

Analysis of Xin Tai Financial Fraud

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Abstract

The purposes of this study were to; 1) study the way Xintai Electric conducted Financial Fraud. 2) study the approach to prevent Financial Fraud.

The sample consisted of the financial fraud case of Xintai Electric, the first company in the Growth Enterprise Market (GEM) market that was forced to withdraw from the market after the China Securities Regulatory Commission issued the Delisting Opinion.

The instruments used for gathering data were the main financial indicators used in the analysis come from Xintai electric financial statements and annual reports.(financial statements publicly issued by listed companies)Then analyze through collection and arrangement.

The research results were the lack of legal awareness of the integrity of the company's internal managers. In order to go on the market and to keep the market after the market, it is due to the performance of the company in order to protect the city. Counterfeiting is not easy to find, and the punishment is very low after being discovered. All factors combined together make Xintai Electric successfully cheat. Finally, aiming at the emergence of fraud, according to the motivation of fraud, we put forward some measures, such as strengthening moral quality construction, introducing external supervisors, high reputation independent directors, implementing audit rotation system and improving illegal costs.

Keywords: Financial Fraud Theory of Fraud Risk Factors Financial Statement Analysis Prevention and Control

Introduction

This paper analyzes and studies the financial fraud case of Xintai Electric, the first company in the Growth Enterprise Market (GEM) market that was forced to withdraw from the market after the China Securities Regulatory Commission issued the Delisting Opinion. This paper takes Xintai Electric financial fraud as an example. It introduces its fraud cases, and then analyzes the means of its fraud, including four aspects: the reduction of accounts receivable, the

preparation of less bad debts, the use of tax incentives and less material cost. After that, the two aspects of financial statements and financial indicators are also analyzed, including the changes in the assets and liabilities items, the composition, the profit table, the internal logical connection between the cash flow statement, the analysis and comparison of the operation ability and profitability of the same industry. Then, using the theory of fraudulent risk factors to analyze the motivation of the financial fraud of Xintai Electric.

Research Questions

1. How Xintai Electric conducts Financial Fraud?
2. How to Prevent Financial Fraud?

Research Objectives

1. To study the way Xintai Electric conducted Financial Fraud.
2. To study the approach to prevent Financial Fraud.

According, research objectives mainly including the fictitious collection of accounts receivable, the undercount of bad-debt provision, the take advantage of tax preference, the undercount of material costs. And improve integrity building, promote the listing system of registration system, introduce institutional investors, and increase the cost of illegal activities.

Literature Review

The Motivation Theory of Fraud

Albrecht (1988) proposed the “three-factor theory” of fraud: pressure, opportunity and excuses. Bologana (1993) and others proposed the “four-factor theory” or GONE theory, which mainly refers to: greed, opportunity, need, exposure. Pankaj Saksena (2001) Through research, it is found that when the internal factors of the enterprise and the external factors are combined, the probability of corporate fraud will increase substantially.

Li Ruoshan (2002) found through empirical research that the main reasons for fraud in contemporary enterprises are: imperfect internal control system of enterprises, expansion of personal money demand of fraud leaders and excessive punishment of fraud. Wang Shuai (2015) also believes Both internal and external factors affect financial fraud.

The Methods Theory of Fraud

Beasley and Carcello (2000) focus on the technology industry and financial services industry companies. A comparative analysis of companies with financial fraud and non-financial fraud from the late 1980s to the 1990s was conducted.

Huang Xinjian (2006) believes that the use of local government support for enterprises is also a means for enterprises to carry out financial fraud. Zhu Jinyu (2007) found through statistical analysis that listed companies usually use more than three different means for financial fraud at the same time. Wang Lidong (2013) Analyze and summarize the financial fraud of listed companies by confirming or deferring the income in advance, depreciating the depreciation of fixed assets, underwriting liabilities, scrambling expenses, inflating sales costs, exaggerating sales scope, etc.

The Recognition Theory of Fraud

Beneish (1999) pointed out that the M. score model for discovering Enron's financial fraud is looking for fraud characteristics from the analysis of the company's historical data. Farber (2005) found that the corporate governance of these companies was significantly worse by studying the financial fraud companies that were investigated.

Wen Yongjun (2009) found through regression research that the tradable shares accounted for the company's total share capital ratio, the type of audit report issued by the firm, the ratio of accounts receivable to liquid assets in financial indicators, and the cash flow and total assets generated by operating activities.

The Governance Theory of Fraud

Warfield (2011) found through research that the more complete the ownership structure, the less likely the corporate fraud is, and proposed the fraud prevention countermeasures to optimize the ownership structure. Prawittal (2012) studied whether the source of internal audit is related to the fraudulent behavior of financial statements

He Yu (2009) believes that the combination of internal audit and internal control is the focus of fraud prevention. Wang Li (2014) improves the implementation of internal control system, ensures execution efficiency, strengthens internal audit, standardizes governance system, and improves accounting and auditing.

Methodology

Based on the existing literature and previous research, this paper first introduces the basic situation of Xintai Electric and reviews the process of fraudulent issuance. Secondly, it

analyzes the fraud methods and analyzes the business status of financial statements and indicators. Furthermore, based on the theory of fraud motivation factor, this paper analyzes the motivation of Xintai Electric fraudulent issuance, and finally proposes the corresponding prevention and control suggestions from the source for the motivation.

1. Equity Structure

The analysis of Xintai Electric's shareholding structure mainly selected the shareholding structure in 2013. Liaoning Xintai Co., Ltd. is the controlling shareholder of Xintai Electric. Its main business is project investment management planning, financial consulting services, chemical raw materials, construction materials, etc. The proportion of shares is 32.58%, and the second largest shareholder Liu Guiwen has a share ratio of 13.01 %. As the controller of Liaoning Xintai Co., Ltd., Wende B. Since 2009, he has served as chairman and general manager. He holds 77.35% of Liaoning Xintai, and Wende's wife Liu Guiwen holds 13.33% of Liaoning Xintai. In this way, the two directly and indirectly hold a 42.54% stake in Xintai Electric, which is a monopoly. The third largest shareholder, Liaoning Shuguang Industrial Co., Ltd., holds 10% of its shares, and its main business is auto parts manufacturing and automobile sales. In addition, Cai Hong, the tenth largest shareholder, is the brother-in-law of Liu Guiwen.

Xintai Electric's top ten shareholder structure in 2013, but according to Xintai Electric's 2014 and 2015 annual reports, the top ten shareholders are basically the same, but the shareholding ratio among shareholders is increasing. In the meantime, the top three shareholders in 2014 and 2015 were Liaoning Xintai Co., Ltd., Liaoning Shuguang Industrial Co., Ltd. and ShixinRonghe Investment Management Co., Ltd.

2. Organization structure

Xintai Electric has its own organizational structure, including the shareholders' meeting, the board of directors, the board of supervisors and other management organizations. It is relatively complete and meets the requirements of internal governance. The number of personnel in each functional department also meets the relevant provisions of the Securities Law.

Based on the accounting and auditing theories, the case analysis method was used to study the financial fraud of Xintai Electric and then propose corresponding measures.

Case Analysis Method: Taking Xintai Electric's financial fraud incident as the research object. First of all, the analysis of its means uses four methods to conduct fraud: defying accounts receivable, under-resolving bad debts, using tax incentives, and underestimating

material costs. Secondly, through the collection and sorting of the data of the year of listing and the data of the previous four years for business analysis.

3. Data Collection Procedures

Most of the main financial indicators used in the analysis come from Xintai electric financial statements and annual reports. (financial statements publicly issued by listed companies) Then analyze through collection and arrangement.

4. Data Analysis Procedures

Mainly includes three aspects: means analysis, report analysis and motivation analysis. The first is the analysis of means. It mainly analyzes Xintai Electric's four methods: fictitious recovery of accounts receivable, under-material cost, use of tax incentives and under-reporting of bad debts for financial fraud. Secondly, report analysis, mainly it analyzes the relevant report data of Xintai Electric before listing, including the balance sheet, income statement, cash flow statement and corresponding financial indicators changes, and analyzes the operation before listing. The third is the motivation analysis, mainly it is based on the motivation factor theory to analyze the motivation of Xintai Electric's financial fraud, including moral quality, fraud motivation, potential fraud opportunities, the possibility of fraud being discovered and the nature and extent of punishment.

Findings and Discussion

Expected Findings

Improvethe Moral and Legal Awareness of the Management

From the financial fraud incident of Xintai Electric, it has revealed that the moral level of most managers in Chinese enterprises is too low. The good integrity of a manager affects the integrity of the entire company, so strengthening the moral construction of managers is a top priority.

First of all, increase the integrity of moral education for relevant personnel, regular training, on time assessment, establish a sense of integrity in the company. Secondly, it will strengthen the propaganda and warnings for moral education, and praise the company executives and intermediaries who have strong moral responsibility and outstanding contributions through media such as Internet TV.

The level of management legal awareness is also related to the fraud of listed companies. Implementing the pre-employment assessment system of the management, the management of the listed company must pass the assessment of the legal knowledge related to the company's operation before it can be employed. In addition, listed company managers must participate in a continuing education program of laws and regulations every year. Finally, the legal professionals with strong professionalism in the industry are hired as legal consultants to form legal concepts in the company.

Improve the Performance Evaluation System for Executives

Change the management's assessment system, introduce reasonable performance assessments such as balanced scorecards and other performance assessment tools, and comprehensively use diversified indicators such as economic value added, market value added, and residual income, and no longer use only the single indicator of accounting profit. The model evaluates the performance of listed companies from multiple perspectives and is more objective and comprehensive. Secondly, improve the employment standards, compensation mechanism and incentive mechanism of senior management, combine short-term incentives with long-term incentives, introduce non-financial indicators, and use the firm to conduct assessment and score. Finally, understand the compensation of competitors and the salary level of the same industry, establish a reasonable salary system, actively update the performance appraisal system, and conscientiously implement the performance appraisal system.

Develop Funds for Institutional Investor and Independent Director

Institutional investors such as securities investment funds, insurance companies, and social security funds are introduced to form shares in the public, and the distribution structure of equity is optimized. The dual agent status of institutional investors, its unique advantages in the collection and processing of information, makes the company more transparent in information disclosure. Secondly, institutional investors have more advantages in terms of capital and talents than those of small and scattered shareholders. They can also grasp the overall situation and long-term development of the company, avoid short-sightedness, and guarantee the authenticity of accounting information.

In addition, an independent director fund is established outside the company. The remuneration of independent directors is not directly issued by the company and is issued through the independent director fund. This is beneficial to independent directors who are not

subject to the remuneration. Since the current remuneration of independent directors in China is the same in each company and has no incentive effect, according to the different performance of independent directors, different remunerations, fixed remuneration and floating value will be formulated to better play the role of independent directors. Finally, appropriately reduce the proportion of independent directors nominated by the controlling shareholder, and increase the number of independent directors nominated by small and medium shareholders.

Discussion

Implement Firm Rotation and Financial Institution Mutual Inspection Mechanism

Intermediaries are important external forces for fraudulent distribution. In the process of Xintai Electric fraudulent issuance, Beijing Xinghua Certified Public Accountant attached an obligation to assist, lost professionalism and lacked independence. The auditing firm that implements the rotation of the accounting firm system and audits the same enterprise may not exceed the maximum of five years. In addition, after an external audit of a listed company, strict restrictions on the company's other consulting services are not strictly accepted to improve the independence of the firm. Secondly, actively develop the signed CPA as a partner of the firm, improve audit cautiousness and audit quality, implement corresponding legal responsibilities, and raise awareness of responsibility. Finally, the audit fees are optimized, and different audit fees are applied to companies with different property rights and different industry attributes, and premiums are imposed on enterprises with high risks.

In addition, Xintai Electric's self-made false bank statements, running water and illegal seals did not receive paper on the bank, but they acknowledged that bank personnel did not maintain independence. Improve the supervision and management of the bank itself, increase the frequency of inter-inspection between banks, implement a six-month and one-small investigation, and improve the off-site supervision capability of the bank in a one-year inspection, and report to banks that have irregular operations and poor supervision. Criticized and announced. Secondly, the bank itself should also strengthen the training of employees, eliminate illegal operations, strengthen audits, and promptly discover counterfeit bank documents and avoid violations and seals. Finally, pay special attention to listed companies with bad records, and cooperate carefully to maintain their credibility.

Implement Classified Disclosure System

US listed companies are broadly divided into three categories: large-scale accelerated disclosure companies, accelerated disclosure companies, and non-accelerated disclosure companies. The corresponding financial information disclosure time is 60 days, 75 days, and 90 days after the end of the fiscal year. Using the network and electronic filing as the main channel, the EDGAR system is used to report accounting information, and information users also use this system for inquiries. Compared with the United States, the disclosure of China's annual report is in the newspapers and websites designated by the CSRC, and the time is also within 4 months after the end of the first fiscal year. It can be seen that China's long disclosure time and disclosure channels are more traditional, and information asymmetry provides opportunities for fraud.

Drawing on the US disclosure system, we will establish a disclosure system suitable for China. First, according to different industries, different sizes of listed companies to develop different information disclosure systems, classified disclosure, and the corresponding disclosure time provisions, do not carry out "one size fits all". Second, accelerate the process of disclosure of electronicization, implement online disclosure, improve the transparency of information disclosure, and find fraud in time. In addition, professional institutions are set up to deal with the information disclosure of listed companies, and the listed companies are supervised to provide timely and effective information and to accept the inspection at any time.

Raise the Cost of Breaking the Law and Improve the Compensation Mechanism

After Xintai Electric's fraudulent issuance was exposed, it was fined 8.32 million yuan, only 1% to 5% of the funds raised. The rest of the company was fined between 30,000 yuan and 8.92 million yuan and some other Treat. Most of China's fraudulent issuance is on administrative penalties.

This punishment is lighter than that of foreign countries. The US Securities Exchange Act clearly stipulates the legal liability of listed companies for breach of information disclosure requirements, including civil liability, administrative liability and criminal liability. However, our country's punishment in this regard is too low and the boundaries are blurred. The government should continue to improve relevant laws and regulations, so that major punishment decisions are well-founded and provide legal reference. Increase the punishment for financial fraud, implement a fraud, be punished for life, increase the amount of fines, and actively promote the implementation of criminal penalties as soon as possible. Eliminate the opportunistic luck of fraudsters and prevent them from committing second fraud.

In addition, we will further improve the claims and protection mechanisms for relevant investors and provide corresponding legal basis for safeguarding the interests of relevant investors. Reduce investor litigation costs, reduce litigation procedures, shorten litigation cycles, and facilitate the public. Timely implementation of class actions, defense evidence, etc., effectively establish a mechanism for defending rights for small and medium-sized investors, and improve the efficiency of the civil litigation protection rights for the interests of the offenders. In addition, the system of accountability according to law is strictly implemented, and the joint responsibility of the responsible persons is investigated according to law, and the system of prior payment is strictly regulated. Finally, the Small and Medium Investor Rights Protection Association was established to provide free consultation and advice services for small and medium investment lawsuits.

Conclusion and Recommendations

Summary of Finding

Xintai Electric has fraudulently listed the company by deducting accounts receivable, under-receiving raw material costs, making less bad debts preparations, and using tax incentives, and continued to implement financial fraud after listing. Based on the analysis of financial statements and financial indicators, focusing on key subjects and accounts, we can find that Xintai Electric's poor management, poor performance, and fraudulent motives. Combined with the theory of fraud risk factors, we found that Xintai Electric's fraud is mainly based on the following five aspects: the first moral factor, because the company's controllers and executives lack corresponding professional ethics and integrity, cannot resist the lure of money. Second fraud Motivation factor, Xintai Electric, which is listed through fraud, has generated fraudulent motives for not being delisted and unreasonable performance appraisal system. Third fraud potential opportunity factor, Xintai Electric's "one big share" and independence The failure of the directors and the dereliction of duty of the board of supervisors have resulted in fraudulent opportunities. The possibility factor of the fourth fraud was found to be less likely to be discovered due to the dereliction of duty of the external audit, the poor supervision of the sponsor institution and the government's cover-up. The extent and nature of the fifth fraud is punishable. Because the laws of the securities market are not standardized, and the corresponding claims mechanism is lacking, the degree of fraud is light.

Aiming at the above-mentioned motivation analysis, the corresponding countermeasures for preventing and dealing with financial fraud of listed companies are put forward. First, the moral training and legal awareness of the company's senior management are strengthened, and the integrity atmosphere is formed within the company. The second is to improve the listing and delisting system, The executives' assessment adopts a multi-dimensional and multi-dimensional mechanism. The third introduces institutional investors, external supervisors, development network voting and cumulative voting system. The fourth implements the firm's audit rotation system, establishes a diversified supervision system, improves the disclosure mechanism, and establishes finance. Early warning system, etc.. Fifth, increase the cost of illegality, improve the compensation mechanism, and establish a credit file.

Recommendations

Of course, there are still some shortcomings in this paper. The analysis data involved in this article mainly comes from the listing plan announced by XintaiElectric, the company's annual report and the news media's relevant reports on the forced delisting of Xintai Electric and the CSRC. There is no internal first-hand resource for the external information such as the administrative penalty decision letter of Tai Electric. The information that can be obtained is limited, and the research may not be comprehensive enough, and the analysis is not thorough enough.

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