

Financial Statements Whitewash of Listed Companies and Its Preventive Measures

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Abstract—While economic globalization drives rapid economic development, there are small deviations between the international accounting system and the use standards of various countries due to the rapid growth of transnational corporations, resulting in the complexity of statement verification, and more serious acts of financial statement whitewash. Starting from the concept of corporate financial statement whitewash, this paper analyses the causes and harms of financial statement whitewash. On this basis, it discusses the identification methods of listed companies' financial statement whitewash, and puts forward the preventive measures of listed companies' financial statement whitewash. Finally, a comprehensive summary is made. It is expected that listed companies in China can further standardize their financial statements from the judicial and social supervision aspects, improve the publicity and transparency of listed companies' information, truly eliminate the whitewash of financial statements, and promote the stable development of social economy.

Keywords—listed companies; financial statement whitewash; preventive measures

I. INTRODUCTION

With the rapid development of social economy, many listed companies use various financial instruments and means to whitewash or even cheat financial statements at any cost in order to satisfy their own interests. The purpose is to create a good illusion for the users of financial statements, which seriously endangers the development of market economy and social and economic stability. Because of the special economic environment in China, listed companies are growing rapidly. Some enterprises whose performance is unsatisfactory or fail to meet the listing qualification try their best to obtain the listing qualification in financial statements and asset evaluation. According to statistics, 15% of domestic listed companies have financial fraud, and more than 70% of listed companies have some problems of financial statements whitewash. In recent years, the deterioration of the whitewash of financial statements of listed companies has attracted the attention of many economists at home and abroad [1], [2], [3]. Considering how to strangle the malicious acts of financial statements whitewash by fraud in the embryonic stage is of great importance for preventing, controlling and reporting functions to play a role in the first time, promoting fair and

open information of capital market, and creating a healthy environment for real and effective financial statements data.

II. THE MOTIVATION AND HARM OF FINANCIAL STATEMENTS WHITEWASH

Financial statements whitewash refers to the specific changes made to the financial statements by means of relevant means. Through these changes, the company's good operation is presented to the outside world. There is no doubt that this is a kind of deception [4], [5]. China is in the period of economic transformation. With the continuous development of the times, listed companies are expanding gradually; various technologies are constantly updated; and various ways of financial statements whitewash are gradually born.

A. Motivation for Financial Statements Whitewash

1) *Compensation contract motivation*: Listed companies in developed western regions use contracts to tie the pay of top leaders to their performance, so as to improve the enthusiasm of the leadership. However, this system is not suitable for the domestic economy, which is at the turning point of economic growth and lacks a compensation system for the leadership of listed companies. The existing domestic remuneration system mainly involves three aspects. The board of directors votes and judges, and correlates with its performance. It is set up according to the relevant requirements of government departments. As a holding enterprise, it pays directly. In a word, the way of payment is evolved according to performance and the value of capital. Because the effect of accounting income data on work performance is very huge, some listed company leaders tend to take the lead for their own interests, resulting in the motivation to whitewash financial statements.

2) *Motivation of financing and refinancing*: After investigating and analyzing the various representative incidents of counterfeit listing, it finds that there are detailed restrictions on the listing of companies in China, both in terms of standards and requirements, the amount of financing in a short time is huge by issuing stocks. For the normal production and operation funds required, any enterprise can't resist the benefits it brings, and it is not surprising that the phenomenon of counterfeiting enterprises

listed on the market. For the enterprises that have entered the market, naturally, they are also doing everything possible to increase their operating performance falsely in order to increase their own interests.

3) *Market and tax motivation:* From the whole stock market, most of the hidden investors make the judgement by the financial reports issued by listed companies. As the major shareholders and the leadership of enterprises, they hope to show a state of good operating benefits through the statements whitewash. In China, the various mechanisms of the stock market are not yet fully mature. Listed companies and organizations will help whitewash financial statements through coordination in order to continuously enhance the stock price. At the same time, for any enterprise managers, tax payment means a large amount of cash outflow, while the company's accounting statements can control the cash flow of the enterprise. In order to reduce tax burden, listed companies need to pay taxes, which is also one of the main motivations of financial statement whitewash.

B. Harm of Financial Statements Whitewash

1) *Weakening the effectiveness of the government's macro-control:* The support of economic data is indispensable for the implementation of macro-economic regulation and control. The alias of economic data in accounting statements is accounting information. If it is whitewashed and presents false accounting information, it will affect the judgement of decision-makers, and then will affect the macro-control of the economy by government departments. The decision-making will deviate, and affect the macro-control, which will have a very bad impact on the short-term goals and long-term plans designated by the government.

2) *Weakening the resource allocation function of the market:* If the information provided by the company is objective and accurate, it will certainly maintain the good performance of the market in resource allocation. But if the presentation of accounting statements has been whitewashed, it is a kind of false behavior, which eventually leads the market to believe that it is true, and many resources will enter the wrong company, thus weakening the market's resource allocation function.

3) *Serious damage to the interests of investors:* As the real shareholders in the company, they can't really supervise and control the company's operation with the help of whitewashed statements, which results in the loss of their interests. From a realistic point of view, many shareholders suffered extremely serious losses in the stock market due to these false data. From the perspective of investors, they make investment decisions according to the initial financial statements of enterprises. If listed companies distinguish between them and do not discover them in time as investors, the false statements issued by listed companies will naturally lead to various errors and ultimately lead to decision failure.

III. IDENTIFICATION METHOD OF FINANCIAL STATEMENTS WHITEWASH OF LISTED COMPANIES

A. Elimination of Non-performing Assets

Non-performing assets refer to bad debts in accounting subjects, including net loss of assets, long-term expenses to be assessed, and other internal items that can't be ignored, such as long-term accounts receivable. How to correctly use the method of eliminating non-performing assets? The following two methods can be used. First, comparing the total amount of non-performing assets with net assets, if the number of net assets is less than or equal to that of non-performing assets, two problems will be explained at this time: there are some problems in the operation of the company; in the past, the company makes a false increase in profits so as to achieve a certain purpose. Second, comparing the proportion and extent of the increase of non-performing assets with the total amount and extent of gaining profits, if the increase and extent of non-performing assets are in the lead, it shows that the company's interests are uncertain.

B. Elimination of Related Transactions

It is necessary to reduce the business income and profits of affiliated enterprises or through affiliated relationships. Whatever we do, it has two sides. Based on this, it does not have to take a negative approach to the affiliated enterprises. Through the affiliated enterprises, it can get a more detailed understanding of the company's business and revenue capacity. What needs special attention is that if the business income and profits of enterprises depend on affiliated enterprises to some extent, they should pay close attention to accounting information processing.

C. Elimination of Abnormal Profits

Asset replacement, equity transfer, transfer price, trusteeship operation, equity investment and cost transfer are common means for listed companies to regulate profits through related party transactions. The abnormal profit elimination method is to remove these non-main business operating profit items from the total profit, such as the investment income subject under the transfer of equity, so as to analyze the reliability of the source of profits and the healthy state of business operation. Abnormal profit elimination is a good way to whitewash statements by regulating income.

D. Cash Flow Analysis

This method mainly compares the net amount of cash generated by the operating exchange and the net amount of cash generated by the investment transaction. Through this comparison method, the earnings obtained by the main business of the company are carefully examined. Generally speaking, if the net flow income of capital is lacking, it must be in a disadvantaged position. If the net flow of funds does not exceed the net benefit for a considerable period of time, the company is likely to have the financial statements whitewash [6].

IV. PREVENTIVE MEASURES FOR FINANCIAL STATEMENTS WHITEWASH OF LISTED COMPANIES

A. *Establishing and Improving the Corporate Governance Structure of Listed Companies*

After analyzing the corporate governance structure, it mainly includes three dimensions: internal supervision and control system, external supervision and control system, and incentive and restriction system [7]. Firstly, it should further improve the property right model of enterprises. In order to achieve this, it must constantly improve the enthusiasm and initiative of supervisors and managers; secondly, it is necessary to further form a sound and perfect system of internal supervision and control. Through various kinds of training, it will continuously improve the cognitive ability of supervisors and controllers in the management of enterprises, and improve their level of examination data and independent thinking. In addition, it is necessary to strengthen measures to regulate and control economic and management behavior. Based on this, enterprises must carry out corresponding planning. Finally, it should further improve the external supervision and control system of enterprises.

At the same time, companies must set an example and be strict with themselves. However, from a practical point of view, in order to highlight their business performance, many executives of enterprises often intentionally guide or instruct accountants to whitewash their financial statements. Therefore, business managers should constantly improve their self-quality, strengthen legal awareness, establish good values, adhere to principles and professional ethics, and resolutely prevent illegal acts.

B. *Improving Accounting Standards System and CPA Audit Supervision*

At present, China is in the most important period of economic transition. Many factors lead to various deficiencies in the current law. In order to avoid the whitewash of financial statements reasonably, the audit supervision function and risk control of CPA are very important. The performance produced by using this method usually plays a role in the interests of the relevant personnel. However, the domestic appointment system of Certified Public Accountants is still not perfect. Many certified public accountants have acted favoritism and fraud in their specific work. They do not pay attention to statement whitewash at all, which seriously violates the professional ethics of the accountants.

To prevent the whitewash of accounting statements reasonably, the current accounting rules and related systems must be further improved. In the process of editing, it is necessary to pay attention to the integrity and locality. Firstly, it is necessary to review the established accounting codes and systems, and make a detailed analysis of their current shortcomings; secondly, it is necessary to be good at discovering new internal elements when reviewing the existing problems; thirdly, on the basis of the above two steps, it is necessary to promulgate new accounting codes and norms to make them more targeted and timely.

C. *Improving the Government's Supervision System*

Strengthening the supervision and prosecution of the government can prevent the whitewash of financial statements to a large extent. The government has set up many organizations, such as finance, taxation, auditing and so on, to monitor the financial statements of the company. Because of the huge size of the institutions, each institution is vague in terms of its rights and responsibilities. Sometimes there will be a phenomenon of mutual prevarication, and sometimes it will be too inclined to its own interests. In addition, the means of supervision and management in China are not keeping pace with the times, but it is still a main way according to the past means of financial final accounts approval. Thus, the ultimate goal of auditing and approving the final accounts is not at all able to ensure the accuracy of the company's accounting statements. The approval of financial accounts is only based on the investigation and judgment made by experience, which has some limitations in reflecting the objectivity and effectiveness of accounting statements. Strengthening the construction of government supervision system, restricting the whitewash of financial statements by legal means when it is necessary, and promulgating more standardized and strict legal standards have a great restraint on the whitewash of financial statements.

D. *Reducing the Motivation of Accounting Statements Whitewash*

It is necessary to start from the embryonic stage and put an end to its occurrence fundamentally to reduce the whitewash of financial statements. Therefore, it needs to start with the motivation of whitewash of financial statements, and implements comprehensive control measures. First, the relevant government departments should improve the political system and eliminate the phenomenon of "political linkages"; the relevant departments should improve the stock issuance system, strictly examine financial statements, and relax the conditions for suspension and termination of the listing of stocks, such as replacing the continuous loss with the continuous loss exceeding the accumulated profit after tax, so as to avoid the motivation of evading punishment; secondly, the enterprises need to establish a complete performance evaluation system and salary distribution system, should avoid the motivation of statement whitewash in order to obtain bonuses and promotion, especially when dealing with the salary correlation of management. Finally, it is necessary to strengthen legal education and improve professional quality of professionals, improve the evaluation system of professional ethics quality, and comprehensively implement the professional ethics quality training with honesty and law-abiding as the leading factor.

V. CONCLUSION

China's social economy is in a special period of development, which determines that the further improvement of Chinese current system needs a relatively long process. Although China started relatively late, it can make full use of the advanced experience provided by developed countries to identify and prevent the whitewash of financial statements.

From the judicial level, China has also introduced a large number of measures to regulate the financial statements of listed companies, and local regulations have been introduced in succession to adapt to the development of listed companies, which to a certain extent deters companies intending to engage in financial fraud. The whitewash of financial statements of various listed companies can also reflect on and solve problems in time in the discovery of problems, and constantly improve the system. From the aspect of social supervision, influential figures in society and relevant news media have begun to pay high attention to this aspect, which has improved the disclosure and transparency of company financial information. To sum up, as long as adhering to the relevant principles of law-abiding, law-enforcing and law-breaking, and severely punishing the disruption of the economic market caused by the whitewash of the financial statements of listed companies, the quality of accounting information in China will naturally become higher and higher, and the development of social economy will become more and more stable.

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