Monsanto's Roundup Incentive Program - Lack of professional skepticism is costly

Prior to its acquisition by Bayer in 2018 for $63 billion, Monsanto was a leading global provider of agricultural products for farmers. It was the world's largest seed company with 90 percent of the world's genetically modified seeds either sold by Monsanto or by companies that used Monsanto genes. Its value proposition was higher yields, primarily from large acre crops, through genetic traits, seed, and herbicide products. Its purpose was to "apply innovation and technology to help farmers produce more while conserving more."

On June 16, 1980, in the case of Diamond v. Chakrabarty, the United States Supreme Court voted in favor of allowing living matter, if it was created, to be patentable. The decision allowed a patent to be obtained if one discovers or invents a new plant in a cultivated state and can asexually reproduce it. The decision was viewed by many as the beginning of the biotechnology industry since it provided assurance that emerging technologies would be protected. Following the decision, biotech crops became the fastest adopted crop technology in the history of modern agriculture. They have helped farmers prevent crop loss through resistance to insect damage/plant viruses, and tolerance to herbicides.[1] A recent meta-study found that GM technology adoption has reduced chemical pesticide use by 37%, increased crop yields by 22%, and increased farmer profits by 68%.[2] In 2008, Monsanto spent more than $2 million a day in research to identify, test, develop and bring to market innovative new seeds and technologies that benefit farmers.[3]

In 1974, Monsanto's began selling Roundup, the trademarked name of glyphosate, which is a non-selective herbicide. Non-selective herbicides kill any plant they come into contact with while being non-toxic to animals and humans.[4] Glyphosate prevents plants from producing the proteins they need to survive. For two decades, farmers used Roundup as a cost-effective way to clear weeds before planting. While Monsanto's patent on glyphosate expired in 1991, through its patent on the isopropylamine salt, the company managed to retain patent protection in the United States until 2000. Through its effective monopoly before 2000, Roundup became the best-selling agricultural chemical product ever, that outsold other chemicals five to one.[5]

In 1990 and 1993, Dr. Dilip Shah et al. of Monsanto filed U.S. patent numbers 4,940,835A and 5,188,642A describing the technique for genetically altering plant seeds. Before Monsanto's glyphosate patent expired, Monsanto transplanted it into the cells of soybean plants that created a genetically modified crop resistant to the Roundup herbicide. Importantly, farmers could spray their fields with Roundup to eliminate weeds without harming the crop. In essence, the genetically modified seeds were resistant to herbicides. Current Roundup Ready crops include soy, corn, canola, sugar beets, cotton, alfalfa, and wheat. Its benefits allowed Monsanto's Roundup Ready gene to become the industry standard, with the company controlling as much as 90% of seed genetics.[6]

Glyphosate Price Competition

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[1] https://www.fda.gov/food/agricultural-biotechnology/how-gmo-crops-impact-our-world
[2] https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4218791/
[3] https://www.vanityfair.com/news/2008/05/monsanto200805
[4] While the U.S. Environmental Protection Agency (EPA) says there's "no evidence that glyphosate causes cancer in humans," The World Health Organization's (WHO) International Agency for Research on Cancer stated in 2015 that glyphosate is "probably carcinogenic to humans."
[5] Barboza, David. "A Weed Killer Is A Block For Monsanto To Build On". The New York Times, 2001.
[6] https://usatoday30.usatoday.com/money/industries/food/2009-12-14-monsanto-practices_N.htm

Prior to Roundup's patent expiry, Monsanto could sell both seeds engineered to withstand Roundup and Roundup itself. However, following the expiry of the Roundup patent, competition from generic glyphosate producers increased and prices fell.[7] In 2007 and 2008, shortages of energy and phosphorus reduced glyphosate output from China. However, by fiscal year 2009, generic competitors were undercutting Monsanto's prices in the U.S. and Canada by more than 70% and Monsanto had lost more than half of its share of the glyphosate market (dropping from 55% market share to less than 25%).[8] In 2009, Monsanto's executive vice president for strategy and operations said that "the sheer volume of competitive product sitting in the distribution channel, particularly in the U.S., is unprecedented."[9] To exacerbate the problem, the economy was still impacted by the 2008 financial crisis.

Monsanto sold Roundup to retailers and distributors rather than to growers. Given the increased competition, many of Monsanto's customers believed that Roundup prices would drop and that any existing inventory they had on hand would be unprofitable. To circumvent the concern, Monsanto's sales force began telling U.S. retailers in 2009 that if they "maximized" their Roundup purchases in the fourth quarter they could participate in a new rebate program in 2010. For the year, 1/3 of U.S. sales of Roundup occurred during that quarter. When commenting on the case, SEC Chair Mary Jo White, found this peculiar given that Monsanto has an Aug. 31 fiscal year end which coincides with the end of summer weed growing season.[10]

Monsanto also offered rebates to distributors who met agreed-upon volume targets. While each distributor had a separate agreement, Monsanto accrued the rebates. When seven customers failed to meet their targets, the company reversed a large portion of the accruals. However, in 2010, Monsanto created a program for the seven customers to earn back the rebates and the rebates were all prepaid. Furthermore, Monsanto agreed to pay rebates to its two largest distributors regardless of target performance.

In Canada, France and Germany Monsanto utilized similar programs to boost sales but then improperly accounted for the rebates as selling, general and administrative expenses which inflated gross margins.

Based on the prevalence of Roundup sales incentive programs, it is reasonable to assume that many Roundup sales were made because of the incentives offered by Monsanto. For this reason, the anticipated costs of the rebates should have been included in the year revenue was recorded. By not doing so, Monsanto misstated profit.

Aftermath

A former financial executive at Monsanto, who chose to remain anonymous, tipped the SEC about the accounting irregularities. Supposedly the employee only shared their concerns with the SEC after first trying to correct the issues internally.

The SEC began an investigation of the customer incentive program in June 2011. Before the SEC investigation finished, on October 3, 2011, the Audit and Finance Committee determined that Monsanto would need to restate its previously issued consolidated financial statements for the fiscal years 2009 and 2010 (including the fourth quarter of fiscal year 2009 and each of the four quarters of fiscal year 2010), as well as for the prior three quarters of fiscal year 2011. On November 14, 2011, Monsanto restated its 2009 and 2010 annual reports and

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[7] https://web.archive.org/web/20160304085158/http://www.frost.com/prod/servlet/market-insight-print.pag?docid=JEVS-5N2CZG
[8] https://www.sec.gov/litigation/admin/2016/33-10037.pdf
[9] https://www.motherjones.com/food/2011/07/roundup-sec-investigates-monsanto/
[10] https://businessjournalism.org/2016/03/monsanto/

its 2011 quarterly reports. The adjustments to net revenues and expenses between periods did not result in a material change to total company income. The potential impact of these changes would affect fiscal year 2009 earnings per share by approximately (\$0.10) to (\$0.05) and affect earnings per share for fiscal year 2010 by approximately (\$0.02) to \$0.03.

On February 9, 2016, Monsanto agreed to pay an \$80 million penalty assessed by the SEC and to retain an independent compliance consultant to settle charges that it violated accounting rules and misstated company earnings. The whistleblower was awarded \$22.4 million, the second largest award in the history of the SEC's whistleblower program that was created in 2011 as part of the Dodd-Frank Act reform.

While the CEO and former CFO were not accused of wrongdoing, both voluntarily repaid cash bonuses and stock awards. Two Monsanto accounting executives, both CPAs, Sara Brunnquell and Anthony Hartke, paid \$55,000 and \$30,000, respectively, while Jonathan Nienas, a former sales executive was fined \$50,000.

Ironically, Monsanto's public accountant, Deloitte, was never fined by the SEC and there has been no explanation why action against the accounting firm was not pursued. The whistleblower's lawyer Stuart Meissner believed that Deloitte should have spotted the fraud. He said that "There was an initial misstatement by Monsanto and a subsequent restatement – the restatement is actually the bigger issue of the two in my view. When auditors are allowed to audit their own mistakes, it is difficult for them to be independent and objective. And when independence is impaired, the professional skepticism needed to recognize and flush out improprieties by management is not present. Professional skepticism of the auditor is the last line of defense for a management team that may have a clear bias in reporting positive results."

Questions:

1. What costs would have been avoided if professional accountants at Monsanto and Deloitte had exercised professional skepticism more rigorously?
2. Why do you think that they did not apply their professional skepticism more rigorously?
3. Do you think the financial statement impact of the incentive program was material?
4. Do you agree with Stuart Meissner's assessment that Deloitte should have caught the fraud? Given the macroeconomic environment, should Deloitte have had different procedures for asserting that financial statements were free from material misstatements?
5. Broadly speaking, should the original auditor be allowed to investigate restatements? Can the original auditor be expected to act with professional skepticism?
6. What does the voluntary repayment of bonuses by C-Suite executives suggest? Given the SEC claw back action under Section 304 of SOX, were the executives trying to maintain reputation?

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Source: Professional Skepticism Case Collection for Professional Accountants, University of Toronto Professional Accounting Centre, 2023, PAC website https://www.utm.utoronto.ca/pac/case-collections/enhancing-professional-skepticism-case-collection.