

# The Parmalat Scandal

Presentation Found OnLine



# Parmalat

- \* Parmalat is a huge and quite well known dairy product company in Italy.
- \* It is in charge of almost 50% of the dairy products in Italy. But this company does not only run in Italy, but it is an international business, which is what makes the scandal a huge affair.
- \* The company's founder and CEO is a Calisto Tanzi; he is the son of a man who ran a small bakery, but as he grew older, he change this to an international business in 1961

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- \* Quick to embrace new pasteurization technology that allowed milk to stay fresh for month without refrigeration.
- \* Parmalat's distinctive cartons soon become fixture in stores across Italy, and ultimately conquered Europe and much of the world.
- \* Tanzi also discovered the power of sports marketing and plastered the Parmalat name on ????

# Parmalat Ethical Code of Conduct

Parmalat's Code of Conduct is divided into 3 parts:

- \* Mission and Values, which sets forth the fundamental principles of the Parmalat corporate culture, thereby creating the foundation for appropriate implementation of individual policies and procedures.
- \* Rules of Ethics, which outlines the areas of responsibility and the behavior that should be followed to remain consistent with the Group's values and stresses the importance of complying with statutory requirements.
- \* Implementation, Control and Updates, which identifies the parties responsible for implementing the Code of Ethics and explains in practical terms how the Code's values and rules should be implemented and made part of daily practice.

# Parmalat Scandal in Brief

- \* In 1997, company entered into financial market by various acquisitions.
- \* By 2001, many of the acquisitions were producing losses, then company started using derivatives.
- \* In Feb 2003, CFO announced issue of bond of 500 million Euros, which raised the question against company debt payment.
- \* CFO Fausto Tonna resigned and was replaced by Alberto Ferrasis.
- \* In Sept 2003, fund raising effort of 300 million Euros was dropped.
- \* Company share was depreciated significantly as a result raised over transaction with mutual fund Epicurum.
- \* The company not able to pay debt of 150 million Euros.
- \* Tanzi resigned as chairman and was replaced by Mr. Bondi.
- \* Bank of America released a document showing 3.95 billion Euros in Bonlat's bank account as a forgery.

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- \* In late Dec, company officially declared bankruptcy and admitted there was hole of 8 billion Euros but did not give any explanation.
- \* Tanzi was charged for financial fraud and money laundering
- \* Police arrested five executives including Fausto Tonna.
- \* Later, by the auditor of administration, determined that total debt amounted to 14.3 billion Euros which is almost eight times the sum originally stated.
- \* Many of the company subsidiary become insolvent
- \* Feb 2004, Tanzi admitted that he diverted 500 million from Parmalat to his daughter's enterprise, Parmatour and elsewhere.
- \* Tanzi's daughter and brother also arrested.
- \* Tanzi was sentenced to 10 years in prison for fraud relating to the collapse of the dairy group. The other seven defendants, including executives and bankers, were acquitted.

# Core Issues that are Violated

- \* Parmalat lacked board independence.
- \* Parmalat is family owned company of Tanzi and Sons, Tanzi is the founder and chairman and CEO of the company.
- \* Parmalat was also weak on the composition of key board committees.
- \* Parmalat does not have sufficient number of independent directors as per the Sarbanes-Oxley (SOX) regulations.
- \* Both audit committee and remuneration committee is completely dependent on Tanzi family.





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- \* Wrong disclosure of financial report. The company was facing debt which is more than double what was disclosed in the financial report.
- \* As per SOX, board should have more than 50% independent directors but in Parmalat, the board was comprised of 3 independent directors; remaining are executive directors out of which only one is an independent director.
- \* Lack of monitoring company operation by the board of directors.
- \* Parmalat had 3 internal auditors which were appointed by the company and neither of them appointed by minority shareholder in order to protect their rights.
- \* Lack of rotation of external auditor, as per Italy corporate governance – external auditor should be rotated after 3 years.

# Roles of Board Of Director, Independent Directors, Senior Management, etc.

- \* **Chairman and CEO: Calisto Tanzi**, who is the founder, chairman and CEO of the company
  - \* No role distinction between CEO and Chairman
  - \* Without understanding the company financial condition, acquired many companies in the food industry which resulted in financial losses.
  - \* To hide losses, manipulated financial report
  - \* Diverted 500 million Euro from company reserve to Parmatour (which belongs to his daughter) without taking approval from shareholders and stakeholders.
- \* **CFO: Fausto Tonna**
  - \* Completely dependent on the company internal auditor, not even access to company books which was handed by an internal auditor.
  - \* Announced a bond issue of 500 million Euro, without communicating to shareholders, stakeholders, and other personnel.
- \* **Independent Directors:** Begin independent directory of the company did not question the company malpractices.

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- \* **Internal Auditor**

- \* Manipulation of balance sheet by reducing debt to half, in order to give company better financial picture.
- \* In order to cover losses, post profit by representing that company involved in aggressive acquisition.

- \* **External Auditor:** Lorenz Penca of Grant Thornton auditing firm, remained chief auditor for 9 years; even Italian government have rotation of role after 3 years.

- \* Not an independent director as related to one of the company subsidiary.
- \* Also involved in company fraud and laundering activities
- \* Company has nonexistent account in Bank of America. Grant Thornton claimed that this account is existing in order to show third part confirmation.

- \* **Senior Management:** not perform efficiently to minimize the risk of company and did not question activities of Executive Director.

- \* **Executive Directors:** company had 7 executive directors, all of them equally involved in company malpractice. They also received compensation for their involvement.

# Other Parties

- \* **Institutional Investors:**

- \* Did not find the company's actual financial condition and invested 150 million Euro.
- \* Helped the company to go public, raised funds from the market.

- \* **Bank of America, Citigroup and J. P. Morgan Chase:**

- \* Largest bond placers helping Parmalat to fake balance sheets and hide their actual financial condition.
- \* Bank of America gave higher rating to Parmalat bonds based on the fake account which never existed.
- \* Citigroup and J. P. Morgan helped Parmalat to build a fraudulent accounting practice.

- \* **Deloitte and Touche: Auditing Firm**

- \* Even after rotation of external auditor in 3 years, agreed to continue Lorenz Prenca to be chief auditor of the company.
- \* Allowed Parmalat to follow wrong accounting practices and help them to cover up fraud
- \* Regulators were also responsible as they were not able to detect pattern of negligence and fraud.

# Failure of Internal Control Management and Risk Management

- \* Internal control and risk management are required to improve the quality of financial reporting.
- \* These are mainly done by chief executive, chief finance officer and auditing firms.

Parmalat's code of conduct defines internal control and risk management as follows:

- \* Verification of the internal control system is working effectively and supports the Board of Directors in defining guidelines for the internal control system. It also supports the Chief Executive Officer in defining the tools and methods needed to implement the internal control system.
- \* Risks entailed by identifying and adequately monitored and updated on a regular basis, and negative elements that can threaten the organization's operational continuity must be assessed carefully and protections adjusted accordingly.
- \* In Parmalat scandal, each auditor, executive directors, senior management, bankers, and auditor firms are involved.
- \* This ultimately leads to failure of internal controls and poor risk management.

# Ethical Issues

- \* The crimes that have been committed are not only illegal, but they go against appropriate behavior; what has been done is completely wrong.
- \* They have not only lied and shown a form of dishonesty, but the company has put a lot of people's careers at stake.
- \* The company, as mentioned before, has made fake profits and built fake subsidiaries in order to gain assets and increase accounts.
- \* They have put a lot of investors and many shareholders under pressure. It does not only financially cause damage, but it shows how the company's CEO lacks integrity and commitment.
- \* Tanzi has tried to go the easy way to earn profit, and unfortunately, he put not only himself but many of his colleagues, friends and family in a big black hole.
- \* The case explained that the BOD and CEP are lacking in accountability, supervisory skills, and strategy formulation.
- \* Raised question as to whether the banks are diligent enough while dealing with Parmalat.
- \* Role function and power of regulators and are they sufficient enough to monitor and enforce guidelines.

# Future Steps

- \* Secure electronic confirmation solutions, like the one offered by Capital Confirmation; streamline the confirmation process by replacing the paper-based confirmation process with a secure electronic confirmation process.
- \* The auditors can be hired from a specific firm and be hired under a contract, and there could be people alternating every specified period.
- \* The Bank should be more precise when giving out loans to businesses, and they should have government officials checking to make sure all the people working at the bank are also honest and not doing any illegal work.
- \* The government should have strong corporate governance measurements and comparison with the profit.
- \* Imposing strict regulation on independent directors, executive director and auditors.
- \* Ontario Securities Commission can pay closer attention and they have a site where it warns investors and other shareholders of what to look for in companies when investing in them, and so investors should also pay attention to that.