Royal Ahold—A Dutch Company with U.S.—Style Incentives

According to the Royal Ahold company profile:

Ahold is a global family of local food retail and foodservice operators that operate under their own brand names. Our operations are located primarily in the United States and Europe. Our retail business consists of retail chain sales, sales to franchise stores and sales to associated stores. The store format that we primarily use is the supermarket. Through our foodservice operations we distribute food, and offer services and expertise to restaurants and hotels, health care institutions, government facilities, universities, sports stadiums and caterers.

In 2003, our consolidated net sales were Euro 56.1 billion, our retail trade and foodservice businesses representing approximately 70% and 30% of this total, respectively. At the end of 2003, Ahold’s average number of employees in full-time equivalents totaled 256,649 worldwide.

The company is listed on the Dutch and U.S. stock markets. Ahold was one of the first big Dutch or European companies to implement U.S.-style large stock option compensation schemes for its managers, and that may have led to its downfall in late 2002 and early 2003.

In 2002, Ahold claimed to be the world’s third largest retail group. However, due to unfavorable market conditions the company had lower than expected U.S. sales. For year, the company outperformed its peers, expanding aggressively, but the expansion left Ahold with $12 billion in debt, one of the largest in the sector. In July, the company revised its full year EPS growth target to 5-8 percent. The company’s figures revealed a 6% fall in its core foodservice business in the United States, and 10% fall in the value of Ahold shares. In October, some investors suggested that Ahold’s chief executive, Cees van der Hoeven, leaked the sales numbers to certain analysts and the share price suffered a first drop.

In February 2003, the company announced that net earnings and earnings per share would be significantly lower than previously indicated for fiscal 2002. In the same month, the company disclosed that its financial statements for fiscal 2000 and fiscal 2001 would be restated. A press release indicated that the restatements primarily related to overstatements of income related to vendor promotional allowance programs at its subsidiary, U.S. Foodservice. Managers of the subsidiary booked much higher promotional allowances (provided by vendors to promote their merchandise) than the company was to actually receive. Ahold estimated the amount of the overstatement to be close to $500 million.

Other irregularities under investigation were the legality and accounting treatment of questionable transactions at the Argentine subsidiary, Disco. Certain joint ventures were consolidated based on misrepresentations to Ahold’s auditors. CEO Cees van der Hoeven and CFO Michiel Meurs resigned immediately. The SEC and the Dutch stock exchange Euronext investigated the irregularities, requiring Ahold to present documentation from 1999 to 2003. The company said the irregularities only began in 2001.

In May 2003, Ahold named a new CEO, former executive of Ikea, Anders Moberg. While waiting for the results of the investigations, the company started a restructuring program that involved divesting Indonesian and South American operations. The company also entered into an emergent credit facility from a syndicate of banks.

In May 2003, a forensic report from PricewaterhouseCoopers (PwC) indicated a total overstatement of pre-tax earnings of approximately US$880 million. Offsetting the bad news of the report, Ahold said that no evidence of fraud was found at other operations. Later in the same month, Jim Miller, president and CEO of U.S. Foodservice, resigned from his position. Ahold considered that he was not implicated. In July 2003, the regulator’s inquiry ended and Ahold disclosed additional $84.4 million in accounting irregularities, bringing the total overstatement to $1.1 billion. The company declined to reveal when or where the latest accounting irregularities occurred.

Ahold’s auditors, Deloitte & Touche, insisted that they warned the firm about problems in its U.S. unit. The auditors also pointed out that Ahold did not supply them with full information. These problems were never disclosed to the public. Deloitte said during the inquiries that they identified the problems during the 2002 audit and gave the details to Ahold’s board immediately before the audit was concluded in 2003.

In January 2005, nine executives were charged by the U.S. Securities and Exchange Commission (SEC) with participating in a scheme of accounting fraud at U.S. Foodservice. All executives were accused of approving documents that claimed U.S. Foodservice was owed millions of dollars more in promotional allowances than was actually the case. Former U.S. Foodservice chief marketing officer Mark P. Kaiser faced charges of conspiracy and fraud, along with former chief financial officer Michael Resnick. Executives Timothy J. Lee, and William F. Carter pleaded guilty to similar charges in 2004. All the executives have been named in a civil case involving John Nettle, former vice president of General Mills; Mark Bailin, former president of Rymer International Seafood; and Peter Marion, president of Maritime Seafood Processors. Nettle confirmed to the auditors false amounts owed by his company to U.S. Foodservice in 2001. Bailin and Marion benefited by buying U.S. Foodservice stock in 2000, ahead of the company’s announcement that Royal Ahold was acquiring it.

According to SEC Litigation Release No. 18929 dated October 13, 2004, the misdeeds were described as:

THE EARNINGS FRAUD AT U.S. FOODSERVICE

With respect to the fraud at U.S. Foodservice (“USF”), Ahold’s wholly-owned subsidiary based in Columbia, Maryland, the Commission’s complaint against Ahold alleges as follows:

A significant portion of USF’s operating income was based on vendor payments known as promotional allowances. USF executives materially inflated the amount of promotional allowances recorded by USF and reflected in operating income on USF’s financial statements, which were included in Ahold’s Commission filings and other public statements.

USF executives also provided, or assisted in providing, Ahold’s independent auditors with false and misleading information by, for example, persuading personnel at many of USF’s major vendors to falsely confirm overstated promotional allowances to the auditors in connection with year-end audits.

The overstated promotional allowances aggregated at least $700 million for fiscal years 2001 and 2002 and caused Ahold to report materially false operating and net income for those and other periods.

THE JOINT VENTURE SALES AND OPERATING INCOME FRAUD AHOLD AND THE TOP OFFICERS

With respect to the fraudulent consolidation of joint ventures, the Commission’s complaints against Ahold, van der Hoeven, Meurs, and Andreae allege as follows:

Ahold fully consolidated several joint ventures in its financial statements despite owning no more than fifty percent of the voting shares and despite shareholders’ agreements that clearly provided for joint control by Ahold and its joint venture partners. To justify full consolidation of certain joint ventures, Ahold gave its independent auditors side letters to the joint venture agreements, signed by Ahold and its joint venture partners, which stated, in effect, that Ahold controlled the joint ventures (“control letters”).

However, at the time or soon after executing the control letters, Ahold and its joint venture partners executed side letters that rescinded the control letters—and thus the basis for full consolidation (the “rescinding letters”).

Meurs signed all but one of the control and rescinding letters on behalf of Ahold. He also knew that Ahold’s auditors were relying on the control letters and were unaware of the existence of the rescinding letters.

Van der Hoeven cosigned one of the rescinding letters and he was at least reckless in not knowing that the auditors were unaware of its existence.

Andreae participated in the fraud by signing the control and rescinding letters for ICA, Ahold’s Scandinavian joint venture, and by knowingly or recklessly concealing the existence of the ICA rescinding letter from the auditors.

As a result of the fraud, Ahold materially overstated net sales by approximately EUR 4.8 billion ($5.1 billion) for fiscal year 1999, EUR 10.6 billion ($9.8 billion) for fiscal year 2000, and EUR 12.2 billion ($10.9 billion) for fiscal year 2001. Ahold materially overstated operating income by approximately EUR 222 million ($236 million) for fiscal year 1999, EUR 448 million ($413 million) for fiscal year 2000, and EUR 485 million ($434) for fiscal year 2001.

In February 2004, Ahold announced its plans with regard to the recommendations of the Dutch Tabaksblat Committee on Corporate Governance. In order to restore trust in its governance processes, thirty-nine executives and managers were terminated, and an additional sixty employees faced disciplinary actions of different degrees. Members of the Corporate Executive Board will serve for a predetermined period, in which continuity and succession have been taken into account. According to the company, these measures will result in significant improvement in transparency and a far-reaching increase in the power of its shareholders.

The company is also replacing a decentralized system of internal controls with a one-company system with central reporting lines. The most important control, however, is making clear to Ahold’s people what the company expects of them going forward. As a first step in this process, they initiated a company-wide financial integrity program. This is aimed at 15,000 managers, the entire middle and top ranks of the organization. The goal of the program is to underscore the importance of integrity and to help guide Ahold’s people to apply its corporate business principles.