The Parmalat scandal: Europe's ten-billion euro black hole

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The much publicized unraveling of Italy's eighth-largest industrial empire, the food giant Parmalat, has caused reverberations around the world. Not only has the flagship Italian producer of some of the most popular dairy products, cookies and beverages collapsed, and its founder Calisto Tanzi been jailed awaiting formal charges (with nine other executives likely facing indictments for corporate fraud), but several major players from the world of international finance are also under scrutiny.

Workers and investors large and small stand to lose millions, while the Berlusconi government seeks to use the scandal to its own political advantage.

Parmalat, which is headquartered in the central Italian city of Parma, was, like most Italian firms, launched as a family business. The *capofamiglia*, Calisto Tanzi, began expanding the business shortly after his father's death in 1961, transforming it from a small sausage and cheese shop into an international food and beverage concern. Along the way, he formed close relationships with the Christian Democrats, who governed Italy throughout the postwar period.

Today Parmalat is a leading producer of such items as pasteurized milk, cheese, yogurt, cookies, juice and iced tea, most of which are sold under a variety of names in different countries. Well-known names in North America include Archway and Mother's cookies, Olivina margarine, Black Diamond and Balderson's cheeses, and Astro yogurt.

Although formal charges have not yet been brought, the elder Tanzi has already admitted that he secretly siphoned off at least 500 million euros ($630 million) from Parmalat to a family-owned subsidiary. Tanzi has resigned from his position within the leadership of *Confindustria*, the powerful employers association.

The Italian judge presiding over the case (brought by the US Securities and Exchange Commission), citing the possibilities of flight and destruction of evidence, has denied Tanzi's request to leave jail and remain under house arrest until trial.

The types of fraud allegedly carried out by Tanzi and his executive cohorts are myriad, with some bearing a similarity to those of Enron, while others are of a more rudimentary character. According to the charges, numerous shell companies were set up to generate fake profits for Parmalat and subsidiaries. In addition, Parmalat's finance director, Fausto Tonna, has told interrogators that he participated in a "cut and paste" forgery, in which a document with Bank of America letterhead was scanned and then added to a document verifying a deposit account with that bank holding over $4.98 billion. The document was then passed through a fax machine several times in order to appear authentic.

In any large business under global capitalism there is an enormous pressure to "perform" in the global market, to bring favorable returns that meet investors' expectations. Not surprisingly, the details that have surfaced thus far indicate that Parmalat's fraudulent activities really "took off" when its stock went public in 1990.

There were two changes that caused Parmalat's schemes to be exposed. First, the firm changed its outside auditor. According to Italian law, this must be done every nine years, and in 1999 Parmalat changed from the up-and-coming firm Grant Thornton to DeLoitte and Touche, one of the "big four" auditing companies.

Although the law is clear on the nine-year rule, it has no provision against a parent company using the same auditor for concerns that it spins off. Grant Thornton, which had been struggling for years to compete against giant multinational firms, was desperate to keep one of its most valuable and high-profile clients. Rather than lose Parmalat, the accounting firm suggested that Parmalat spin off its travel concern and a few other businesses, and allow these to remain under its watch.

In this way, Parmalat could maintain a fair degree of propriety in its main division, which was now monitored by DeLoitte and Touche, and use the spun-off concerns to generate illicit payments to the parent firm. The executives would create debts owed to Parmalat by the subsidiaries, and the latter would create false accounts from which to pay the debts. Grant Thornton accountants then presented records of these transactions to DeLoitte accountants, who rubber-stamped most of them.

Numerous press reports indicate that Grant Thornton's accountants were intimately aware of the shell games being played by Parmalat's executives. No doubt, the pressures to compete exerted on both companies by global markets drove the two into each other's arms.

Shell companies and "cut and paste" forgery were combined with more traditional fraud, such as the falsifying of sales figures. In one particularly flagrant case of "cooking the books," the Cayman Islands subsidiary Bonlat claimed to have sold enough powdered milk *in one year* to Cuba to produce 55 gallons of milk for each and every citizen of the small island nation.

The second and, it appears, key event leading to Parmalat's exposure came when Calisto Tanzi and his son Stefano, who was a top executive at several of the family's concerns, met December 9 with the private equity firm Blackstone Group in New York to discuss selling all 51 percent of the family's stake in the food empire. During the conversation, in preparation for the opening of their books to a transition team from Blackstone, the Tanzis let slip that the cash on hand was somewhat less than the 3 billion euros listed in the company's annual report. They admitted that, in fact, there were hardly any liquid assets, and the company was 10 billion euros in debt.

It is as yet not clear how the US Securities and Exchange Commission (SEC) was alerted to these discrepancies, but within a fortnight the company was under bankruptcy protection, the Tanzis were in custody, and the company's stock had fallen to pennies a share. (Italian authorities had already been investigating the company, following up on the one instance in which Deloitte amended a tax return due to undocumented income. The Italians had, however, issued no formal complaint.)

According to the attorney for the elder Tanzi, his client is "a broken man" who knew nothing about finance and simply wanted to provide for himself and the community. There are, however, a multitude of victims in the scandal.

First, there are the 36,000 employees whose jobs are in danger. Second, there are the producers of raw materials. Recent reports state that dairy farmers in both Brazil and Australia are awaiting payment for milk already delivered.

Third, there are investors both large and small. In addition to the now worthless stock, there are $1.5 billion in bonds outstanding. The Tanzi family became well known within investors' circles for their visits, which were made to promote—and, it now appears, lie about—the health of Parmalat in advance of bond and note offerings. In a cruel irony, the receipts from one such issue, which was controlled by Citibank, were deposited in an account named "*Buconero*," or "black hole."

The government of Italian Prime Minister Silvio Berlusconi is seizing on the Parmalat scandal to argue that the governors of the Bank of Italy have failed in their duties as overseers of commerce, and that the bank should henceforth be governed by a body to be appointed by the prime minister.

At the same time, Berlusconi, a right-wing, billionaire media mogul, is pressing for legislation to remove penalties on accounting firms that commit fraud.

In an attempt to downplay the extent to which corruption and fraud have penetrated to the heart of global capitalism, commentators have seized on the fact that many of Parmalat's former top executives are related to claim that the scandal is simply a case of a "family firm" failing to adhere to good corporate governance practices. Not surprisingly, Parmalat's top executives are going along with this story, insisting they were only acting "under orders" from the *padrone*.

The scandal, however, has engulfed other major firms. There are the accounting firms—Grant Thornton and Deloitte and Touche, and the banks—Citicorp and Bank of America. Citicorp is directly linked to the $1.5 billion in bad debt, and while Bank of America many not have known of the "cut and paste" forgery mentioned above, it has, since 1999, assisted Parmalat Venezuela in obtaining credit to the tune of $170 million.