

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**

**Release No. 57662 / April 14, 2008**

**ACCOUNTING AND AUDITING ENFORCEMENT**

**Release No. 2808 / April 14, 2008**

**ADMINISTRATIVE PROCEEDING**

**File No. 3-13006**

**In the Matter of**

**MELVIN DICK, CPA,**

**Respondent.**

**ORDER INSTITUTING PUBLIC  
ADMINISTRATIVE PROCEEDINGS  
PURSUANT TO RULE 102(e) OF THE  
COMMISSION'S RULES OF PRACTICE,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative proceedings be, and hereby are, instituted against Melvin Dick, CPA ("Dick" or "Respondent") pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice.<sup>1</sup>

**II.**

In anticipation of the institution of these proceedings, Dick has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Dick consents to the entry of this Order Instituting Public Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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<sup>1</sup> Rule 102(e)(1)(ii) provides, in pertinent part, that:

The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission . . . to have engaged in . . . improper professional conduct.

### III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

#### A. SUMMARY

1. This matter concerns improper professional conduct by Melvin Dick, an audit partner with the public accounting firm Arthur Andersen LLP ("Andersen"), in connection with the audit of the financial statements of WorldCom, Inc. ("WorldCom") for its fiscal year ended December 31, 2001. Dick was the lead engagement partner on the audit. As the lead engagement partner, Dick was responsible for planning the conduct and scope of the WorldCom audit and overseeing all of the services performed by the Andersen staff, including reviewing the work performed by Andersen's staff on the 2001 audit. In the planning and performance of that audit, Dick failed to comply with Generally Accepted Auditing Standards ("GAAS") as described below.

#### B. RESPONDENT

2. Melvin Dick, age 54, resides in Sagle, Idaho. Dick was a partner with Andersen from 1987 to 2002, and was the head of the firm's Global Telecommunications, Entertainment and Media industry practice at the time of Andersen's audit of WorldCom's fiscal year 2001 financial statements. In 2003, Dick allowed his CPA licenses in several jurisdictions to expire, and he currently is not a licensed CPA.

#### C. RELATED PARTIES

3. Arthur Andersen LLP was, at all times relevant, a limited liability partnership headquartered in Chicago, Illinois that performed, among other things, accounting and consulting services, and was one of the so-called "Big Five" accounting firms in the United States.

4. WorldCom, Inc. was, at all times relevant, a global telecommunications company incorporated in Georgia with its principal offices in Jackson, Mississippi.

#### D. FACTS

##### *WorldCom's Fraudulent Accounting for Capital Expenditures and Line Cost Expenses*

5. From 1998 through 2001, WorldCom made substantial cash outlays to enhance and expand its global telecommunications network. WorldCom recorded these capital expenditures as assets on its balance sheet and grouped them into various categories within Property, Plant & Equipment ("PP&E"), such as Transmission Equipment, Communication Equipment and Furniture, Fixtures & Other.

6. PP&E constituted the second largest category of assets on WorldCom's balance sheet. In any given year, a majority of WorldCom's capital expenditures was related to construction in progress ("CIP"), which represented the accumulated cost of constructing assets before the assets are placed in service. Each of the CIP projects was supposed to be approved through WorldCom's budgetary Authorization for Expenditure ("AFE") process; when approved, AFE numbers were assigned to those projects. WorldCom accumulated the costs incurred for each project in a CIP account. Once the project was completed and ready for use, it was transferred from CIP into the appropriate PP&E "in-service" account, where the asset would begin to be depreciated or expensed.

7. WorldCom tracked the acquisition, disposition, and transfer of its assets on the PP&E Rollforward Schedule ("Rollforward"). Andersen received a copy of the Rollforward each quarter in connection with its quarterly reviews and audit testing. Respondent identified PP&E as a material account for the 2001 WorldCom audit, and designated the capital expenditures cycle at WorldCom as a "critical process."

8. Line costs comprised the largest single expense item on WorldCom's income statement. WorldCom's line costs could be classified into domestic, international and internet line costs, with domestic line costs being the largest of these three categories. A major component of WorldCom's line cost expenses were the fees it paid to third-party telecommunications carriers under long term lease agreements for rights of access to their telecommunications networks. These lease agreements required WorldCom to pay the fees whether or not WorldCom used all of the leased capacity. During 2001, WorldCom's line costs had increased, in large part due to its obligations under the long-term lease agreements it had entered into based on its incorrect anticipation of growth in demand for telecommunications capacity.

9. U.S. Generally Accepted Accounting Principles ("GAAP") required WorldCom to expense its line costs in the period they were incurred because they represented actual or expected cash outflows from ongoing major operations. During 2001, WorldCom improperly removed approximately \$3 billion in its line cost expenses from its income statement, improperly and fraudulently characterizing these expenses as "assets" on its balance sheet. This improper accounting was accomplished by manual journal entries to line cost and PP&E accounts.

#### *Failure to Take Engagement Risks Into Consideration*

10. In 2001 as well as in prior audits, Andersen utilized a risk assessment tool it called the "SMART" tool to evaluate risks related to serving an audit client. Application of Andersen's SMART tool by the WorldCom engagement team resulted in a "High" risk classification for the 2001 WorldCom audit. The engagement team, however, manually increased the risk classification to "Maximum," Andersen's highest risk rating, as Andersen had done in the prior year's audit. WorldCom's risk classification was increased due to "the volatility of [its] industry, its future merger and acquisition plans and its reliance on a high stock price to fund those acquisitions."

11. At the time of the 2001 WorldCom audit, Respondent knew that WorldCom's CEO, Bernard Ebbers, owed substantial personal debt secured by the WorldCom stock he owned. Respondent was also aware that Ebbers faced margin calls on this indebtedness as WorldCom's stock price rapidly declined. Respondent was also aware that WorldCom had guaranteed more than \$200 million of Ebbers' personal debt. However, the audit workpapers for the 2001 audit did not identify either the financial pressure on Ebbers or the significant decline in WorldCom's stock price as a fraud risk. Respondent did not modify the audit plan to address this risk.

12. Respondent participated in an "Expanded Risk Discussion," required under Andersen policy for all Maximum risk clients, for the 2001 WorldCom audit. During that process, Respondent became aware that in prior years Andersen had identified WorldCom's "aggressive accounting policies" and "desires to maintain high stock valuations in anticipation of a security offering or a merger" as fraud risk factors.

13. At the time of the 2001 audit, Respondent had also learned that in the prior year's audit, Andersen had become aware that in the first quarter of 2000 WorldCom's then Controller had directed the making of a post-closing journal entry, which had no documentary support, to reduce line cost expenses at WorldCom's United Kingdom subsidiary by approximately \$33.6 million.

14. Respondent should have reasonably recognized that the deteriorating market conditions in the telecommunications industry created a pressure that also increased the risk of fraud. In 2001, the telecommunications industry experienced a significant downturn, experiencing overcapacity, declining prices paid for services, and declining stock prices. WorldCom's own stock price had declined more or less steadily from a high of \$50 in February 2000 to \$14 by the end of 2001, a decline of almost seventy percent. WorldCom's revenue growth was reduced, many of its customers were financially ailing or failing. Despite reduced revenue growth, WorldCom had to service massive amounts of debt it had issued. The Andersen audit workpapers, however, fail to reflect consideration of these industry conditions in general or as experienced by WorldCom and their implications on the risk of fraud in the financial statements.

15. Notwithstanding that Respondent knew that management had the ability to override, and had overridden, WorldCom's accounting controls, he failed to exercise due professional care or maintain professional skepticism toward WorldCom in planning and performing the audit. Despite the numerous fraud risks at WorldCom of which he was aware or reasonably should have been aware, Respondent did not ensure the 2001 audit of line costs and PP&E incorporated adequate procedures to obtain reasonable assurance that the financial statements were free of material misstatements as required by GAAS. Respondent's failure to modify the 2001 audit plan, given the increased and significant fraud risks existing at WorldCom, compromised Andersen's ability to detect the massive fraud occurring in WorldCom's PP&E and line costs accounts in 2001.

Failures in Audit of PP&E Accounts

16. Even though Respondent's audit team determined that PP&E was a critical audit area, they failed to perform adequate testing in this area. The audit team's testing was inadequate to determine whether WorldCom's controls were sufficient to prevent material misstatements of PP&E through error or fraud, testing only a subset of the additions to PP&E. Moreover, the auditors only performed testing of additions to PP&E through the end of WorldCom's third quarter, September 30, 2001, and not as of the end of WorldCom's fiscal year.

17. Respondent's audit plan was premised on the inaccurate assumption that all new recorded PP&E had been added through the AFE process and that no additions to PP&E could be made outside of that process. Consequently, the Andersen audit team tested accounting controls on additions to WorldCom's PP&E by selecting a sample of twenty-three open CIP projects identified by AFE numbers, and checked each project for, among other things, the existence of an approved AFE form for the project and noting whether open CIP projects were on schedule to be completed by the expected completion date.

18. While Respondent tested the controls surrounding the segregation of duties of employees involved in the AFE process, Respondent failed to obtain sufficient evidence to determine whether additions to PP&E could be made outside of the AFE process. Respondent also failed to test whether management could circumvent the AFE controls to make potentially improper additions to PP&E, despite being aware of management's ability to manually override controls in place.

19. WorldCom's third quarter Rollforward—which Andersen received in performing the audit—showed total additions to PP&E of approximately \$6.4 billion as of September 30, 2001, a figure that included the improper entries made in the course of the fraud. Respondent tested a smaller subset of additions to PP&E, selecting the twenty-three projects from a population of \$4.1 billion in open CIP. Had Respondent reconciled the \$4.1 billion population tested to the \$6.4 billion in total PP&E additions reflected in the third-quarter Rollforward, or in the General Ledger, Respondent would have discovered that Andersen was merely testing a subset of total additions to PP&E. Because the smaller population Respondent tested was only a subset of all additions to PP&E, the testing necessarily could not, and did not, provide Respondent with sufficient competent evidence regarding WorldCom's accounting controls for additions to PP&E.

20. The audit team did not conduct any substantive testing of the PP&E accounts following its testing of an incomplete subset of total PP&E additions as of the end of WorldCom's third quarter. WorldCom subsequently added \$841 million in improperly capitalized line costs to its PP&E in the fourth quarter of 2001. The fraudulent additions amounted to nearly half of the total PP&E additions in that quarter. As a result of Andersen's failure to conduct further testing of PP&E balances as of year

end, or to examine PP&E activity as of the balance-sheet date subsequent to its interim testing, these additional improper and fraudulent additions to PP&E were not subject to auditing.

21. Respondent failed to adequately plan the audit to provide for adequate substantive testing of the details of PP&E. Based on the deficient testing of PP&E controls during the audit, Respondent improperly assessed the control risk at below a maximum level and, as a result, planned and performed insufficient audit testing of PP&E.

22. In failing to: take the fundamental step of ensuring that the population of property additions his audit team tested was complete and corresponded to the total property additions reflected in WorldCom's balance sheet; ensure that appropriate testing was done to provide a reasonable basis for extending conclusions regarding PP&E account balances from the date of interim testing to the balance-sheet date; and conduct adequate substantive testing of PP&E accounts, Respondent failed to exercise due professional care (American Institute of Certified Public Accountants ("AICPA"), *Codification of Statements on Auditing Standards*, ("AU") §§ 150.02, 230.01)<sup>2</sup> and professional skepticism (AU § 230.07) in the planning and performance of the audit, and failed to obtain sufficient evidential matter (AU §§ 150.02, 326.01) to provide him with a reasonable assurance that WorldCom's financial statements were free of material misstatement.

#### *Failures in Audit of Line Cost Accounts*

23. Respondent failed to exercise due professional care in the planning and performance of the audit (AU §§ 150.02, 230.01), and failed to obtain sufficient competent evidential matter (AU §§ 150.02, 326.01), by failing to reconcile the line cost expenses being audited to the Company's financial statements and general ledger.

24. Had such a reconciliation been included in the audit plan or performed, Respondent's audit team would have discovered that the line cost expenses they were testing were significantly larger than the line cost expenses reflected in WorldCom's financial statements and general ledger. This difference existed because the fraudulent entries reducing those expenses were not included in the schedules Andersen received to audit, but were reflected in the line cost expenses reported in the financial statements.

25. The audit that Respondent designed subjected line cost expenses to testing through the identification and testing of WorldCom's internal controls relevant to line cost expenses. Based on the results of that testing of controls, Respondent determined the control risk was below the maximum risk, and, consequently, insufficient testing of line cost expenses was performed.

26. However, the audit workpapers Respondent reviewed in making his control risk determination did not document how the controls identified and tested were relevant

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<sup>2</sup> The AU cites referenced throughout the document pertain to GAAS standards that were in effect in 2001.

to preventing or detecting misstatements in the assertions embodied in the line cost expense account balance. The failure to link specific internal controls to the asserted line cost expense account balance resulted in a failure by Respondent to obtain sufficient evidential matter (AU §§ 150.02, 326.01), in violation of GAAS.

*Failure to Review Non-Standard Journal Entries*

27. The fraudulent reduction of WorldCom’s line cost expenses was accomplished through the recording of large unsupported journal entries, known as on-top or top-side entries, after the close of each quarter, in even monetary amounts ranging from \$38.5 million to \$600 million.

28. Despite the fact that Respondent’s audit team had rated WorldCom as a “Maximum” risk client, despite other risk factors that Respondent either knew or reasonably should have known provided an incentive for fraudulent misstatement of WorldCom’s financial statements, and despite Respondent’s awareness that management had the ability to override accounting controls, Respondent did not exercise due professional care in the planning and performance of the audit (AU §§ 150.02, 230.01) by failing to design or implement audit procedures to identify and review non-standard journal entries.

29. Respondent placed undue reliance on WorldCom’s management’s representation that there were no significant top-side entries. Respondent failed to exercise due professional care (AU §§ 150.02, 230.01), maintain an attitude of professional skepticism (AU § 230.07), and to obtain sufficient competent evidential matter (AU §§ 150.02, 326.01), by not planning and performing reasonable audit procedures to identify potentially improper or fraudulent top-side journal entries and by relying on management’s representation that there were no significant top-side journal entries.

*Inadequate Workpaper Documentation of the Audit*

30. Respondent’s audit workpapers for the 2001 WorldCom audit did not adequately document the audit procedures applied, tests performed, information obtained and pertinent conclusions reached in the audit engagement and failed to show that the accounting records agree or reconcile with the financial statements (AU § 339). Additionally, key documents purportedly used in performing the audit are not included in the workpapers.

**E. VIOLATION**

Dick failed to comply with GAAS in connection with the 2001 WorldCom audit by unreasonably: (i) failing to exercise due professional care in the planning and performance of the audit, AU §§ 150.02, 230.01; (ii) failing to exercise an attitude of professional skepticism throughout the audit, AU § 230.07; (iii) failing to obtain sufficient evidential matter to afford a reasonable basis for Andersen’s opinion regarding WorldCom’s financial statements, AU §§ 150.02, 326.01; (iv) failing to consider

expanding the extent of the audit procedures applied, applying procedures closer to or as of year end, particularly in critical audit areas, or modifying the nature of procedures to obtain more persuasive evidence, in light of the significant risks of material misstatement that existed at WorldCom, AU § 312.17; (v) failing to plan and perform the audit to obtain reasonable assurance about whether the financial statements were free of material misstatement, whether caused by error or fraud, AU § 110.02; and (vi) issuing an audit report that falsely stated that the audit was conducted in accordance with GAAS and that WorldCom's financial statements were presented in conformity with GAAP, AU § 508.07.

Rule 102(e)(1)(ii) of the Commission's Rules of Practice provides, in part, that the Commission may censure or deny, temporarily or permanently, the privilege of appearing or practicing before the Commission in any way to any person who is found by the Commission to have engaged in improper professional conduct. Rule 102(e)(1)(iv) defines improper professional conduct with respect to persons licensed to practice as accountants.

As applicable here, improper professional conduct means a violation of applicable standards that resulted from "repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission." (Rule 102(e)(1)(iv)(B)(2)). As a result of the conduct described above, Respondent repeatedly acted unreasonably in failing to conduct or supervise the audit of WorldCom's financial statements for the year ended December 31, 2001 in accordance with GAAS.

## **F. FINDINGS**

Based on the foregoing, the Commission finds that Respondent engaged in improper professional conduct pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

## **IV.**

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Respondent is denied the privilege of appearing or practicing before the Commission as an accountant.

B. After four years from the date of this order, Respondent may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:



1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the Respondent's or the firm's quality control system that would indicate that the Respondent will not receive appropriate supervision;

(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Nancy M. Morris  
Secretary