BT Italia engulfed in "accounting irregularities" scandal

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British Telecom's (BT) Italian arm, BT Italia, is under investigation for so-called "accounting irregularities."

Italian prosecutors have opened a criminal investigation into BT Italia. Fabio De Pasquale, the Milanese prosecutor working on the case, said the probe was focused on allegations of "false accounting and embezzlement," but would not comment further when pressed.

BT Italia is accused of using a financial transaction called "factoring"—a form of debtor finance, in its Italian operations. Factoring involves a business selling its accounts receivable (invoices) to a third party at a discount. What appears to have occurred at BT Italia is that they over-reported their earnings for years, while they borrowed money against unpaid debts and used that money to then pay the company's own suppliers—thereby masking their underlying cash position.

Britain's Serious Fraud Office has yet however to intervene in the affair, stating, "We have noted the news. We cannot confirm or deny our interest."

Last October, BT announced a warning to investors and the markets that what they termed "inappropriate management behaviour" and equally unspecified "accounting irregularities" at their Italian operation, would cost approximately £145 million to rectify.

However in late January this year, on the verge of releasing their third quarter results, BT announced that after further investigation by auditors KPMG, the BT Italia affair would now cost somewhere in the region of £530 million to correct. Their shock profit warning was compounded by a downturn in BT's British fortunes, uncertain market conditions and the loss of British and European state contracts.

Upon the announcement of profit warnings, BT's share price collapsed, wiping off £8 billion from their FTSE 100 company share valuation. Forecasts for BT's next two operating years have been cut. As a result, profits are estimated to be £300 million lower than previously expected. BT's ability to outbid Rupert Murdoch's Sky for the broadcasting rights to televise lucrative European Champions League soccer may be affected.

BT has a vast global presence with operations in 180 countries. Earlier this month, it was revealed that Deutsch Telekom—the German company that is BT's largest single shareholder—is set to announce in its full-year results on March 2 a £3 billion write-down on its shareholding.

One after another household names from the blue chip FTSE100 have come under investigation for alleged criminal business practices designed to secure profits and market dominance. The investigation into BT Italia follows hot on the heels of the record fine of Rolls Royce aerospace for corrupt activities.

Not worried by the consequences and knowing no serious punishment will be meted out, BT merely suggested a "need to reflect" on why the illegal behaviour was not spotted by BT Italia's management, the wider BT group, or even by its auditors.

BT's London based senior management claim they were initially alerted by a whistleblower to wrongdoings at their Italian division last summer. BT Italian chief executive Gianluca Cimini and chief operating officer Stefania Truzzoli have since left the business, after their initial suspension by BT.

In business circles, BT's serious profit warning was deemed far more critical than any alleged crimes committed at BT Italia. Bloomberg's Gadfly column typically bemoaned how "Britain's largest provider of communication services used the bad tidings from Italy to bury even worse news: a profit warning.”

In light of the scandal BT’s remuneration committee are to examine bonus payments, previously paid to leading directors based on profit targets that were probably never achieved in the real world. Any such moves may well require the paying back of such payments given to senior Italian executives, two of whom were initially suspended and have now left the business. In addition, BT’s European head, Corrado Sciolla resigned from his post shortly after the scandal broke.

BT chief executive Gavin Patterson said BT was investigating its other overseas interests, but believed the problem was specific to Italy. Patterson argued that the BT Italia affair involved a very complex set of manipulations, involving lots of people over many years. He stated, “This is a very disappointing situation. It’s been going on for a number of years. It’s a complex situation that’s involved a lot of people and a business we thought was profitable but in truth was probably unprofitable for a number of years.”

Patterson alone earned some £5.3 million during 2016, including an annual bonus worth over £1 million, and share options worth another £3 million. BT’s international finance director, Tony Chanmugam, due to step down in the summer, received £2.8 million with a further £587,000 bonus.

BT and their auditors PwC have not offered as yet any explanation as to why and how the wrongdoing at their Italian operations apparently continued year after year, unabated until recently. BT’s chief executive said only, “We need to take stock and understand why the company’s management, internal audit and auditors failed to spot this over time.”

The crisis at BT has a widespread knock-on effect within the UK population, as some 700,000 of its 827,000 shareholders own 1,600 shares or fewer.

In the summer of 1982, the Thatcher Conservative government sold off what had been until 1977 an integral part of the state-owned Post Office. The Carter Report was designed to begin breaking up state monopolies and to introduce free market principles. It separated British Telecommunications, trading as British Telecom, off from the Post Office. In November 1984, more than 50 percent of British Telecommunications shares were sold to the public, in what was at the time the largest share issue in the world. Within a decade, the government’s remaining shares in British Telecommunications were sold off, raising £5 billion. A third flotation in July 1993 saw 750,000 new shareholders to the company taking out a stake.

What had previously been commonly termed the “country’s crown jewels,” i.e., gas, water, electricity, the telephone system and later the train transportation system—British Rail—were all privatised, with prices and bills for consumers skyrocketing.

BT Italia was originally formed by British Telecom in the late 1990s, together with a number of other regional privately owned media corporations. These included Mediaset, owned by former Italian prime minister Silvio Berlusconi, as the Italian government aped the British example and privatised whole swathes of their economy.

The scandal surrounding business practices at BT Italia compounds protracted issues over the company’s huge pension deficit, which has recently climbed to approximately £7 billion. According to a report published last year by MSCI, which analysed the health of more than 5,000 company pension funds across the globe, BT has the second-worst funded pension scheme in the world. The dire state of its pension system meant that BT has not been able to be sold or merged. The financial chicanery revealed at BT Italia is a culmination of this process, with new criminal means devised in order to enrich a few major players.

BT joins other formerly state-owned companies like British Steel and British Aerospace that were privatised during the 1980s and have since come to grief. The orgy of more than 50 privatisations of public services and utilities that occurred during the Thatcher and Major Tory administrations has been a disaster for the consumer and a boon for its richest shareholders.