

Analysis of Financial Fraud Based on XinYi Holding Co., Ltd.

Boya Zhao*

School of Accounting, Guangzhou College of Commerce, Guangzhou, 511363, China

*Corresponding author: Boya Zhao

Abstract: Since 1990, with the development and growth of the capital market, listed companies and executives of listed companies have been engaged in financial fraud for a long time in order to pursue their own interests. Taking XinYi Holding Co., Ltd. Holding Co., Ltd.'s forced delisting due to financial fraud and other violations as an example, this paper focuses on the ways and means of financial fraud, discusses the motivation of corporate fraud, and puts forward targeted suggestions on preventing financial fraud of listed companies on this basis.

Keywords: financial fraud; XinYi Holding Co., Ltd.; related party transactions; GONE theory, accounting firm

1. Introduction

Since the implementation of the new securities law for two years, financial fraud has always been the focus of regulators. On the evening of March 3, 2022, as St Xinyi received the suspension notice issued by Shanghai Stock Exchange, the decision on administrative punishment ruled by China Securities Regulatory Commission and the relevant regulatory work letter on termination of listing, St Xinyi became the first company to be forcibly delisted due to violation of the law this year. Many relevant documents pointed out that the indicators in the three-year financial report of St Xinyi from 2018 to 2020 actually violated the relevant laws and regulations of China's listed companies, resulting in being forced to delist. It is common for listed companies to be forced to withdraw from the market due to financial fraud such as fictitious company profits, which not only has a serious impact on the company, shareholders and creditors, but also affects China's social and economic order. Based on the financial fraud of St Xinyi, this paper analyzes the causes and means of financial fraud of Listed Companies in China, and puts forward corresponding suggestions.

2. Theory

Since December 1990, the establishment of China's Shanghai Stock Exchange and Shenzhen Stock Exchange has marked an important milestone in China's capital market. With nearly 30 years of development, China's capital market has experienced a high-speed process from difficult start to rapid development, from immature to gradual improvement. Now, China has become a

country with strong capital strength. Listed companies, as an important part of the capital market, have played a very important role in the development of China's capital market. However, driven by the temptation of money and interests, financial fraud of listed companies occurs frequently, which infringes on the legitimate rights and interests of the company, shareholders, creditors and other relevant contacts, and has a great trust crisis for relevant investors, creditors and operators on China's market supervision, internal and external audit and enterprise internal control. Therefore, this paper analyzes the financial fraud of St Xinyi case company according to the gone theory, clarifies the pre consequences of the event, and hopes to put forward effective governance suggestions for the financial fraud of listed companies and provide some help for building a better capital market.

Gone theory is based on the classic fraud triangle theory in audit theory, including greed, opportunity, need and exposure^[1]. Analysts can analyze the case company from these four perspectives, dig out the reasons for the company's financial fraud, find the deficiencies in the company's internal control, and better put forward corresponding suggestions.

Greed factor refers to a series of improper or even illegal means adopted by stakeholders in the company to pursue their own personal interests and ignore the ethics, moral bottom line and professional ethics to infringe on the legitimate interests of other stakeholders. This behavior is common in management and financial personnel^[2].

Opportunity factor is that the infringers seize the loopholes of the company in the whole economic market background, including the internal and external environment of the enterprise, and want to find opportunities for fraud in these loopholes to improve their own interests. These internal and external environments include policy loopholes and enterprises' own management^[3].

The need factor is the possibility that the company, shareholders, executives, etc. may have the idea of financial fraud because of some need. For example, the company pursues the maximization of interests, the individual pursues fame and wealth, and the urgent needs of personal finance^[4].

The exposure factor is the punishment of financial fraud by laws and regulations, the moral condemnation

of fraud and the influence of the public [5]. Exposure factor can also analyze the exposure probability of counterfeiting behavior. The smaller the probability, the more likely counterfeiting behavior is to occur.

3. Analysis on Financial Fraud of XinYi Holding Co.,Ltd.

3.1. Introduction to the Company and Accounting Firm

3.1.1. Company profile

St Xinyi, fully known as Xinjiang Yilu Wangyuan Industrial Investment Holding Co.,Ltd, was established on September 28, 1998. It is a joint-stock limited company restructured from Sichuan ceramic factory [6]. In August 1999, it issued new shares for the first time to raise funds, mainly engaged in the production and sales of ceramic products, mining investment, mineral product sales, mining consulting, import and export of goods and technology and other businesses. Debt restructuring was carried out in 2015. On March 3, 2022, due to financial fraud and other violations, it was ordered to be forcibly delisted by relevant departments.

3.1.2. Introduction to accounting firm

With the approval of Shenzhen finance bureau, Shenzhen Tangtang certified public accountants Co., Ltd. was incorporated in Futian, Shenzhen on December 31, 2004. It is a small and medium-sized accounting firm, with 4 partners, 13 certified public accountants and 55 corresponding employees. Since undertaking the audit report of the first A-share listed company, it has been 18 years. In addition to undertaking routine audit, consulting and other businesses, it has also undertaken a large number of high-risk ST companies. In September 2020, Shenzhen Tangtang engaged in securities service business through the Ministry of Finance and the CSRC [7].

In 2019, Shenzhen Tangtang began to undertake the annual audit of St Xinyi, knowing that the last year's annual report of St Xinyi was issued with an audit report that could not express an opinion by the appointed accounting firm, and knowing that the annual audit business of St Xinyi was rejected by many accounting firms[8]. In 2022, the CSRC conducted on-site inspection on the two-year audit reports of St Xinyi company in 2019 and 2020, found many doubts and problems, and also found many practice problems, and gave corresponding administrative penalties.

3.2. Overview of Financial Fraud of Xinyi Company

3.2.1. Review of financial fraud

In 2015, St Xinyi announced that it was difficult for the company to maintain its daily production and operation due to the lack of capital operation. In addition, the company's heavy debt made it difficult to repay creditors' funds, so it announced the debt restructuring.

In 2018, Sichuan Huaxin certified public accountants, the auditor of St Xinyi, issued an audit report that could not express an opinion on its annual report of that year. Among them, Sichuan Huaxin certified public

accountants pointed out that there are major adjustments in many accounting subjects of the company. In 2019, the company hired Shenzhen Tangtang accounting firm as the annual audit firm, which issued qualified audit reports for it in 2019 and 2020.

On January 14, 2022, St Xinyi received the filing notice sent by the CSRC. The filing notice showed that Huang Wei, as the actual controller of St Xinyi, was suspected of illegal disclosure, selective disclosure and non disclosure of important information legally disclosed by listed companies, which constituted an illegal and criminal act. The next day, the closing price of the company was only 0.97 yuan, less than 1 yuan.

On the evening of March 3, 2022, as St Xinyi received the suspension notice issued by the Shanghai Stock Exchange, the decision on administrative punishment ruled by the CSRC and the relevant regulatory work letter on the termination of listing, St Xinyi, the actual controller Huang Wei and supervisor Li Yong were warned and fined. St Xinyi became the first company to be forcibly delisted due to violation of the law in 2022. At the same time, the regulator decided to ban Huang Wei and Li Yong from entering the securities market for life.

Based on various controversial issues of St Xinyi since 2015, the company and relevant responsible persons have been subject to administrative punishment by the CSRC and disciplinary action by the Shanghai stock exchange for many times.

3.2.2. Financial fraud method

From many cases of financial fraud of listed companies, it is not difficult to find that the common way of financial fraud of listed companies is to falsely increase operating revenue and write down financial expenses, so as to falsely increase profits. In fact, many financial fraud cases with bad influence are instructed by the controlling shareholders and actual controllers.

St Xinyi is no exception. During the two years of 2018 and 2019, there were false records in the financial report. The main financial data are falsely recorded as table1 and table2:

Table 1. Fictitious situation of operating income

Particular year	business income		
	Actual number	Virtual increment	Proportion
2018	1338.54	1338.54	100%
2019	1038.22	572.36	55.13%

Source: Company annual report

Table 2. Total profit fiction

Particular year	Total profit		
	Actual number	Virtual increment	Proportion
2018	2463.93	129.11	5.24%
201	3122.71	7924.82	253.78%

Source: Company annual report

According to the analysis of the falsification of St Xinyi's main financial data, the actual operating revenue

of St Xinyi in 2018 was 13.3854 million yuan and the total example profit was 24.6393 million yuan. However, St Xinyi falsely increased the operating revenue and total profit by 13.3854 million yuan and 1.2911 million yuan respectively.

In addition, the operating revenue and total profit disclosed by St Xinyi in the 2019 annual report also have serious false growth. The actual operating revenue should be 10.3822 million yuan and the total profit should be 31.2271 million yuan. However, the data disclosed to the public showed a false increase of 55.13% and 253.78% respectively.

St Xinyi clearly has the fraud of financial statements, and the par value of its shares has been less than 1 yuan for many consecutive days. In addition, according to the real financial data, the operating revenue of St Xinyi in 2018, 2019 and 2020 was less than 100 million yuan for three consecutive years. St Xinyi has touched on major illegal delisting.

3.2.3. Financial fraud means

In 2018, St Xinyi falsely increased its operating income by 13.3854 million yuan through improper related party transactions. According to the financial data released by the company that year, St Xinyi signed a purchase contract for iron concentrate with Sibe investment. In addition, at the same time, St Xinyi signed a sales contract for iron concentrate with Axin commerce and trade. On the surface, one purchase and one sale, secretly manipulating the transmission of interests, and a seemingly perfect purchase and sale economic chain has been formed between the upstream and downstream. However, the investigation found that he, the shareholder of Sibe investment, also served as the actual controller of Axin commerce and trade. In addition, he also had another identity, which was the friend of Huang Wei, the actual controller of St Xinyi for many years. The hidden relationship between layers makes the management collude, which provides an opportunity for collusion in the implementation of financial fraud. In addition, the investigation found that st Xinyi did not obtain the actual control of relevant commodities in the purchase and sales of iron concentrate, and the purchase and sales contracts did not have commercial essence and did not meet the revenue recognition conditions specified in the accounting standards. Therefore, there was a huge virtual increase in the operating revenue announced by the company in 2018.

The following year, St Xinyi signed the purchase and sales contract of iron concentrate with the above two companies in the same way of fraud, falsely increasing the operating income by 2.2166 million yuan. In addition, the investigation found that st Xinyi falsely increased its operating income through its own controlled subsidiary dingshengyuan. When the subsidiary has no business, it made up property management contracts, invoices and provided false property management services. In addition, St Xinyi signed a rent credit agreement in violation of the accounting standards, fabricated Hongsheng real estate leasing business, fabricated its leasing business

and offset its previous debts when it actually did not lease the real estate. The above three fraud methods falsely increased the income by 5.7236 million yuan.

In addition, there are still major omissions in St Xinyi's financial report. The actual controller Huang Wei deliberately concealed major events and did not disclose important mortgage and guarantee events, in violation of the provisions that listed companies should disclose.

3.3. This Paper Analyzes the Financial Fraud of St Xinyi Company by Using the "Gone" Theory

3.3.1. Greedy factor

Since the listing of St Xinyi, the performance level has been in a state of continuous decline, and the sustainable operation ability of the core main business is weak. The annual report shows that if the company continues to lose money, it will have a serious negative impact on the future development of the company, and may face the risk of loss of shareholders, panic of investors and delisting of the company. In addition, the standardized operation ability of the company is poor, and the audit opinions of annual reports over the years are non-standard opinions such as unable to express opinions and qualified opinions. Therefore, under the dual influence of vanity and pressure of major shareholders and management, the main motivation of financial fraud is caused. In this regard, in order to protect their own interests, the management chose the way of financial fraud to whitewash the financial statements, change important financial data, conceal important related party transactions, and forge good financial data to defraud the trust of relevant legal departments and many investors.

3.3.2. Opportunity factor

Huang Wei, the actual controller of the company, conceals important financial report disclosures, which is the most critical opportunity for the development of corporate fraud. Every major fraudulent transaction of St Xinyi has fictitious business contracts and formal cash flows. It is difficult to find abnormalities only by looking at the financial statements. In addition, St Xinyi has many holding companies, and the actual controllers and executives of the company involve many related parties. The use of hidden connections for business transactions has become the most commonly used means of financial fraud of many listed companies.

At the same time, St Xinyi replaced the certified public accounting firm, and signed an annual audit business with Shenzhen Tangtang certified public accountants without issuing an opinion before continuing to renew the contract. It is reported that in order to expand its business and improve its operating income, the accounting firm recklessly undertook a large number of audit services of ST company, ignoring audit norms and relevant legal provisions. This incompetence and the goal of pursuing short-term income provide an opportunity to cover st Xinyi's financial fraud.

Therefore, to sum up, the imbalance of internal management mechanism of ST company and the

effectiveness of external governance institutions provide an important opportunity for financial fraud.

3.3.3. Demand factor

St Xinyi is mainly engaged in the development and sales of mineral products, which are important scarce resources in China and non renewable. Relevant products may face national macro-control policies in the future. At the same time, they will also be subject to market changes and uncertain factors in operation and management, and there is a risk that they will not achieve the expected benefits. In addition, the company's efficiency has been depressed in recent years, which has brought great pressure to the company. In addition, the company is faced with the decline of share price in the capital market, serious problems in capital turnover, backward technology and great limitations in its business. The company's management needs to seek other ways to seek benefits for its own performance evaluation, maximization of personal salary and under great pressure. Improper financial fraud has become the way for the management to improve profits.

3.3.4. Exposure factor

The frequent occurrence and repeated prohibition of financial fraud mainly lies in the wide coverage of fraud and the concealment of fraud means. In addition, the senior executives of St Xinyi enterprises lack financial knowledge and use inappropriate means to falsely increase profits, thinking that they are seamless and will not be found, but they often cover up the eyes. At the same time, executives themselves also have serious problems of their own moral integrity, forming a set of reasonable excuses, leading to frequent financial fraud.

4. Enlightenment and Suggestions

4.1. Legal and External Supervision

With the gradual expansion of the capital market and the gradual improvement of relevant laws and regulations, China has basically formed a series of normative systems around financial regulations, civil compensation, criminal accountability and so on. It has deterred the fraud environment and improved the fraud behavior of the market. However, the supervision of listed companies still needs many efforts.

Therefore, the state, the government and relevant regulatory departments should perform their respective duties, strengthen joint law enforcement, and improve the efficiency of investigating illegal and criminal acts. Strengthen the punishment of fraud, remind listed companies to be practical and professional, and don't easily test on the edge of the law, so that financial fraudsters have nowhere to hide and escape. With the introduction of policies one after another, the punishment of financial fraud continues to be strengthened, forming a deterrent to some listed companies and executives.

In addition, trade associations should also play a supervisory role. On the one hand, they should cultivate good and professional management talents, and on the other hand, they should also focus on violations of law

and discipline. Publish the details and punishment consequences of many financial fraud cases, which can be used as a warning for other listed companies to learn.

4.2. Listed Companies

Many listed companies may have a mechanism similar to stock option incentive measures for managers in order to improve their profits. Under the company's pursuit of profit maximization and the significant competitive pressure borne by senior executives, financial fraud is common. As long as there is interest driven, plus the opportunities and loopholes in the internal and external environment of the enterprise, such as excessive concentration of rights and the virtual existence of the company's internal control mechanism, listed companies are likely to have financial fraud. St Xinyi has major defects in the internal control of financial reporting, lack of sufficient and high-level financial personnel, lack of awareness of the counter requirements of the financial reports of listed companies, and failed to issue financial reports in compliance. Although it promised to take corresponding positive measures to correct after the fraud was exposed, it has not been effectively changed.

Therefore, the enterprise itself should improve the awareness of the concept of internal control, avoid the phenomenon of power concentration, and put an end to all acts in violation of the company's legal system and the articles of association. Strengthen the legal awareness and moral education of management and employees. Maintain the separation of decision-making power, management power and supervision power, and the system between the board of supervisors, the board of directors and various departments should not just exist in vain. We should form a situation of checks and balances between powers and fully protect the functions and powers of independent directors.

In addition, the board of directors and board of supervisors of listed companies should include more employee representatives to express the wishes of the majority of employees, and can also accept the suggestions and supervision of employees.

4.3. Accounting Firm

When conducting audit business, certified public accountants have the responsibility and obligation to strictly implement the audit work in accordance with the provisions of audit standards, and give reasonable assurance for the material misstatement of the statements as a whole. Therefore, when undertaking new business, the accounting firm should be cautious to comprehensively investigate the situation of the audited unit and should not take too high risks because of excessive pursuit of income. In addition, when renewing the audit project, it is not allowed to over trust or even shield the auditee because of the long cooperation time with the auditee or for other reasons. Be vigilant and independent at all times. Identify and analyze the important related party transactions that may be concealed by the back unit, and be alert to the implied financial fraud.

In addition, in this case, Shenzhen Tangtang accounting firm, which is responsible for the audit business of St Xinyi, is a small and medium-sized accounting firm. Small and medium-sized accounting firms are different from large accounting firms. China's large accounting firms have sufficient human and material resources. However, small and medium-sized accounting firms have small scale, low profits and various management mechanisms have not been formally improved. Therefore, a common problem of small and medium-sized accounting firms is that they are likely to undertake high-risk audit projects recklessly in order to absorb more customers and improve the profitability of the firms. Select high-risk audit customers, so bury the hidden danger of audit risk. Therefore, when undertaking business, small and medium-sized accounting firms should formulate customer selection standards in line with their own development, screen and eliminate high-risk customers. Even if they undertake high-risk audit projects, they should also formulate a set of risk prevention system to adapt to their own, and do not issue inappropriate audit reports because of the trend of interests.

Secondly, due to the lack of funds and the serious shortage of employees, in order to save costs, many small and medium-sized accounting firms did not improve the quality of these links when reviewing reports and composite reports, resulting in the increase of the risk of misstatement. Therefore, small and medium-sized accounting firms should not only absorb more professional audit practitioners, but also improve and monitor the whole audit process.

5. Concluding Remarks

Based on the analysis of St Xinyi's financial fraud and forced delisting cases, this paper analyzes its fraud means and methods, analyzes its fraud motivation by applying the gone theory, and puts forward some suggestions on the governance of financial reports of listed companies. The reasons for financial fraud are mostly unreasonable internal governance structure, improper incentive mechanism, paying attention to short-term goals, etc. the external reasons are that the role of intermediary gatekeeper is not played enough. It is

believed that the efforts of the government, enterprises and certified public accounting firms are needed to eliminate the occurrence of financial fraud of listed companies. These include formulating a more severe punishment mechanism, improving the internal control of enterprises and the standardization of certified public accounting firms in business undertaking and development. To control financial fraud, we should improve civil compensation and accelerate the implementation of delisting system, enhance the deterrence of financial fraud for listed companies, further compact the role of market gatekeeper of intermediary institutions, and accelerate the application of high-tech means in the supervision of listed companies.

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