Ghost cattle fraud

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ABSTRACT

Cody Easterday perpetrated one of the largest cattle frauds in United States history. The fraud was perpetrated over a period of five years, from 2016 to 2020, and defrauded Tyson Foods and another company out of $244 million by charging the companies for the raising of 265,000 cattle that never existed.

Key Words: Ghost cattle, fraud, internal control, materiality

INTRODUCTION

Cody Easterday contracted with Tyson Foods "to purchase and feed cattle on behalf of Tyson…Per the agreement, Tyson... would advance Easterday Ranches the costs of buying and raising the cattle." (The United States Department of Justice 2022). From 2016 to 2020, Cody Easterday fraudulently charged Tyson for the purchase and feeding of 265,000 cattle that did not exist and defrauded Tyson of approximately $244 million (The United States Department of Justice 2022). These are the ghost cattle used to defraud Tyson Foods and another company. Cody Easterday pleaded guilty to the charges of fraud and was sentenced to 11 years in prison. The judge at his sentencing hearing said that the ghost cattle fraud was "the biggest theft or fraud I've seen in my career – and the biggest I hope to see." (Pope 2022)

BACKGROUND

Tyson Foods is one of the largest meat processors in the United States. Tyson processed 20% of all the chicken, beef, and pork in the United States, in 2021 (King 2023). It owned and operated six beef processing plants in the United States. One of Tyson's largest meat processing plants was in Wallula, Washington, where some 1,400 employees worked in very close conditions, cutting and processing meat. When the COVID Pandemic first hit the United Sates, meat processing plants were one of the earliest epicenters for the contagion. In May of 2020, approximately 20% of the Wallula plant employees tested positive for COVID (Bernton 2020) and the plant was closed to manage the spread of the virus. This resulted in a severe disruption to the livestock and meat supply chain.

The Easterday Farm was started by Ervin Easterday in 1958 when the family purchased 300 acres of undeveloped scrubland in Washington state (King 2023). In 1987, the farm went bankrupt and, in 1989, Cody Easterday, Ervin's grandson, decided to drop out of college and help his family run the farm and pull it out of bankruptcy (King 2023). Cody oversaw the entire financial operation of the farm by the age of 20. He was hardworking and full of optimistic energy (King 2023). Cody expanded and diversified the family business, and, by 2009, the family business generated $250,000,000 in annual revenue and employed over 200 people. Cody Easterday had a strong reputation for honesty and keeping his word in the community (King 2023). Business deals were often made based on a handshake. Cody Easterday's farms provided two percent of the beef processed in Tyson Foods Wallula plant (King 2023).

United States Meat Supply Chain

The United States beef supply chain is a multi-step process beginning with inputs for raising livestock and ending in the products sold to the end consumer in supermarkets, restaurants, and other outlets. The process is very organized and controlled. When a calf is born a farmer knows exactly when the animal must be taken to the processing plant for slaughter and processing. Cattle market weight is about 1200 pounds to 1300 pounds and cattle reach that weight in approximately 14-15 months. Any delay results in animals too large to process on the equipment in the processing facilities (King 2023). Figure 1 presents a flow chart of the beef supply chain (Cowley 2020; Lowe and Gereffi 2009).

Easterday farms contracted with Tyson Foods to raise cattle and supply them to the Tyson processing plant on specific dates. Cody Easterday would purchase calves from the breeders and then feed them and raise them until they were ready for slaughter. Cody would charge Tyson for the calves and the feed needed to raise them. Calves are sold by breeders when they are weaned at about 6 months to 10 months of age and between 450 pounds to 700 pounds in weight as indicated in Figure 1 (Appendix). Within the cattle raising industry, the feed supply and feeding process is very organized. All the large ranchers use sophisticated computerized systems to track the delivery, payment, and distribution of feed (King 2023). Feed is purchased and delivered by the ton and recorded using weigh stations and touch screen computers.

GHOST CATTLE

When Tyson closed its processing plant in May of 2020 because of a COVID outbreak among the employees, it faced a supply chain catastrophe. Cattle had to be slaughtered on a specific date after birth; the schedule was very rigid. If the cattle were left to feed longer, then the cattle would become too big for processing and would have to be euthanized. Tyson began to examine their inventory of cattle more closely (King 2023). Tyson buys cattle from over 4000 independent ranchers across the United States and processes about 155,000 heads of cattle per week (Tyson Food 2023). In 2022 Tyson had $53 billion in total sales of which 36% or $19 billion was from the beef segment. Tyson sent an executive out to the Easterday ranch to inspect the cattle. The executive could not find the cattle; they did not exist. “Tyson officials flew drones to count the cattle that were actually on Cody’s ranch. They couldn’t find hundreds of thousands of animals that they’d already paid for.” (King 2022). Table 1 (Appendix) shows Tyson Foods total sales and net income for 2016 – 2020.

Shortly after, Cody confessed to the fraud and showed Tyson executives how he had meticulously forged the supporting documentation and invoices to defraud Tyson (King 2022). Cody used the fraudulently obtained money to cover losses incurred in commodity futures trading and for personal expenses (Pope 2022).

DISCUSSION QUESTIONS

1. What is the difference between financial statement fraud and misappropriation of assets? Cite the auditing standards that apply. (LO 1)
2. Did Cody Easterday commit financial statement fraud or misappropriation of assets? Support your answer with reasons. (LO 1)
3. What is the auditors’ responsibility for detecting fraud? (LO 1)
4. What is materiality? Was the fraud material to Tyson Foods financial statements? (LO 2)
5. What were the weaknesses in Tyson Foods’ internal controls? What internal controls should Tyson Foods implement to prevent this type of fraud in the future? (LO 3)

TEACHING NOTE

This descriptive case describes an actual fraud. The fraud was perpetrated by Cody Easterday, the owner of Easterday Farms, over a period of five years when Mr. Easterday defrauded Tyson Foods and another company of over $244 million by fabricating the existence of over 265,000 cattle. Tyson Foods discovered the fraud after there was an acute disruption to the meat supply chain in 2020 due to the COVID pandemic. To assess the livestock on hand, Tyson Foods sent employees out to the farms to count the animals. That is when the fraud was discovered (King 2023).

Cody Easterday used the defrauded $244 million to cover losses on commodity future trades and for personal expenses (Pope 2022). Cody plead guilty to the fraud and in October 2022, after a trial, he was sentenced to 11 years in prison (Pope 2022).

This case is most appropriate for an auditing course. The course can be an undergraduate or a graduate course.

LEARNING OUTCOMES

After completing this case students will be able to:
1. Describe the difference between fraud and embezzlement.
2. Apply the concept of materiality and evaluate if the ghost cattle fraud materially affected Tyson Foods financial statements.
3. Evaluate the internal controls at both Tyson Foods.

ANSWERS TO DISCUSSION QUESTIONS

1. What is the difference between financial statement fraud and misappropriation of assets? Cite the auditing standards that apply. (LO 1)

Fraud is an intentional act that results in a misstatement in the financial statements. In contrast, an error is an unintentional misstatement. There are two types of fraud: financial statement fraud and misappropriation of assets. Financial statement fraud is also called management fraud and occurs when upper-level management intentionally misstates the numbers in the financial statements or omits substantial information from the financial statements. Misappropriation of assets is also called embezzlement and occurs when assets are stolen from the company.

The auditing standards that apply are AS 2401 (PCAOB 2002) and AU-C 240 (AICPA 2012) Consideration of Fraud in a Financial Statement Audit.

2. Did Cody Easterday commit financial statement fraud or misappropriation of assets? Support your answer with reasons. (LO 1)

Cody Easterday misappropriated assets from Tyson Foods. Cody was not an employee of or part of management at Tyson Foods, therefore he could not have committed financial statement fraud at Tyson Foods. He stole money from Tyson.

Cody committed both misappropriation of assets and financial statement fraud at Easterday Farms. He took money from the business to cover the losses from commodities trading and did not report those losses. He also used the money for personal expenses.

3. What is the auditors' responsibility for detecting fraud? (LO 1)

The auditor is responsible for detecting any misstatements that could affect a financial statement user's decision per AS 2401 (PCAOB 2002). This includes fraud. Auditors are responsible for detecting material frauds.

4. What is materiality? Was the fraud material to Tyson Foods financial statements? (LO 2)

An amount is material if it will affect a user's decision on whether or not they will invest in the company. Materiality is not an absolute amount because both qualitative factors and quantitative factors affect materiality. In quantitative terms the fraud was not material to Tyson's financial statements. Even if you apply the entire amount of the fraud to any one year of the fraud period, the amount is immaterial. For example, if we take the lowest net income year, 2017, as the year for fraud then the fraud is 0.6% of sales (244,000,000/36,881,000,00). As a general rule of thumb, we can use the SEC's Staff Accounting Bulletin (SAB) No. 99 (SEC 1999) as a guide for the upper-limit materiality threshold. SAB No. 99 suggests 5% as a reasonable starting point.

Auditing standards do not provide any rules on what to use as the base for calculated materiality. Students' assessments of materiality will be different, but the general conclusion is that the amount is not material to Tyson's financial statements. If we distribute the total amount of the fraud evenly across the five years, then the fraud amount is $48.8 million for each year ($244,000,000/5). This amount is not material for Tyson for any of the five years as shown in Table 2 (Appendix).

We use sales and net income as bases for calculating materiality. The conclusion is the same if we use total assets as the base for materiality. The fraud was perpetrated by a party external to Tyson. There was no cover up by Tyson's management or any other qualitative factors that would raise the fraud amount above the materiality threshold.

The Easterday fraud was not material to Tyson Foods financial statements because the Easterday Farms provided two percent of the cattle processed at the Washington meat processing plant. Tyson Foods has other meat processing plants in the United States. Also, the fraud was committed over a period of five years and the amounts were not material to Tyson Foods' financial statements in any of those years.

5. What were the weaknesses in Tyson Foods' internal controls? What internal controls should Tyson Foods implement to prevent this type of fraud in the future? (LO 3)

Students' answers will vary for this question. Students should demonstrate some understanding of internal controls, specifically control activities that could either prevent this type of fraud or detect and correct this type of fraud.

For example:

Possible internal control weakness: Tyson did not verify the expenses that ranchers charged them for the raising of cattle and Tyson did not verify the existence of cattle.

Tyson can implement the following internal control: surprise cattle inspections at the farm ranches who raise the cattle.

This is an example response. Student responses will vary.

EPILOGUE

Easterday Ranches and Easterday Farms went into bankruptcy and much of the assets, which included land, was purchased by a third party (McCoy 2023). Easterday used the bankruptcy proceeds to settle most of the smaller claims by debtors against their business. Easterday owes Tyson Foods over $260 million (McCoy 2023).

In December of 2022, Cody Easterday filed a counter lawsuit against Tyson Foods for breach of contract for $163 million (Carlson 2023). The lawsuit accuses Tyson Foods of antitrust violations, creating a monopsony (a monopsony is a market condition where there is only one buyer) in the Pacific Northwest market, and breach of contract for a personal branding agreement. Easterday is seeking triple the damages incurred (Carlson 2023).

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APPENDIX

Figure 1: Flow Chart of the Beef Supply Chain

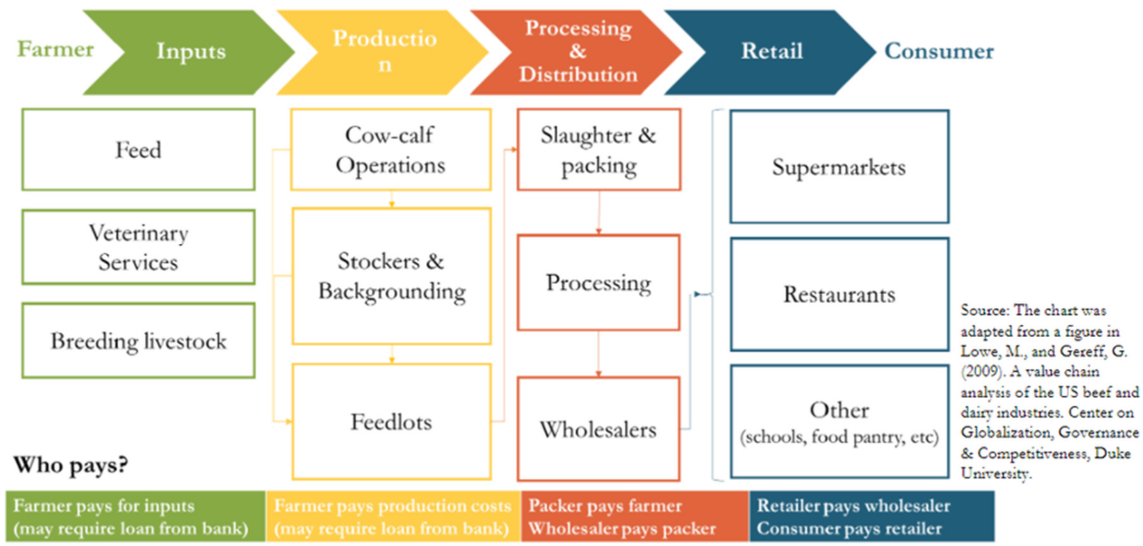

Table 1: Tyson Food Sales and Net Income in millions of U.S. dollars

Year	2016	2017	2018	2019	2020
Sales	36,881	38,260	40,052	42,405	43,185
Net Income	1,768	1,774	2,140	2,022	3,027

Table 2: Tyson Food Sales and Net Income in millions of U.S. dollars

Year	2016	2017	2018	2019	2020
Sales	36,881	38,260	40,052	42,405	43,185
Net Income	1,768	1,774	2,140	2,022	3,027
5% of sales	1,844	1,913	2,002	2,120	2,159
5% of net income	88	88	107	101	151