

Defendants' Experts' reports on a line by line basis. Instead, I have summarized major disagreements into general categories prevalent throughout those reports. I have listed these categories below and my comments and conclusions thereupon follow.

- I.** Reliance on the Restatement and on the Report of the Special Investigative Committee of the Board of Directors of WorldCom, Inc. (the "SIC Report")
 - A. Independent Analysis
 - B. Adequate Support
 - C. Hindsight
 - D. New Management
 - E. Restatement Procedures were Appropriate

- II.** Professional Standards
- III.** Harris L. Devor's Qualifications
- IV.** Reliance on Correspondence from the Securities and Exchange Commission ("SEC")
- V.** Specific Areas of Disagreement
- VI.** Unsupported Statements
- VII.** Errors and Omissions Addressed by Mr. Bartko

3. I may revise or supplement this report if additional evidence is presented or if asked to further respond to opinions expressed by any Defendant experts. Moreover, since my analysis is ongoing, I may modify these opinions based on additional analysis and on review of additional evidence.

I. Reliance on the Restatement and SIC Report

A. Independent Analysis

4. The Defendants' Experts have stated throughout their rebuttal reports that, in essence, I have blindly accepted the Restatement (restatement adjustments), substantially relied upon the SIC Report and have performed little or no independent analysis or investigation of the facts and circumstances addressed therein.¹ Further, the Defendants' Experts also claim that I ignore evidence that contradicts important elements of my assertions. I disagree and address my comments and conclusions below.

5. First, it is evident from my initial Rule 26 Report that I did not blindly adopt the restatement. As an example, I only considered in my analysis a small percentage of the many, many entries that comprised the restatement.

6. The Statement on Standards for Consulting Services, as described below, states that sufficient relevant data should be obtained to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed. I or my staff have **independently reviewed and analyzed**, and have not blindly accepted², all of the materials set forth in Exhibits #3 and #4 to my Rebuttal Report. This includes thousands of pages of documents produced in this matter, deposition testimony, and professional standards relevant to the issues in this matter. It is my conclusion, therefore, that I and the staff working under my direction have obtained sufficient relevant data to afford a reasonable basis for the conclusions set forth in my report in accordance with the Statement on Standards for Consulting Services.

7. Mr. Kirby also states:

¹ E.g. Kirby Rebuttal Report, pp. 1, 2, 33; Bartko Rebuttal Report, pp. 2, 11, 15, 16; Erickson Rebuttal Report, pp. 2, 4, 10, 12, 13, 15

² Kirby Rebuttal Report, p. 2

Mr. Devor has not performed a re-audit of the Company's financial statements; he has not interviewed any of the past or current Company personnel; he has not independently verified the data used in preparing the restatement adjustments; and as such has relied solely upon the work done and conclusions reached by others. Additionally, Mr. Devor has made no attempt to analyze the restatement adjustments on the basis of the facts and circumstances that existed at the time of the original audits.³

8. In response to Mr. Kirby's statement, I believe that he is confusing audit opinions with expert opinions. It is appropriate and reasonable for me, as an expert, to consider and to rely on discovery that has been produced in this matter, which includes, in part, restatement documents and testimony. Furthermore, it is appropriate and reasonable for me to consider, in reaching conclusions, that the restatement process included an exhaustive number of experts that are proficient in accounting and other technical matters. Further, the record indicates, as addressed below in the "Hindsight" section, that those involved in the restatement process analyzed restatement adjustments on the basis of facts and circumstances that existed at the time of the original audits.

9. In evaluating documents produced relating to the restatement, I considered how the information was obtained and the procedures that were performed to reach the conclusions. Interestingly, although Mr. Kirby charges me with, for instance, failing to perform a re-audit and to interview past or current Company personnel, there is no evidence that Mr. Kirby performed any such procedures himself, yet somehow reached the conclusions that the AA's audits of WorldCom's 1999, 2000 and 2001 financial statements were conducted in accordance with GAAS.

³ Kirby Rebuttal Report, p. 1

10. With respect to the allegations, specifically of Mr. Bartko, regarding my reliance upon the SIC Report, I have the option and, further, perhaps a requirement as an expert, to consider all relevant discovery.

11. The SIC Report is not only a public document, but it has been marked as an exhibit to depositions in this matter.⁴ The SIC Report is, therefore, considered discovery in this matter, as are the documents produced with, and in support of, the SIC report, including interviews conducted as part of the SIC investigation and the documents pertaining directly to those interviews, to which I cite in my initial Rule 26 Report. As a result, not only am I *able* to consider such documents, including the actual SIC Report, I am *required* to do so, for they are quite pertinent to my overall charge as the expert in this matter.

12. Having said that, upon review of my initial Rule 26 Report, I conclude that the following statement by Mr. Bartko, at page 18 of his Rebuttal Report, is ludicrous:

Devor also relies extensively on the Report of Investigation.

13. Although there are references throughout my initial Rule 26 Report to the SIC Report or to the documents emanating from the SIC investigation, the majority of those references are included merely to provide the reader of my initial Rule 26 Report with certain pertinent background information. Mr. Bartko states, for example, the following within Footnote 57 to the Bartko Rebuttal Report:

For example, paragraphs 168 through 175 of the Devor Report are entirely referenced to the Report of Investigation.⁵

⁴ Depositions of Messrs. Schoppet and Dick

⁵ Bartko Rebuttal Report, p. 18

14. Upon review of those specific paragraphs in my initial Rule 26 Report, the information presented therein, for which the SIC Report may have been cited, is entirely background information to allow the reader a better understanding of the revenue accounting process at WorldCom. None of the material presented within paragraphs 168 to 175 of my initial Rule 26 Report provides the basis for my ultimate opinions relating to revenue.

B. Adequate Support

15. Mr. Kirby states that “restatement adjustments were made simply because the restatement team could not find adequate support for the entries.”⁶ Many items were accounted for as an error and restated because of both (a) the conclusion that appropriate documentation did not exist to support what had been originally recorded *and* (b) as a result of other factors surrounding the account and the entry.⁷

16. In discussing whether items that lacked support should be recorded as an error or left unadjusted, Mr. Farrell Malone, KPMG Engagement Partner, stated the following, in relevant part:

...if something appears reasonable based on the facts and circumstances as - - as we have available today, although what we might call robust documentation may not exist, a judgment would need to be made as to whether the balance should be adjusted or not...I would say that in some cases, adjustments were made; in other cases, they were not made, depending on not only the availability of documentation, but the facts and circumstances surrounding the account, how the account might have been used in the past, and the...analysis of the history of a particular account. So there's a lot of factors that went into determination of whether a

⁶ Kirby Rebuttal Report, p. 2

⁷ Malone, pp. 167-168

restatement...entry should have been recorded or not.⁸

Based on my understanding of the restatement process, through documents produced and testimony obtained in this matter, I believe it was appropriate for certain restatement adjustments to have been made when the original entries were found to have been made without support.

C. Hindsight

17. Messrs. Kirby and Bartko have claimed, in their Rebuttal Reports, that hindsight and new judgments and information were used in WorldCom's restatement.⁹

18. APB No. 20, *Accounting Changes*, states, inter alia, the following:

Errors in financial statements result from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared.¹⁰

Mr. Malone described an "error," with respect to WorldCom and to KPMG's audits of the restated financial statements for 2000 and 2001, in the following manner:

... information that clearly indicated that an error had been made in the financial statements based on the facts and circumstances that existed at the time and that were known or should have been known...¹¹

⁸ Malone, pp. 169-170

⁹ E.g. Kirby Rebuttal Report, p. 2, Bartko Rebuttal Report, p. 17

¹⁰ APB No. 20, ¶ 13

¹¹ Malone, p. 153

19. The record indicates that individuals on the audit teams (discussed in paragraphs 27 to 29 below), at all levels, were aware that the use of hindsight was inappropriate and should clearly be avoided.¹² More specifically, James Renna, Director of Mergers and Acquisitions at MCI (WorldCom), testified as follows relating to hindsight:

Q: What kind of controls were in place to insure that WorldCom personnel working on the restatement were not using hindsight?

A: In the end of the day I am a reviewer of the work of my group and as is a controller... There were checkpoints. And quite frankly our auditor reviewed every piece of work, too.¹³

20. KPMG was also cognizant of the reality that facts and information that became available based on hindsight should not be "pushed back" to the restated financial statements. Mr. Malone stated, in relevant part:

[A] clear distinction was attempted to be made between an error which would be included in the restated financial statements, vs. a change in estimate, which would not be pushed back into previously-issued financial statements. That was a topic of much discussion among the company and the audit team...¹⁴

21. Mr. Malone further stated, in relevant part:

Throughout the work that the company undertook to restate its financial statements, there was a concern that hindsight should not be a significant component of what was included in the restatement exercise and the calculation of the restatement adjustments. So there was a constant concern that hindsight not

¹² Renna, pp. 118-119, 121

¹³ Renna, p. 122

¹⁴ Malone, pp. 153-154

be automatically used vs. what information was present at the time or should have been present at the time.¹⁵

Other individuals' testimony similarly indicates that the restatement team was on notice not to use hindsight and did not.

22. Mr. Renna also commented on this issue in the following manner, responding to the criteria by which new WorldCom management determined the appropriateness or inappropriateness of reliance upon hindsight:

I think the company deemed the use of hindsight inappropriate, so I mean because it is simply not appropriate to use it when you're going back and restating you need to put yourself in the timeframe that you're in and that's what we did.¹⁶

D. New Management

23. In discussing WorldCom's (i.e., new management's) role in the restatement process, Mr. Kirby stated, in relevant part:

Certain of the restatement adjustments relate to new management's application of different judgments about prior operations and expectations about the future, changes in previously accepted accounting methods and policies, and subsequent business operations and activities, including WorldCom's filing for bankruptcy protection.¹⁷

24. Mr. Malone has expressed that new management exercised its best judgment based on the facts and circumstances that existed during 2000 and 2001 and made judgments on information that was available or should have been

¹⁵ Malone, p. 268

¹⁶ Renna, p. 126

¹⁷ Kirby Rebuttal Report, p. 2

available at that point in time.¹⁸ Based on my review of the discovery produced in this matter, nothing has come to my attention that has led me to believe that new management made inappropriate judgments based on information that was available or should have been available during 2000 and 2001, at least in the areas of the restatement which I have studied and with which I concur.

E. Restatement Procedures were Appropriate

25. MCI WorldCom issued its Form 10-K for the year ended December 31, 2002 on March 13, 2004. This filing included restated financial statements for the years ended both December 31, 2000, and December 31, 2001. During the restatement process, which took almost two years, numerous entities, other than internal WorldCom personnel and WorldCom's independent auditor, KPMG, provided assistance to the Company in the form of knowledge, research, and analysis. Deloitte & Touche ("D&T"), Resource Connections, Kforce, and Hyperion provided technical accounting assistance.¹⁹ As an indication of the expansiveness of the restatement effort, there were approximately 600 D&T employees on site at WorldCom, and WorldCom also had access to D&T's technical offices around the country.²⁰ Additionally, there were over 300 other contractors from, for example, Resource Connections, Kforce, and Hyperion that were available to WorldCom.²¹

26. Other third-party consultants that participated in the overall restatement process included, but are not limited to, American Appraisal Associates ("AAA"), DoveBid Valuation Services, Inc. ("DoveBid"), and AlexPartners. As part of the restatement process, AAA performed a valuation of assets in connection with certain purchase accounting transactions. KPMG met with AAA and WorldCom to discuss the work that was being performed and audited the results of that

¹⁸ Malone, pp. 191-192

¹⁹ Renna, pp. 31-32

²⁰ Renna, p. 51

²¹ Renna, p. 72

analysis. DoveBid assisted KPMG in an independent assessment of the work that AAA performed.²²

27. The restatement work was performed by WorldCom audit teams. Team members included WorldCom personnel, experts from public accounting firms and/or other external third party experts mentioned above. Each audit team and often multiple audit teams were assigned to a specific area (e.g., purchase accounting, impairment, line costs, and revenue). The leader of each audit team reported to the controller specifically responsible for that area. The record indicates that these audit teams employed a tight monitoring process throughout the restatement effort. There were daily meetings that were attended by key senior management from WorldCom, KPMG (including, Mr. Malone) and D&T. Status reports and deliverables (which included items identified for the restatement) were discussed at these meetings.²³

28. Once the WorldCom audit teams had created deliverables, a quality control and review process ensued. If a WorldCom employee believed there was an entry or restatement adjustment to be made, he would document the position in a "white paper," propose the journal entries that were required, and then review those items with KPMG.²⁴ KPMG either agreed or disagreed with the Company's view on what needed to be restated.²⁵ Either through consultation with the Company or as a result of its own audit work,²⁶ if KPMG agreed, these entries would then be reviewed by the respective controller who would ultimately approve or disapprove of the entry. Following approval by the controller was a comprehensive process whereby a quality control team would review the entry before it was entered into the DSAP or ESAP system. The morning after it was

²² Malone, pp. 157-159

²³ Renna, pp. 73-78

²⁴ Renna, pp. 85-86

²⁵ Malone, pp. 157-158

²⁶ The scope of KPMG's engagement, relating to the restatement, was to audit the financial statements of 2002 and the restated financial statements of 2001 and 2000. (Malone, p. 199)

entered into the system, WorldCom and KPMG would check to see if the entry had been reflected correctly in the Company's records.²⁷

29. As part of the restatement process, KPMG identified a list of areas about which it had questions or concerns. It was not assumed that every area in which KPMG had a question would be restated. Instead, the process was organized so that as WorldCom's audit teams obtained more information about an area, and in the instances where it was believed a restatement adjustment would not be appropriate, personnel at the Company would discuss it with KPMG. If KPMG agreed that restatement was not appropriate, the item would be removed from the list.²⁸

30. Ultimately, KPMG expressed an opinion on the restated 2000 and 2001 financial statements which said, in part:

We have audited the accompanying consolidated balance sheets of WorldCom, Inc. and subsidiaries (Debtors-in-Possession from July 21, 2002) as of December 31, 2002 and 2001, and the related consolidated statements of operations, changes in shareholders' equity (deficit), and cash flows for each of the years in the three-year period ended December 31, 2002 ...

We conducted our audits in accordance with auditing standards generally accepted in the United States of America ...

In our opinion ... based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of WorldCom, Inc. and subsidiaries (Debtors-in-Possession from July 21, 2002) as of December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2002, in

²⁷ Renna, pp. 85-86

²⁸ Renna, pp. 76-77

conformity with accounting principles generally accepted in the United States of America ...²⁹

31. Nothing has come to my attention that would indicate that KPMG now believes the restatement was materially wrong. Under GAAS and, specifically, The American Institute of Certified Public Accountants ("AICPA") Auditing Standards Board Statement on Auditing Standards ("AU") 561, an auditor has a responsibility to "withdraw" his report on financial statements if he believes that further reliance thereon is not warranted. KPMG has not withdrawn its opinion on the restated 2000 and 2001 financial statements and I have seen no evidence to indicate that such an action would be necessary or appropriate.

II. Professional Standards

32. On page 5 of his report, Mr. Bartko states the following, in relevant part:

The Devor Report is subject to the Statement on Standards for Consulting Services ("SSCS"). The SSCS provides that Devor should comply with the general standards in Rule 201 of the AICPA Code of Professional Conduct. The general standards require compliance with the following standards: professional competence, due professional care, planning and supervision, and sufficient relevant data. The "sufficient relevant data" standard provides that Devor obtain data that is sufficient to provide a reasonable basis for his conclusions. (Footnotes removed.)

33. Litigation services can be described as consulting services performed in a judicial environment where the practitioner's services are subject to analysis and challenge by the opposing party. Because of this, some of the AICPA professional standards are applicable to litigation services and some are not. Statement on

²⁹ WorldCom, Inc. Form 10-K for the three-year period ended December 31, 2002, F-2

Standards for Consulting Services (“SSCS No. 1”) *Definition and Standards*, effective on January 1, 1992, classifies consulting services into six broad categories, one of which is transaction services. By specific example in the standard, litigation services are included under the transaction services category and, therefore, are governed by SSCS No. 1.

34. SSCS No. 1 states, in relevant part:

Standards for Consulting Services

.06 The general standards of the profession are contained in Rule 201 of the AICPA Code of Professional Conduct [ET section 201.01] and apply to all services performed by members. They are as follows:

Professional competence. Undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence.

Due professional care. Exercise due professional care in the performance of professional services.

Planning and supervision. Adequately plan and supervise the performance of professional services.

Sufficient relevant data. Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

.07 The following additional general standards for all Consulting Services are promulgated to address the distinctive nature of Consulting Services in which the understanding with the client may establish valid limitations on the practitioner's performance of services. These Standards are established under Rule 202 of the AICPA Code of Professional Conduct [ET section 202.01].

Client interest. Serve the client interest by seeking to accomplish the objectives established by the understanding with the client while maintaining integrity and objectivity.

Understanding with client. Establish with the client a written or oral understanding about the responsibilities of the parties and the nature, scope, and limitations of services to be performed, and modify the understanding if circumstances require a significant change during the engagement.

Communication with client. Inform the client of (a) conflicts of interest that may occur pursuant to interpretations of Rule 102 of the Code of Professional Conduct [ET section 102.03], (b) significant reservations concerning the scope or benefits of the engagement, and (c) significant engagement findings or events. (Footnotes removed.)

35. It is my opinion that, with respect to this litigation, the work performed by me and those working under my supervision, as described in my initial Rule 26 Report, was in accordance with all the standards set forth above and listed in paragraphs #6 and #7 of SSCS #1 and, by reference thereto, with the AICPA Code of Professional Conduct.

36. I note, additionally, that of the seven general standards set forth above, Mr. Bartko specifically stresses only one standard, “sufficient relevant data.” He does not conclude that I have violated that standard, and I am unsure as to why he stresses this standard alone as applying to me, since all seven apply to me equally. In view of all of the materials I or my staff have reviewed, however, as set forth in Exhibits #3 and #4 to my Rebuttal Report, including thousands of pages of documents produced in this matter, deposition testimony and professional standards relevant to the issues in this matter, it is certainly my conclusion that I, and the staff working under my direction, have obtained sufficient relevant data to afford a reasonable basis for the conclusions set forth in my report.

III. Harris L. Devor Qualifications

37. On page 10 of his report, Mr. Erickson states the following, in relevant part:

From my review of Mr. Devor's background and resume, I see no training or certifications to suggest that Mr. Devor has the qualifications to provide opinions as to the purchase price allocations associated with the MCI acquisition.

38. My resume indicates that my "[e]xperience includes 30 years of planning, organizing, administering and supervising all phases of audits and other financial engagements for large to small size clients in a variety of different industries including extensive involvement with publicly-held clients and SEC requirements, ..." In the course of performing those engagements, I encountered countless occasions where I had to apply my knowledge of Generally Accepted Accounting Principles ("GAAP") relating to purchase accounting issues, including the application of Accounting Principles Board Opinion ("APB") No. 16, *Business Combinations*, APB No. 17, *Intangible Assets*, Statement of Financial Accounting Standards ("FAS") No. 2, *Research and Development Costs*, FAS No. 36, *Accounting for Preacquisition Contingencies of Purchased Enterprises*, FAS No. 142, *Goodwill and Other Intangible Assets*, and FASB Interpretation ("FIN") No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*.

39. Further, I note that Mr. Erickson is not a certified public accountant ("CPA") and, accordingly, question whether he has the expertise to opine on GAAP and *accounting* issues relevant to this matter. In fact, I question whether many of the items opined on by Mr. Erickson require the services of a valuation expert. For example, with respect to In-Process Research and Development

(“IPR&D”), a valuation expert might be useful if the methodology at issue concerned how the value of the IPR&D was actually computed. But, in this matter, the dispute centers on whether there was *any* IPR&D at the time of WorldCom’s acquisition of MCI (i.e., whether at the time of the acquisition of MCI in 1998 there was a \$3.1 billion value for of IPR&D, or *zero* value).

40. Similarly, with respect to intangible assets such as customer base and assembled workforce, the dispute seems not to be one of how to mechanically compute such a value but, instead, whether there were *any* such assets at the time of acquisition. Furthermore, it is a GAAP issue, not a valuation issue, as to whether an asset, with a realistic life of 4 and 13 years for (customer base) and 6 years (for assembled workforce), should be written off over 40 years.³⁰

IV. Reliance on Correspondence from SEC

41. Messrs. Kirby and Bartko have stated that I ignored evidence that the Securities and Exchange Commission (“SEC”) reviewed WorldCom’s accounting treatment of certain matters (including, for example, the useful life of goodwill, IPR&D, and other areas of purchase accounting).³¹ Further, Mr. Kirby and Mr. Bartko specifically state that the SEC “did not oppose” or “did not object to” WorldCom’s accounting treatment of these matters,³² as well as that the SEC “no longer challenged”³³ WorldCom’s accounting treatment of these matters. I disagree with these statements. If Messrs. Kirby and Bartko have decided, however, to rely upon the aforementioned as evidence that the relevant accounting matters were handled in accordance with GAAP, I conclude that such reliance is unreasonable as set forth below.

³⁰ 1KPMG270780014

³¹ Kirby Rebuttal Report, pp. 48-54, 56, 58-59, 61-62; Bartko Rebuttal Report, pp. 5, 6, 10, 17

³² Kirby Rebuttal Report, pp. 48, 52-53, 56, 58-59, 61

³³ Bartko Rebuttal Report, p. 5

42. One of the SEC's roles is to review and comment on a company's public filings such as Forms 10-K, 10-Q, 8-K and registration statements. The SEC's review of a filing may involve several rounds of comments from the SEC and related responses from the company. SEC comment letters often address areas in which the SEC believes that disclosure should be improved and supplemented. The SEC's "review" of public filings and the issuance of comment letters does not equate to an audit or a "review," as defined by GAAS or by Statements on Standards for Accounting and Review Services. Comment letters and/or other correspondence between the SEC and registrants do not provide assurance that a company has prepared its financial statements in accordance with GAAP. Further, Mr. Malone has testified the following in this matter:

[T]he SEC typically does not give approval. It asks questions and asks the company to produce support to it, to support the company's accounting position.³⁴

43. Additionally, Mr. Malone responded as follows:

Q: In your experience, when...clients have had objections from the SEC and you've engaged in this comment process and they accept what is represented, in your experience, have you relied upon the process to sign off on your reports?

A: No. The exchange with the SEC is an independent process of arriving at an audit opinion on the consolidated financial statements. The SEC may ask questions about historical financial statements or registration statements which may have pro formas; but as an auditor, I do not rely on what the SEC might do or not do in comment letters.³⁵

44. The statements of Mr. Kirby and Mr. Bartko, therefore, providing that the SEC "did not oppose"³⁶ or "no longer challenged"³⁷ WorldCom, or their

³⁴ Malone, p. 79

³⁵ Malone, p. 83

³⁶ Kirby Rebuttal Report, pp. 48, 52-53, 56, 58-59, 61

implications that the SEC “was ultimately satisfied with”³⁸ or “no longer raised as an issue”³⁹ certain accounting treatments with WorldCom does not explicitly, nor implicitly, signify that the SEC had concluded, in any way, that WorldCom’s financial statements were presented in accordance with GAAP.

V. Specific Areas of Disagreement

45. There are many areas and on many counts where I believe the Defendants’ Experts opinions are wrong, or unsupported. My initial Rule 26 Report, as well as my Rebuttal Report, sets forth my opinions, many of which are contrary to those of the Defendants (and their Experts), and the bases for them. Since it would be senseless to repeat the opinions contained in those reports a third time herein, I have not. Instead, I have listed below several examples of differences between my opinions and those of the Defendants’ Experts and have attempted to demonstrate, accordingly, why I believe my conclusions to be appropriate and supportable. Such items are only examples and are not an exhaustive list of such disagreements.

- (a) **Release of Reserves** - I opine in my initial Rule 26 Report that the timing and amounts of the line costs reserve releases was not supported by contemporaneous analysis or documentation. This opinion was based on an independent analysis of information that was provided by former WorldCom management, restatement documents, and other discovery produced in this matter. Mr. Kirby incorrectly states that my conclusions are based on the work performed by WorldCom’s Special Investigative Committee and the restatement team and not the result of any independent analysis.⁴⁰

³⁷ Bartko Rebuttal Report, p. 5

³⁸ Bartko Rebuttal Report, p. 5

³⁹ Bartko Rebuttal Report, p. 10

⁴⁰ Kirby Rebuttal Report, p. 42

Further, I disagree with Mr. Kirby in that, during my independent analysis of the discovery in this matter, I did, in fact, consider the nature and timing of transactions that allegedly supported those releases, to the extent that it was available and supportable.

Mr. Kirby states that it does not appear that I evaluated, tested, analyzed, or otherwise audited and concluded as to the adequacy of the line cost and other accrual balances at each year end for the three years ended December 31, 2001.⁴¹ Further, Mr. Bartko states that I did not perform any analysis necessary to render an expert opinion with respect to the release of certain accrual balances in 2000.⁴²

The examples Mr. Bartko offers to support this statement are inappropriate, are overly broad, and do not assist in proving or disproving that the accrual releases were inappropriate. For instance, simply stating that AA issued a clean opinion, or that AA participated in quarterly line cost review meetings, or further that AA's conclusion that line cost accruals presented no residual audit risk,⁴³ does not adequately assist in demonstrating that the accrual releases were appropriate. Such reasoning is faulty provided that, as previously stated in my initial Rule 26 Report, AA's procedures did not evidence an audit sufficient under the guidelines established by GAAS. Further, by way of example, Mr. Bartko states:

... the evidence shows that accrual releases are customary in the telecommunications industry, as companies settle line cost disputes or make line cost payments that otherwise reduce the amount of line

⁴¹ Ibid.

⁴² Bartko Rebuttal Report, p. 11

⁴³ Bartko Rebuttal Report, p. 12

cost expense previously recorded.⁴⁴ (Footnote removed.)

This overly broad statement clearly lacks any specific evidence to demonstrate that the accrual releases were appropriate.

Mr. Bartko also provides examples of "evidence" that "may justify WorldCom management's judgment (prior to the Restatement) to release accruals."⁴⁵ From the examples of "evidence" cited, I note that the information is either (a) broad and non-specific to the particular accrual releases made in this matter, or (b) does not provide specific proof that the accrual releases were supported by any contemporaneous analysis.

Lastly, Mr. Bartko claims that I ignored other evidence that appears to contradict my conclusions about the propriety of the accrual releases.⁴⁶ Mr. Bartko's claim is false and has no merit. I have considered the information cited by Mr. Bartko on page 14 of his Rebuttal Report, in addition to all the information set forth in Exhibits #3 and #4 to my Rebuttal Report, in reaching the conclusions discussed in my initial Rule 26 Report and my Rebuttal Report.

(b) **Post Closing Entries** - Mr. Kirby states the following on page 24 of his Rebuttal Report, in relevant part:

The auditing standards in effect during the three years ended December 31, 2001 did not require the testing of top-side or nonstandard journal entries.

⁴⁴ Ibid.

⁴⁵ Ibid.

⁴⁶ Bartko Rebuttal Report, p. 14

Although such a conclusion seems an attempt to support larger themes within the Kirby Rebuttal Report, it is unsupportable. First, the conclusion, as set forth above, ignores the elements of AU 326, *Evidential Matter*, considered extensively in my initial Rule 26 Report.

Additionally, my Rebuttal Report cited specific professional literature that demonstrated the importance of reviewing non-standard, top-side adjustments near period-ends. Such literature was public information and, therefore, was available to AA during the relevant timeframe. (Refer to my Rebuttal Report for excerpts from two sources.)

On July 24, 2000 (later revised at August 24 and September 29 of that year), potentially upon recognition of and/or in response to such literature, AA even issued a firm-wide bulletin discussing, specifically, the requirements of an engagement team regarding the identification and consideration of risk when a client had been assessed at maximum risk. As discussed in my initial Rule 26 Report, WorldCom fit that criterion. This bulletin sought to provide guidance to ensure that such risks were “appropriately managed and reduced to an acceptable level.” (AA118712) Among other things, this bulletin served to outline a number of means through which management might initiate fraud. It specifically recommended performing an assessment of the pressure or influence asserted, or potentially asserted, by management over certain processes, **including the potential for a CFO to initiate entries that might serve to “cook the books.”** (AA118718)

Additionally, the bulletin provided, in relevant part:

Risks related to fraud most frequently occur
in the following timeless fraud areas:

- Revenue recognition ...
- **Non-standard journal entries...**
- Concealment of contract or asset losses

- Profits generated in consolidation⁴⁷
(Emphasis added.)

This bulletin is conveniently ignored by Mr. Kirby in both the initial Kirby Report and the Kirby Rebuttal Report. The Kirby Rebuttal Report asserts, however, on page 24, that extensive audit work was performed during AA's audits whereby, according to the report:

... [it] reviewed how the Company recorded financial information in the general ledger and confirmed that the Company was not making top-side entries.

As previously addressed in both my initial Rule 26 Report⁴⁸ and my Rebuttal Report,⁴⁹ I believe the procedures AA performed to "confirm" that WorldCom was not making top-side entries were inadequate.

Mr. Kirby later states the following at page 25 of his Rebuttal Report, in relevant part:

Mr. Devor's conclusion that "real-time, read-only access" would have allowed the engagement team to easily discover and identify WorldCom's fraudulent entries also rests on the assumption that WorldCom would have provided [AA] accurate information and unaltered electronic access to all levels of the general ledger. Given the massive collusion and undisputed evidence of WorldCom concealing information from Andersen and altering documentation provided to [AA] auditors, both Mr. Devor's assumption and conclusion are unsupportable.

⁴⁷ AA118718-119

⁴⁸ See paragraphs 304, 306, 308, and 311 of my initial Rule 26 Report.

⁴⁹ See paragraphs 44 to 46 of my Rebuttal Report.

This statement ignores another fundamental flaw in the procedures performed by AA in its alleged consideration of such post-closing, top-side entries. Based on my experience, sufficient consideration of the potential for significant unusual and/or inappropriate post-closing journal entries would have included the engagement team either (a) obtaining a comprehensive listing of such journal entries and reconciling the total amount of such entries to the difference between the audited balances in the workpapers and the financial statements (or the general ledger (“G/L”) reflecting the financial statements), or (b) independently obtaining access to WorldCom’s G/L.

Either of the two aforementioned options should have made AA aware of the existence of top-side entries despite the collusion referred to by Mr. Kirby. Specifically, the latter option would have enabled AA to isolate and review those top-side or non-standard adjustments that occurred at or near period-ends. Had such access been obtained by AA and the adjustments identified, although it may not have been obvious, upon first glance, that particular entries were inappropriate, GAAS would have nonetheless required AA to inquire further about the nature of those journal entries. For example, AU 326 would have required that the auditors obtain sufficient competent, evidential matter with the goal of obtaining a clear, reasonable and GAAP-appropriate understanding of what the entries truly represented.

Additionally, Mr. Kirby has claimed repeatedly that AA accessed WorldCom’s G/L as a matter of course during AA’s audits in its alleged efforts to capture any fraudulent top-side journal entries, and that AA’s workpapers reflect numerous instances when the engagement team agreed information to the G/L. There is a clear distinction, however, between the procedures AA claims to have

performed and the procedures AA should have performed. As indicated by its workpapers, the presumably standalone record of the procedures performed by the auditors during the relevant timeframe, AA failed to agree many of the relevant balances (accounts) to the final G/L reflecting the reported financial statements.

- (c) **40-Year Useful Life** - Mr. Bartko claims, in pages 4 to 6 of his Rebuttal Report, that based on review of public filings, there is evidence a 40-year life for goodwill was commonly used in the industry. As previously stated in paragraphs 89 to 90 of my initial Rule 26 Report, there has been discovery in this matter that supports a useful life of a much shorter period.

Such paragraphs set forth the bases for the reduction of life, attributable to both Mr. Brian Heckler, a KPMG partner who worked on the restatement, and a document showing the actual derivation of the revised 15 year life. Mr. Heckler also noted, correctly, that in addition to reviewing what other companies in the industry were doing, the lives of the other principal assets acquired were considered in arriving at the life reduction.⁵⁰ Further, certain companies identified by Mr. Bartko simply disclose, in their public filings, a range of years over which goodwill is amortized (e.g., 5 to 40 years). Based solely on this information, there is no basis for Mr. Bartko, or any reader of the financial statements, to determine how much of the goodwill reported by these companies is being amortized over 40-years versus a much shorter period of time. Finally, I note that one of the companies listed by Mr. Bartko as using a 40 year goodwill life, Qwest, Inc. (“Qwest”), is currently a defendant in litigation alleging misstatements of financial statements.

⁵⁰ Heckler, pp. 188-189

(d) **Triggering Events** - As stated in paragraphs 139 to 156 of my initial Rule 26 Report and in paragraphs 66 to 71 of my Rebuttal Report, I believe that triggering events had taken place by December 31, 2000, requiring the WorldCom management team to perform a cash flow analysis under FAS 121. I disagree with the opinions of the Defendants' Experts, each of whom claims that no triggering events had occurred prior to December 31, 2000, and, therefore, that management was not required to perform a cash flow analysis at that date.⁵¹

Mr. Bartko implies, specifically, that since "no other significant telecommunications company recorded an asset impairment related to its core network assets,"⁵² it was therefore acceptable for WorldCom not to have recorded any asset impairment in 2000 and 2001. This theory is flawed and implies that it is more appropriate for a Company and its management to follow the actions of its peer group than it is to analyze its own situation and to ensure that its financial statements are in accordance with GAAP.

I noted further, in reviewing the public filings of other companies within the telecommunications industry, that a number of telecommunications companies did, in fact, report impairment charges in 2000 and 2001. Specifically, Qwest's 2002 Form 10-K, filed with the SEC on January 13, 2004, states the following, in relevant part:

During 2002, 2001 and 2000, we recorded asset impairment charges of \$829 million, \$49 million and \$335 million.

⁵¹ Kirby Rebuttal Report, pp. 45-46; Bartko Rebuttal Report, pp. 7-9; Erickson Rebuttal Report, pp. 4-6

⁵² Bartko Rebuttal Report, pp. 7-9

Qwest's 2000 Form 10-K also includes a statement indicating that 1998 separation costs and asset impairment charges were \$129 million.

Ironically, another one of WorldCom's competitors, Sprint Corporation ("Sprint"), a company that the Defendants' Experts specifically name in their analysis supporting their conclusion on impairment, also reported an asset impairment charge in 2000. In reviewing Sprint's Form 10-K, filed with the SEC on March 13, 2001, it provides the following, in relevant part:

In the 2000 fourth quarter, Sprint completed its analysis of the valuation of various FON Group assets and investments resulting from its reassessment of the FON Group's business strategies in response to **recent changes in the overall telecommunications industry**. This analysis resulted in two asset impairment charges. The first was a \$238 million pre-tax charge primarily related to goodwill associated with Sprint's Parant operations. The second was an \$87 million pre-tax charge related to the write-down of an equity method investment. (Emphasis added)

Further, in its Form 10-K for the year ended December 31, 2001, filed with the SEC on March 4, 2002, Sprint disclosed the following under the heading "Restructuring and Asset Impairment," in relevant part:

In the 2001 fourth quarter, Sprint terminated its efforts to provide its Sprint ION consumer and business offerings and announced a restructuring of the remaining global markets division business. This decision resulted in a one-time charge of \$1.7 billion associated with asset write-offs, termination of supplier agreements, real estate leases, and other contractual obligations, as well as work force reduction severance costs.

- (e) **IPR&D** – Upon review of the Kirby Rebuttal Report, I note that Mr. Kirby fails to address the core issue relating to IPR&D, which is whether or not the specific charges taken by WorldCom as IPR&D truly met the definition of IPR&D under GAAP, as previously explained in paragraph 117 of my initial Rule 26 Report.
- (f) **Reliance on DoveBid and Matt Clark** - On pages 14 and 15 of the Erickson Rebuttal Report, Mr. Erickson states that I relied on reviews by, and evidence from, DoveBid and Matt Clark, President of DoveBid, to form my opinion that WorldCom’s \$3.1 billion of IPR&D charges, taken as part of the MCI acquisition, was improper. AAA, not DoveBid and Mr. Clark, performed the purchase accounting valuation work relating to IPR&D during the restatement. In reaching my conclusions, I analyzed AAA's work for reasonableness. Further, in addition to analyzing AAA's work regarding IPR&D recognized as part of the MCI transaction, I reviewed documentation relating to WorldCom’s, KPMG’s, and DoveBid’s independent considerations of AAA’s findings. I note that WorldCom, KPMG, and DoveBid all concurred with the conclusions reached in the valuation by AAA.
- (g) **Reliance on SOP 98-1** - Mr. Kirby makes the following statement in his Rebuttal Report:

It appears that one basis for restating the IPR&D is the restatement team’s decision to apply SOP 98-1 and guidance from the AICPA written in 2001 when neither was effective in 1998.⁵³

⁵³ Kirby Rebuttal Report, p. 62

Mr. Kirby has no basis, however, to conclude that *my* opinions, specifically relating to IPR&D, were based on applying SOP 98-1 or on guidance from the AICPA authored in 2001. It is unclear to me why Mr. Kirby includes the above statement in his rebuttal report. During *my independent analysis* of transcripts and documents supporting the restatement, I concluded, as previously stated, that IPR&D was misstated as a result of the Company failing to comply with FAS No. 2, *Accounting for Research and Development Costs*, FIN No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*, and FAS No. 86, *Accounting for Costs of Computer Software to be Sold, Leased or Otherwise Marketed*, **not** SOP 98-1. In fact, neither SOP 98-1 nor guidance from the AICPA authored in 2001 is even mentioned in my initial Rule 26 Report or in my Rebuttal Report.

(h) **Detection of Improper Capitalized Line Costs** - Mr. Kirby states that my conclusion that AA should have detected line costs capitalization fraud is based on hindsight and access to internal documentation and information that was not made available to the AA engagement teams as part of its audits during the relevant timeframe.⁵⁴ He further claims, in relevant part:

... that conclusion cannot be reached based on the information available to the [AA] auditors at the time of the audits.⁵⁵

My conclusion that AA should have detected improper capitalized line costs is **not** based on hindsight or upon access to internal documentation and information that was not made available to the AA engagement teams during the audits but instead on information

⁵⁴ Kirby Rebuttal Report, p. 11

⁵⁵ Ibid.

described in my initial Rule 26 Report, including, for example, in paragraphs 395, 410 to 417, 419 to 421, 450 to 451, 456 to 459, and 488.

VI. Unsupported Statements

46. The Defendants' Experts distort and misstate information that has been presented in my initial Rule 26 Report. Listed below is but a sample of these occurrences:

(a) On page 18 of the Kirby Rebuttal Report, specifically relating to two fraud risks identified by the audit engagement team, Mr. Kirby states:

Mr. Devor attempts to characterize these fraud risks as line cost specific, which was not the case.

- Nowhere in my report do I characterize these risks as relating to line costs specifically. I do note, however, that since Mr. Kirby has raised the point, both of these risks could be applicable to line costs. That conclusion is supported, for example, by comments made by Mr. Dick in his deposition for this matter, as excerpted in paragraph 408 of my initial Rule 26 Report.

(b) On page 19 of the Kirby Rebuttal Report, Mr. Kirby incorrectly paraphrases the following testimony from Mr. Melvin Dick:

As Mel Dick explained in his deposition, the engagement team referenced these work papers to be the areas where work was done that may have discovered whether the company was improperly

making top side entries in revenue and whether the company was improperly capitalizing expenses. (Footnote removed.)

- The pages of Mr. Dick's testimony cited by Mr. Kirby do not address any comments made by Mr. Dick relating to top-side entries or revenue.

(c) On page 22 of the Kirby Rebuttal Report, Mr. Kirby states:

Mr. Devor contends that WorldCom's line cost expense-to-revenue ratio should have been similar to those of AT&T and Sprint based on changes within the industry in 2000 and 2001, without giving any consideration as to how the ratios compared prior to 2000.

- Nowhere in my report do I explicitly or implicitly state that WorldCom's line cost expense-to-revenue ratio should have been similar to those of AT&T and Sprint.

(d) On page 22 of the Kirby Rebuttal Report, Mr. Kirby states:

Mr. Devor's assertion that the downturn in the telecommunications industry should have automatically resulted in the Company having a line cost expense-to-revenue ratio of around 50% is unfounded.

- Nowhere in my report do I explicitly or implicitly state "that the downturn in the telecommunications industry should have automatically resulted in the Company having a line cost expense-to-revenue ratio of around 50%."

(e) On page 31 of the Kirby Rebuttal Report, Mr. Kirby states:

As noted by Mr. Devor, KPMG's assessment of the Company's systems and internal controls took into consideration the requirements of Sarbanes-Oxley Section 404 ("SOX 404"). As SOX 404 was not signed into law until July 30, 2002, the Andersen auditors would not have considered the provisions and requirements of SOX 404. (Footnote removed.)

- Nowhere in my report do I explicitly or implicitly state that KPMG's assessment of the Company's systems and internal controls took into consideration the requirements of Sarbanes-Oxley Section 404. Upon review of the Management Letter dated June 3, 2003, which addresses the Company's systems and internal controls, I note that there is a *separate, distinct* section of this report that addresses Sarbanes-Oxley Section 404 which would seem logical since this report was written subsequent to the issuance of Sarbanes-Oxley. Mr. Kirby appears to be making a weak attempt to try to show that AA should not be held accountable for any of the system and internal control deficiencies identified by KPMG.

(f) On page 31 of the Kirby Rebuttal Report, Mr. Kirby states:

[Mr. Devor] criticizes the engagement team specifically for failing to obtain an understanding of the "EDS Ratable Accrual" when the engagement

team received a revised Corporate Unallocated schedule that included the item.⁵⁶

- Mr. Kirby distorts my opinion by taking it out of context and by, therefore, failing to address the entire conclusion I reach with respect to the EDS Ratable Accrual. Most notably, as previously stated in my initial Rule 26 Report, I conclude that for the third quarter of 2001, AA received a schedule detailing Corporate Unallocated revenue that **did not include an element related to EDS**. Shortly thereafter, AA received a second Corporate Unallocated revenue schedule for the third quarter of 2001 that included, expressly, a line item labeled “EDS Ratable Accrual.” AA failed to obtain an explanation for the change in the schedule.

(g) Mr. Erickson notes, on page 15 of the Erickson Rebuttal Report, the following:

Mr. Devor relied on faulty work by KPMG and DoveBid and therefore has no basis to concur with the reversal of the \$3.1 billion IPR&D charge.

- Mr. Erickson’s statement is inaccurate. KPMG and DoveBid did not perform any of the valuation work I have reviewed. KPMG is the independent auditing firm of the Company and, in light of the Sarbanes-Oxley Act of 2002, cannot provide valuation services to a publicly-held client. DoveBid was hired by KPMG to serve as a SAS No. 73 expert

⁵⁶ Kirby Rebuttal Report, p. 35

and was not engaged to perform the valuation by WorldCom. It was AAA who was hired by the Company to perform the valuation, and I have relied, in concluding on certain issues, on discovery produced by AAA, as noted in paragraph 45 (g) above. Mr. Erickson, in his Rebuttal Report, does not claim that the work of AAA in this area was faulty.

VIII. Errors and Omissions Addressed by Mr. Bartko

47. The MMDS impairment adjustment identified by Mr. Bartko at #11 of Schedule B to the Bartko Rebuttal Report was, as described therein, inadvertently listed in the third quarter of 2001 in Exhibit #5 to my initial Rule 26 Report instead of appropriately in the fourth quarter of 2001, as it was accurately described in my initial Rule 26 Report. Additionally, based on a formula error in the spreadsheet included as Exhibit #5 to my initial Rule 26 Report, the \$50 million “Reversal of SG&A” shown in the second quarter of 2001, although properly classified thereupon, was not included in the “Total” column aggregating all of the adjustments for 2001. Both of these items have been appropriately adjusted in the “Amended Exhibit #5” attached hereto. Neither of these items impacts or changes, in any way, the conclusions and opinions expressed in my initial Rule 26 Report.

48. With respect to the minor typographical errors listed by Mr. Bartko at #11 of Schedule B to the Bartko Rebuttal Report, review of such items does indicate that Mr. Bartko has correctly identified and characterized those errors. I note, however, that none of the items impact or change, in any way, the conclusions and opinions expressed in my initial Rule 26 Report.

49. Upon review of the remaining statements made by Mr. Bartko in Schedule B to his Rebuttal Report, I note these statements to be either (a) inaccurate, (b) simply a difference of opinion between Mr. Bartko and myself, or (c) of little relevance/consequence.

September 29, 2004

Harris L. Devor

Amended Exhibit 5
WorldCom Securities Litigation
Summary of Selected
Misstatements - Financial Statement Impact (in millions)

	1Q00	2Q00	3Q00	4Q00	2000 Total	1Q01	2Q01	3Q01	4Q01	2001 Total	1Q02
	75.00	150.00	828.00	407.00	1,460.00						
	59.00	77.00		70.00	206.00						
	(22.50)	(22.50)	(22.50)	127.50	60.00	(22.50)	(22.50)	(22.50)	(22.50)	(90.00)	
	111.50	204.50	805.50	604.50	1,726.00	(22.50)	(22.50)	(22.50)	(22.50)	(90.00)	
	370.00	184.00		120.00	674.00						
	33.60				33.60						
	515.10	388.50	805.50	724.50	2,433.60	(22.50)	(22.50)	(22.50)	(22.50)	(90.00)	
						544.00	560.00	743.00	841.00	2,688.00	797.00
						227.00	50.00	(50.00)	100.00	327.00	(12.00)
						771.00	610.00	681.00	929.00	2,991.00	785.00
	(75.00)				(75.00)						
				(407.00)	(407.00)						
						(50.00)				(50.00)	
								(1.00)	(18.00)	(19.00)	(18.00)
	(75.00)	-	-	(407.00)	(482.00)	-	(50.00)	(1.00)	(18.00)	(69.00)	(18.00)
	440.10	388.50	805.50	317.50	1,951.60	748.50	537.50	657.50	886.50	2,832.00	767.00

