Walt Pavlo’s MCI Scams/Frauds

Walt Pavlo joined MCI in 1992, and rapidly became second in command at the company’s Finance or long-distance collections unit as is documented in the Manipulation of MCI’s Allowance for Doubtful Accounts. Walt left MCI in 1996, and ultimately resigned in early 1997. During the four years and just afterward, he participated in several frauds on MCI and on customers who were dealing with MCI. The frauds against MCI and the frauds he perpetrated against others are detailed here. Walt’s motivation, opportunity for and rationalization of these frauds are also analyzed here.

Walt initially became caught up in an attempt to cover up the fact that many of the accounts receivable from companies that resold MCI’s telephone connection time to consumers were far past due, and collection ultimately unlikely. Senior executives at MCI were reluctant to show the true state of MCI’s bad debts because they wanted to isolate the company’s earnings and assets in order to attract a favorable takeover bid buy-out of shares that would make them rich. Consequently, although total bad debts approached $120 million, upper management encouraged MCI finance staff to use a number of techniques to minimize the visibility of the problem and limit the annual write-off of bad debts to only $15 million. The minimization techniques included:

Restructuring a $55 million account receivable into the form of a promissory note—but one without collateral—so that the amount would not appear old in an aging analysis.

Restructuring other bad debts into notes in a similar fashion.

Lapping—applying checks from one creditor to the account of another to make it appear that bad accounts were being paid. The accounting system was notorious for its delays and inaccuracies, so if a customer complained about his account, it was “fixed” by a transfer from another customer’s account with only a few accounting staff knowing what was going on.

Disappearing an account—an extension of lapping where the balance on an account is eliminated by spreading it into the accounts of others through lapping.

Recording “cash in transit” and using it to reduce problem accounts receivable—large payments of $50-60 million per month from WorldCom, for example, were picked up by a clerk, faxed in, and recorded as a debt to cash in transit with the credit to a problem account. When the real check arrived, the entries would be reversed and proper entries made, but the interval of a few days allowed some “management” of accounts receivable.

Misapplying vagabond payments—millions of dollars per month were sent in which MCI’s inefficient accounting system could not figure out which account the money belonged.

Walt was encouraged to “make his bad debt aging numbers,” as he says in his own words: “Instead of gaming the system, MCI Finance had turned the system into a game, going so far as to send around a monthly internal report, grading departments on how well they did in sticking to their ‘aging’ numbers. Pavlo got a hearty pat on the back from his supervisors, and he passed on the favor by praising his staff for their heroism in battle. Walt was seen, and saw himself, as a “solutions provider” for MCI in managing the exposure to and of its bad debts.

One of Walt’s customers, Harold Mann, introduced him to Mark Benveniste, the owner of a company called Manatee Capital, who had a proposal for “factoring” MCI’s accounts receivable—paying MCI up front for a portion of certain receivables, and collecting the entire receivable when it was paid. MCI would get their money much faster in return for a factoring discount or fee. It sounded great except that Manatee would not do the deal unless MCI guaranteed any accounts that proved to be uncollectible. In Walt’s terms, Manatee would, in effect advance or loan money to MCA’s clients to allow them to pay early, provided MCI guaranteed these loans—and Walt was sure that MCI wouldn’t.

Nonetheless, as time went on, Walt was under increasing pressure to “make his numbers” in terms of collections which meant hiding overdue accounts receivable. Hoping a solution would emerge, Walt agreed to meet with Manatee’s bankers from the National bank of Canada. The meeting went well. Walt felt great—in charge—and he continued discussions with Benveniste over the coming months until the day came to sign off the legal documents. Although he had not discussed the Manatee arrangements with anyone at MCI, and he knew that only company officers were authorized to sign such documents, he went ahead anyway and signed the bank documents committing MCI to guaranty up to $40 million if Manatee could not collect. The bank took Walt at his work after checking with a switchboard operator that he was employed at MCI. Walt’s bosses didn’t find out until it was too late, and by then they were on the hook for millions.

Needless to say, Walt took the factoring scheme forward within MCI under the banner of the Rapid Advancement Program for financing sales. It made him extremely popular with both the sales and collections people. Walt was a hero, and no one investigated how it worked sufficiently to question the economics involved or uncover the MCI guaranty.

During one of his meetings with Harold Mann, Walt told Harold that Robert Hilby, whose shady MCI reseller operation, Simple Access, had offered Walt a job, and that he was considering it. Not wanting to lose Walt as a potential co-operator within MCI, Mann proposed that Walt play “hardball” with Hilby by threatening to cut him off from the network (essentially stopping his business) unless he came up with a $2 million payment to eliminate his overdue account. Mann further suggested that Walt tell Hilby that Mann would help him raise the money for a fee. Mann had earlier told Walt that he would make their relationship “worth his while,” so Walt told Hilby the MCI’s new zero tolerance policy would require him to pay up, and that he should talk to Mann. Hilby did call Mann, who told him that Mann would take over Hilby’s company’s $2 million debt in return for an up-front payment of $300,000, plus monthly payments to Mann until the $2 million was fully paid. Walt questioned Mann about where the money was actually going to go, and Mann proposed that if Walt would write off or “disappear” the $2 million account, he and Walt could split the money. Mann rationalized this saying: “…if we don’t pay MCI, it’s not really out anything. I mean, you can’t steal money MCI wasn’t going to get anyway, right?” Walt protested, but Mann countered: “You guys are cooking the books over there and you know it. Everybody cheats. That’s the way the world works.”

Walt decided to think about it. It “was no worse than what MCI customers were doing to MCI, or what MCI was doing to its shareholders. Embezzlement was the legal term for Mann’s proposal. But it wasn’t like he was going to trick old ladies out of their savings or bash anyone over the head. It was victimless embezzlement—unless you counted hustlers as victims.” In the end, Walt decided to go for it.

Walt went on to play hardball with other MCI customers. They would pay Mann and his company, Walt would make the amount owing MCI disappear, and he and Mann would split the money. At least that was how it should have worked. Ultimately Walt found that Mann was taking more than his share. In addition, Walt had to work through others in MCI Finance, who became accomplices. Unfortunately for Walt, one of these decided to deal with Mann directly, and Walt lost control of the operation. Ultimately, between the bilked clients, and the National Bank wanting its guaranty, the house of cards that Walt built came tumbling down.