of her coworkers who will be profoundly affected by any revelations brought about by the investigation? Should he continue working although previous employees have been fired for raising similar questions? Should she keep going even though the information could conceivably destroy the company, costing investors money and people jobs?

These are all questions encountered in the WorldCom case. Cooper, Morse, and Smith were forced to work at night to keep their work from being discovered and to make sure they had the time and resources they needed to expose the truth. When the CEO and CFO discovered what was happening, of course they tried to persuade the trio to cease and desist the query. Other coworkers showed their displeasure along the way by refusing to give information and afterwards by expressing their wish that the three had left the issue alone. Smith received an email detailing the firing of an employee for questioning the accounting procedures of the company. In light of the Enron scandal that was raging at the time, the exposure of this

information could easily be foreseen to bring about the downfall of WorldCom and the financial ruin of thousands.

These are daunting obstacles, but somehow they did not deter, but rather encouraged and strengthened, the trio. In the face of these consequences, quietly letting the information fall to the responsibility of the outside auditors or the SEC to investigate would have been easy. These, however, were not the only concerns.

Along side the professional risks were the personal risks to Cooper, Morse, and Smith. Should they risk their jobs and their careers for justice and the truth? Should they suffer the deteriorated health that comes with long nights and stress? Should they allow their families to suffer through the strain that comes with absence and short tempers? Should they do the unpopular thing even though the CFO and the outside auditors have signed off on the procedures, effectively giving them immunity from prosecution if anyone found out?

Again, even at the risk of personal and professional problems, Cooper, Morse, and Smith threw caution to the wind in an effort to find truth and to set the record straight. Why would they do this? Did they felt they had to, they felt they should, or they wanted to? Below is an attempt to explain their actions through the eyes of three major ethical theories: Virtue Ethics, Kantian Ethics, and Utilitarianism.

Virtue Ethics

Virtue ethics was the basis for Aristotle's ethical system and has been discussed throughout the centuries since then. Its basic tenant is that a person should do what is right for the sake of doing the right thing. A person should do good because it is good and not to merit from it.

Kantian Ethics

Immanuel Kant lived in the second half of the 18th century. He was a philosopher who in his writings detailed a slightly different view of ethics than the virtue theorists were doling out. He felt that, rather than doing things because they were the right things to do, people should do things because everyone else should be expected to do the same. He formulated this idea in his First Categorical Imperative. This is a law that states: Act only according to that maxim by which you can at the same time will that it should become a universal law. What this means, simply, is that a person should do only the things that he can rationally expect everyone else to do. This seems to prevent a world full of liars and thieves because a world like that would be self-defeating. Kantian ethics differs from virtue ethics in that it deals more with the effect of actions than the existence of rules. In spite of being different, Kantian ethics can still be applied to the case at hand to shed some light on the ethics of the situation.

Could Cooper, Morse, and Smith possibly expect everyone in the world to keep quiet when they found out about lies, both in general and in the business world? Of course not. This would cause a chain reaction of events that would cripple economies and relationships just the same. Investors would never invest in any company because they could never know when investing was a good idea and when the proposal was made up. People could not talk to one another on any level without feeling intense suspicion of every word flowing from the mouth of the person facing them. This would not be a world of progress or pleasure. The world would be full of loneliness and pain. So, despite all of the reasons that they could come up with, the lost jobs, ruined company, the orders from superiors, and the health concerns, the three could not allow the lies to go unnoticed.

They worked toward a world where irregularities were uncovered and explained. They were working toward a world in which people did everything in their power to promote the truth. They could feel the possibilities if every person worked as hard as they could for the common good of society and not only for their selfish pleasures. Perhaps without consciously meaning to, they were willing their own maxim, that when a person finds out the truth is being hidden, he or she should work to disclose it, to be a universal law.

Utilitarianism

Utilitarianism is an ethical theory that is solely based on the consequences of a person's actions and not a set of rules or imperatives. The main idea of utilitarianism is that a person's action is right if it produces the most possible utility, with utility being pleasure or happiness. The consequences of an action determine the utility the action produces, so the consequences, and not the act itself, dictate the ethical value of the action. When evaluating an act, an individual must conclude that more good will come from the action than bad and that more people will be pleased than displeased before perpetuating the act.

A survey of the situation in the WorldCom case might bring about the following conclusions about the utility produced:

Displeasure is present for the bosses that ordered the cover-up and who eventually were fired, for the coworkers who lost their jobs, for the investors who lost money, for Cooper, Morse, and Smith due to the lost time and health, and for all of the families of all of these people.

The good will come for the investors who were never suckered in by the inflated profits, by Cooper, Morse, and Smith themselves for knowing they did what was right, for the general public who can now see businesses being monitored and know that a few more crooked business

people have been taken care of. The livelihood of businesses comes from the ability to present accurate financial records and gain investors and customers from this strength. With a new set of rules and a new emphasis on integrity, customers and investors can now trust the financial numbers in the face of these scandals. This trust can ensure that the economy continues without stocks and businesses crumbling from investors removing their money.

In that analysis, every person who received bad also received good, except for the executives who were punished by disclosure of their lies. Their utility is far outweighed by the good that is done to society by ensuring the trust and integrity of American businesses.

In this way, Cooper, Morse, and Smith have followed the utilitarian ethical philosophy by acting in order to produce the most good for society on the whole.

Conclusion

Cooper, Morse, and Smith acted responsibly and ethically in their pursuit of truth in the WorldCom case. While they do not appear to be directly influenced by any ethical theory, characteristics of the major theories can be seen in their actions. Their pursuit of good and truth in the face of incredible resistance and obstacles show that virtue ethics may be ingrained in their personalities because they had no real reason to risk their careers except to ensure that the truth came out. Kantian ethics is also represented in the analysis of their actions because they acted as they felt anyone should do in their situation. They could not imagine what might happen if everyone, including themselves, ignored the truth in favor of the prosperity of the lies, so they did what they would expect anyone to do in their place. They exposed the fraud. Utilitarianism can also be seen at work in their situation. In their minds, the world would be better off if this corporation's fraud came out into the open, so they worked toward that end. They shed light on

the fraud in order to bring more pleasure and happiness in the long run to society. While a predominant ethical theory may not be at work in the minds of Cooper, Morse, and Smith, clearly the traits of ethics can be seen in their lives as factors that motivated their pursuit.

October 30, 2002

How Three Unlikely Sleuths Exposed Fraud at WorldCom

Firm's Own Employees Sniffed Out Cryptic Clues and Followed Hunches

By SUSAN PULLIAM and DEBORAH SOLOMON
Staff Reporters of THE WALL STREET JOURNAL

CLINTON, Miss. -- Sitting in his cubicle at WorldCom Inc. headquarters one afternoon in May, Gene Morse stared at an accounting entry for $500 million in computer expenses. He couldn't find any invoices or documentation to back up the stunning number.

"Oh my God," he muttered to himself. The auditor immediately took his discovery to his boss, Cynthia Cooper, the company's vice president of internal audit. "Keep going," Mr. Morse says she told him.

A series of obscure tips last spring had led Ms. Cooper and Mr. Morse to suspect that their employer was cooking its books. Armed with accounting skills and determination, Ms. Cooper and her team set off on their own to figure out whether their hunch was correct. Often working late at night to avoid detection by their bosses, they combed through hundreds of thousands of accounting entries, crashing the company's computers in the process.

By June 23, they had unearthed $3.8 billion in misallocated expenses and phony accounting entries. It all added up to an accounting fraud, acknowledged by the company, that turned out to be the largest in corporate history. Their discoveries sent WorldCom into bankruptcy, left thousands of their colleagues without jobs and roiled the stock market.

At a time when dishonesty at the top of U.S. companies is dominating public attention, Ms. Cooper and her team are a case of middle managers who took their commitment to financial reporting to extraordinary lengths. As she pursued the trail of fraud, Ms. Cooper time and again was obstructed by fellow employees, some of whom disapproved of WorldCom's accounting methods but were unwilling to contradict their bosses or thwart the company's goals.

WorldCom is under investigation by the Justice Department and the Securities and Exchange Commission. Scott Sullivan, WorldCom's former chief financial officer and Ms. Cooper's boss, has been indicted. He has denied any wrongdoing. Four other officers have pleaded guilty and are cooperating with prosecutors. Federal investigators are still probing whether Bernard J. Ebbers, the company's former chief executive, knew about the accounting improprieties. Since the initial discoveries, WorldCom's accounting misdeeds have grown to $7 billion.

Behind the tale of accounting chicanery lies the untold detective story of three young internal auditors, who temperamentally didn't fit into

WorldCom's well-known cowboy culture. Ms. Cooper, 38 years old, headed a department of 24 auditors and support staffers, many of whom viewed her as quiet but strong willed. She grew up in a modest neighborhood near WorldCom's headquarters and had spent nearly a decade working at the company, rising through its ranks. She declined to be interviewed for this story. Mr. Morse, 41, was known for his ability to use technology to ferret out information. The third member of the team was Glyn Smith, 34, a senior manager under Ms. Cooper. In his spare time he taught Sunday school, took photographs and bicycled. His mom had taught him and Ms. Cooper accounting at Clinton High School.

Frightened that they would be fired if their superiors found out what they were up to, the gumshoes worked in secret. Even so, their initial discrete inquiries were stonewalled. Arthur Andersen, WorldCom's outside auditor, refused to respond to some of Ms. Cooper's questions and told her that the firm had approved some of the accounting methods she questioned. At another critical juncture in the trio's investigation, Mr. Sullivan, then the company's CFO, asked Ms. Cooper to delay her investigation until the following quarter. She refused.

Ms. Cooper's first inkling that something big was amiss at WorldCom came in March 2002. John Stupka, the head of WorldCom's wireless business, paid her a visit. He was angry because he was about to lose $400 million he had specifically set aside in the third quarter of 2001, according to two people familiar with the meeting. His plan had been to use the money to make up for shortfalls if customers didn't pay their bills, a common occurrence in the wireless business. It was a well-accepted accounting device.

But Mr. Sullivan decided instead to take the $400 million away from Mr. Stupka's division and use it to boost WorldCom's income. Mr. Stupka was unhappy because without the money, his unit would likely have to report a large loss in the next quarter.

Mr. Stupka's group already had complained to two Arthur Andersen auditors, Melvin Dick and Kenny Avery. They had sided with Mr. Sullivan, according to federal investigators.

But Mr. Stupka and Ms. Cooper thought the decision smelled funny, although not obviously improper. Under accounting rules, if a company knows it is not going to collect on a debt, it has to set up a reserve to cover it in order to avoid reflecting on its books too high a value for that business. That was exactly what Mr. Stupka had done. Mr. Stupka declined to comment.

Ms. Cooper decided to raise the issue again with Andersen. But when she called the firm, Mr. Avery brushed her off and made it clear that he took orders only from Mr. Sullivan, according to the investigators. Mr. Avery and Mr. Dick declined to comment. Patrick Dorton, a spokesman for Andersen, said his firm thought that the $400 million wireless reserve was not necessary.

"That was like putting a red flag in front of a bull," says Mr. Morse. "She came back to me and said, 'Go dig.' "

Some internal auditors would have left it at that and moved on. After all, both the company's chief financial officer and its outside accountants had signed off on the decision. But that was not Ms. Cooper's style. One favorite pastime among the auditors who reported to her was applying the labels of the Myers-Briggs & Keirsey personality test to their fellow staffers. Ms. Cooper was categorized as an INTJ -- introspective, intuitive, a thinker and judgmental. "INTJs," according to the test criteria, are "natural leaders" and "strong-willed," representing less than 1% of the population.

And so Ms. Cooper decided to appeal the decision. As head of auditing, it was her responsibility to bring sensitive issues to the audit committee of WorldCom's board. She brought the reserves question to the attention of the committee's head, Max Bobbitt. At a committee meeting at the company's Washington offices on March 6, she and Mr. Sullivan presented their cases, according to minutes from the meeting. Mr. Sullivan backed down, according to people familiar with his decision.

The next day he tracked down Ms. Cooper. Unable to reach her immediately, Mr. Sullivan called her husband, a stay-at-home dad to their two daughters, to get her cell phone number. He finally caught up with her at the hair salon. In the future, she was not to interfere in Mr. Stupka's business, Mr. Sullivan warned, according to people familiar with the reserves question.

The confrontations put Ms. Cooper in a sticky position. Mr. Sullivan was her immediate supervisor. Plus, her vague discomfort with the way WorldCom was handling its accounting led her into areas that were not normally her bailiwick. Although her department did a small amount of financial auditing, it primarily performed operational audits, consisting of measuring the performance of WorldCom's units and making sure the proper spending controls were in place. The bulk of the company's financial auditing was left to Arthur Andersen. But neither of those things dissuaded Ms. Cooper from following her nose to the root of the ill-defined problem.

A Surprise Request

On March 7, a day after Ms. Cooper had visited with the audit committee, the SEC surprised the company with a "Request for Information." While WorldCom's closest competitors, including **AT&T** Corp., were suffering from a telecom rout and losing money throughout 2001, WorldCom continued to report a profit. That had attracted the attention of regulators at the SEC, who thought WorldCom's numbers looked suspicious.

But investigators had grown frustrated as they combed through public filings looking for evidence of wrongdoing, according to people familiar with the inquiry. So they asked to see data on everything from sales commissions to communications with analysts.

Concerned about why the SEC was sniffing around, Ms. Cooper directed her group to start collecting information in order to comply with the request.

She also was growing concerned about another looming problem. Andersen was under fire for its role in the Enron case, which soon would lead to the accounting firm's indictment. It was clear that WorldCom would have to retain new outside auditors.

Ms. Cooper set off on an unusual course. Her own department would simply take on a role that no one at WorldCom had assigned it. The troubles at Enron and Andersen were enough to warrant a second look at the company's financials, she explained to Mr. Morse one evening as they walked out to WorldCom's parking lot. Her plan: her department would start doing financial audits, looking at the reliability and integrity of the financial information the company was reporting publicly.

It was a major decision, which would necessitate a lot more work for Ms. Cooper and her staffers. Still, Ms. Cooper took on financial auditing without asking permission from Mr. Sullivan, her boss, according to investigators and a person familiar with Ms. Cooper's decision.

"We could see a strain in her face," recalls her mother, Patsy Ferrell, about that time period. "She didn't look happy. We knew she was working late and some of the other people were working late. We would call and say, 'Can we bring some sandwiches?' and her father would bring them sandwiches."

A Curious E-Mail from Afar

Several weeks later, Mr. Smith, a manager under Ms. Cooper, received a curious e-mail from Mark Abide, based in Richardson, Texas, who was in charge of keeping the books for the company's property, plants and equipment.

Mr. Abide had attached to his May 21 e-mail a local newspaper article about a former employee in WorldCom's Texas office who had been fired after he raised questions about a minor accounting matter involving capital expenditures. "This is worth looking into from an audit perspective," Mr. Abide wrote. Mr. Smith, who declined to be interviewed, forwarded the e-mail to Ms. Cooper, according to investigators and a lawyer involved in the case.

The e-mail piqued Ms. Cooper's interest. As part of their initial foray into financial auditing, Ms. Cooper and her team had already stumbled on to the issue of capital expenditures, a subject that would prove to be crucial to their quest.

The team had run into an inexplicable $2 billion that the company said in public disclosures had been spent on capital expenditures during the first three quarters of 2001. But they found that the money had never been authorized for capital spending.

Capital costs, such as equipment, property and other major purchases, can be depreciated over long periods of time. In many cases, companies spread those costs over years. Operating costs such as salaries, benefits and rent are subtracted from income on a quarterly basis, and so they have an immediate impact on profits.

Ms. Cooper and her team were beginning to suspect what was up with the mysterious $2 billion entry: It might actually represent operating costs shifted to capital expenditure accounts -- a stealthy maneuver that would make the company look vastly more profitable.

When Ms. Cooper and Mr. Smith asked Sanjeev Sethi, a director of financial planning, about the curious adjustment, he told them it was "prepaid capacity," a term they had never heard before. Further inquires led them to understand that prepaid capacity was a capital expenditure. But when they asked what it meant, Mr. Sethi told them to ask David Myers, the company's controller, according to Mr. Morse and a person familiar with Ms. Cooper's situation. Mr. Sethi did not return phone calls.

Ms. Cooper and Mr. Smith opted instead to call Mr. Abide, who had pointed out a capital expenditures problem in his e-mail. When they asked him about "prepaid capacity," he too answered very cryptically, explaining that those entries had come from Buford Yates, WorldCom's director of general accounting.

While perusing records looking for accounting irregularities later that same day, May 28, Mr. Morse made the big discovery of the $500 million in undocumented computer expenses. They also were logged as a capital expenditure. "This stinks," Mr. Morse recalls thinking to himself. He immediately went to Ms. Cooper to tell her what he'd found. She called a meeting of her department. "I knew it was a horrific thing and she did too, right off the bat," says Mr. Morse.

Several days later, Ms. Cooper and Mr. Smith met to try to make sense of their growing list of clues. Particularly puzzling were the cryptic comments made by Mr. Sethi and Mr. Abide. Finally the two auditors came up with a plan of action to test their sense that when it came to the booking of capital expenditures, something was very wrong at WorldCom. Ms. Cooper would send Mr. Smith an e-mail saying she wanted to know more about prepaid capacity as soon as possible, and asking how much harder they should press Mr. Sethi. They would copy Mr. Myers on the e-mail.

Mr. Myers shot back an e-mail. Mr. Sethi should be working for him and did not have time to devote to Ms. Cooper's inquiries, he wrote. Ms. Cooper had been stonewalled yet again.

A Secret Plan

Ms. Cooper and Mr. Smith didn't know it, but they had stumbled onto evidence that some executives were keeping two sets of numbers for the then-$36 billion company, one of them fraudulent.

By 2000, WorldCom had started to rely on aggressive accounting to blur the true picture of its badly sagging business. A vicious price war in the long-distance market had ravaged profit margins in the consumer and business divisions. Mr. Sullivan had tried to

respond by moving around reserves, according to his indictment. But by 2001 it wasn't enough to keep the company afloat.

And so Mr. Sullivan began instructing Mr. Myers to take line costs, fees paid to lease portions of other companies' telephone networks, out of operating-expense accounts where they belonged and tuck them into capital accounts, according to Mr. Sullivan's indictment.

It was a definite accounting no-no, but it meant that the costs did not hit the company's bottom line -- at least in the version of the books that were publicly scrutinized. Although some staffers objected, the scheme progressed for the next five quarters.

Ms. Cooper, Mr. Smith and Mr. Morse didn't know this. They only knew that accounting entries had been hopscotching inexplicably around WorldCom's balance sheets and that nobody wanted to talk about it. To put all the pieces together, they would need to plumb the depths of WorldCom's computerized accounting systems.

Full access to the computer system was a privilege that normally had to be granted by Mr. Sullivan. But Mr. Morse, a bit of a techie, had recently figured out a way around that problem.

Without explaining what he was up to, Mr. Morse had asked Jerry Lilly, a senior manager in WorldCom's information technology department, for better access to the company's accounting journal entries. Mr. Lilly was testing a new software program and gave Mr. Morse permission to road test the system, too.

The beauty of the new system, from Mr. Morse's perspective, was that it enabled him to scrutinize the debit and credit sides of transactions. By clicking on a number for an expense on a spreadsheet, he could follow it back to the original journal entry -- such as an invoice for a purchase or expense report submitted by an employee, to see how it had been justified.

Sifting through the data for answers to still-vague questions about capital expenditures amounted to a frustrating task, Mr. Morse says. He combed through an account labeled "intercompany accounts receivables," which contained 350,000 transactions per month. But when he downloaded the giant set of data, he slowed down the servers that held the company's accounting data. That prompted the IT staff to begin deleting his requests because they were clogging and crashing the system.

Mr. Morse began working at night, when there was less demand on the servers, to avoid having his work shut down by the IT department. During the day, he retreated to the audit library -- a windowless, 12-by-12 room piled with files from previous projects and tucked away in the audit department -- to avoid arousing suspicion. By the first week of June, Mr. Morse had turned up a total of $2 billion in questionable accounting entries, he says.

The Sleuths Get Nervous

Having found the evidence they were looking for, the sleuths were suddenly faced with how serious the implications of their endeavor really were.

Mr. Morse grew increasingly concerned that others in the company would discover what he had learned and try to destroy the evidence, he says. With his own money, he went out and bought a CD burner and copied all the incriminating data onto a CD-Rom. He told no one outside of internal audit what he had found.

Mr. Morse even kept his wife, Lynda, in the dark. Each night, he'd bring home documents he was studying. He instructed his wife not to touch his briefcase. His wife thought the usually gregarious father of three looked drained.

Ms. Cooper had begun confiding in her parents, with whom she was especially close. Without going into detail, she told her mother that she was worried about what her team was finding, and that it was definitely a very big deal, according to a person close to Ms. Cooper.

Meanwhile, Mr. Sullivan began to ask questions about what Ms. Cooper's team was up to. One day the finance chief approached Mr. Morse in the company cafeteria. When Mr. Morse saw him coming, he froze. The auditor had only spoken to Mr. Sullivan twice during his five-year tenure at WorldCom.

"What are you working on?" Mr. Morse later recalled Mr. Sullivan demanding. Mr. Morse looked at his shoes. "International capital expenditures," he says he replied, referring to a separate, and less-threatening auditing project. He quickly walked away.

Days later, on June 11, Ms. Cooper got an unexpected phone call from Mr. Sullivan. He told her that he would have some time later in the day, and invited her to come by and tell him what her department was up to, according to a person familiar with Ms. Cooper's situation.

That afternoon, Ms. Cooper, Mr. Smith and another auditor arrived at Mr. Sullivan's office. They talked about pending promotions and other administrative matters, according to lawyers involved in the case.

As the meeting was breaking up, Ms. Cooper turned to Mr. Smith and suggested that he tell Mr. Sullivan what he was working on. It was meant to seem like a casual comment. In fact, the two auditors had planned it out beforehand, so that they could gauge Mr. Sullivan's reaction, according to a person familiar with Ms. Cooper's situation.

Mr. Smith briefly described the audit, without going into the explosive material they already had found.

Mr. Sullivan urged them to delay the audit until after the third quarter, saying there were problems he planned to take care of with a write-down, according to several people familiar with the meeting.

Ms. Cooper replied that no, the audit would continue. Mr. Sullivan didn't respond, and the meeting ended in a stalemate.

Concerned now that Mr. Sullivan might try to cover up the accounting improprieties, Ms. Cooper and Mr. Smith appealed to Mr. Bobbitt, the head of WorldCom's audit committee. Mr. Bobbitt had to travel to Mississippi from his home in Florida for a board meeting scheduled for June 14, so the day before he met with Ms. Cooper and Mr. Smith at a Hampton Inn in Clinton.

The two auditors told Mr. Bobbitt what they had found. He asked Ms. Cooper to contact KPMG, the company's new outside auditors, and brief them on what was happening. Mr. Bobbitt did not raise Ms. Cooper's suspicions at the board meeting the next day, according to a document WorldCom later submitted to the SEC. James Sharpe, Mr. Bobbitt's lawyer, declined to comment.

Farrell Malone, the KPMG partner in charge of the WorldCom account, urged Ms. Cooper to make sure she was right.

On June 17, Ms. Cooper's team began a series of informal confrontations meant to convince themselves that there was no legal explanation for the accounting entries.

That morning, Ms. Cooper and Mr. Smith went to the office of Betty Vinson, director of management reporting, and asked her for documentation to support the capital-expense-accounting entries. Ms. Vinson told the two that she had made many of the entries but did not have any support for them, according to an internal memo prepared by Ms. Cooper and Mr. Smith. Ms. Vinson's lawyer did not return phone calls.

Next they walked a few feet to Mr. Yates's office. He said he was not familiar with the entries and referred Ms. Cooper and Mr. Smith to Mr. Myers.

The duo then paid a call on Mr. Myers. When confronted, he admitted that he knew the accounting treatment was wrong, according to the memo. Mr. Myers said that he could go back and construct support for the entries but that he wasn't going to do that. Ms. Cooper then asked if there were any accounting standards to support the way the expenses were treated, according to the memo, which was later made public by a Congressional committee.

Mr. Myers answered that there were none. He said that the entries should not have been made, but that once it had started, it was hard to stop.

Mr. Smith asked how Mr. Myers planned to explain it all to the SEC. Mr. Myers replied that he hoped it wouldn't come to that, according to the memo.

An hour or so later, Ms. Cooper returned to her department to brief Mr. Morse and her other auditors. "They have no support," she told them, according to Mr. Morse.

It was clear to Ms. Cooper's team that their findings would be devastating for the company, and the prospect of going before the board with their evidence was sobering. They worried about whether their revelations would result in layoffs and obsessed about whether they were jumping to unwarranted conclusions that their colleagues at WorldCom were committing fraud. Plus, they feared that they would somehow end up being blamed for the mess.

Ms. Cooper's staffers began to notice that she was losing weight. Mr. Morse's wife noticed he was preoccupied and short tempered.

During the third week in June, Mr. Smith called his mother, who was vacationing in Albuquerque, according to a person familiar with the conversation. Without providing specifics, he told her that he was about to take actions at WorldCom that were not going to make people happy. He asked his mother, Ms. Cooper's former high school accounting teacher, to remember him in her prayers and to pray for him to be strong.

Ms. Cooper prepared for several meetings with the audit committee. At one, on June 20, Mr. Sullivan was scheduled to defend himself.

One evening, as Ms. Cooper worked late with accountants from KPMG, she suddenly dropped her head into her arms on the conference-room table. Mr. Malone of KPMG led her onto a balcony, put his arm around her and showed her the sunset, according to a person familiar with the meeting.

Ms. Cooper, Mr. Smith and Mr. Malone headed to Washington to brief the board's audit committee. At the meeting on Thursday, June 20, Mr. Malone described the transfer of line costs to capital accounts and told the audit committee that, in his view, the transfers didn't comply with generally accepted accounting principles, according to a document WorldCom later submitted to the SEC.

Mr. Sullivan tried to give an explanation for the accounting adjustments but asked for more time to support the line-cost transfers. The committee gave Mr. Sullivan the weekend to explain himself. He got to work constructing what he called a white paper that argued that the accounting treatments he used were proper, according to the document.

It didn't work. On June 24, the audit committee told Mr. Sullivan and Mr. Myers they would be terminated if they didn't resign before the board meeting the next day. Mr. Sullivan refused and was fired. Mr. Myers resigned.

The next evening, WorldCom stunned Wall Street with an announcement that it had inflated profits by $3.8 billion over the previous five quarters.

Afterward, Ms. Cooper drove to her parents' house, which was near WorldCom's headquarters. She sat down at the dining-room table without saying anything, says Ms.

Ferrell, her mother. "She was deeply, deeply pained. She was grief stricken that it was true and that all these people would feel the consequences of having gone astray," Ms. Ferrell says. "We were all so proud of WorldCom and it's just been the saddest, most tragic thing."

Mr. Morse worked late that night, and his wife phoned after she watched the news. The anchors were calling the company World-Con, she reported. Did he know anything about it?

The SEC on June 26 slapped the company with a civil fraud suit, and trading of WorldCom's stock was halted. Ultimately the company was delisted by the Nasdaq Stock Market.

Mr. Sullivan is preparing to go to trial. "We will demonstrate at the appropriate time that a number of the negative points that WorldCom's internal auditors have recently suggested about Mr. Sullivan are not accurate," says Irvin Nathan, a lawyer for Mr. Sullivan. "The fact is that he was always supportive of internal audit and was instrumental in the promotion of Cynthia Cooper and securing resources for her staff."

Mr. Myers, Mr. Yates, Ms. Vinson and Troy Normand, the director of legal entity accounting, have all pleaded guilty to securities fraud and a variety of other charges. David Schertler, an attorney for Mr. Yates, says that while his client pleaded guilty, "all the evidence would suggest he was acting under the orders of supervisors."

Ms. Cooper and her team have continued to work at WorldCom's Clinton headquarters and are responding to requests related to the various investigations of the company. Ms. Cooper, Mr. Smith and Mr. Morse have been interviewed by FBI agents in connection with the Justice Department's investigation.

Some WorldCom employees have told the auditors that they wish they had left the accounting issues alone.

UNIVERSITY HONORS PROGRAM

SENIOR PROJECT - PROSPECTUS

Name: JEFFREY ALEXANDER

College: BUSINESS Department: ACCOUNTING

Faculty Mentor: DR. KIGER

PROJECT TITLE: ETHICS IN ACCOUNTING?

PROJECT DESCRIPTION (Attach not more than one additional page, if necessary):

THIS PROJECT WILL BE A CASE STUDY OF THE ENRON AND WORLD COM SCANDALS. IT WILL LOOK AT BOTH THE CAUSE AND METHOD OF THE FRAUDS. IN RESPONSE TO THESE EVENTS, THE PROJECT WILL DISCUSS THE EFFECTS, BOTH ACTUAL AND NEEDED, IN THE EYES OF THE WRITER, ON GOVERNMENT LEGISLATION, BUSINESSES, STOCK HOLDERS, BUSINESS SCHOOLS, AND THE GENERAL PUBLIC.

Projected completion date: 12/02

Signed: Jeffrey Alexander

I have discussed this research proposal with this student and agree to serve in an advisory role, as faculty mentor, and to certify the acceptability of the completed project.

Signed: _____, Faculty Mentor

Date: 11-07-02

Return this completed form to The University Honors Program, F101 Melrose Hall, following your first presentation in the Senior Project Seminar.