

The View on Curbing Financial Fraud of Listed Companies

WenhuaJiang^{1, a}, HongkaiCui^{2, b}

^{1,2} Business School, University of Jinan, Jinan, Shandong, China

^ajiangwh999@163.com

^bsm_jiangwh@ujn.edu.cn

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Abstract: Real and effective financial information is an important cornerstone of the orderly operation of the capital market. However, in recent years, the frequent occurrence of financial fraud cases in the capital market of our country has seriously affected the confidence of the majority of investors and the healthy development of the capital market of our country. Therefore, it is of great significance to study the financial fraud of listed companies. This paper puts forward three measures on how to curb the financial fraud of listed companies: optimizing the internal control of listed companies; strengthening supervision; increasing punishment; And changing the employment relationship between accounting firms and companies.

1. Introduction

China's capital market has made remarkable achievements since the establishment of two securities markets in Shanghai and Shenzhen in 1990, but at the same time, it is accompanied by a large number of scandals of financial fraud of listed companies. The financial fraud of these companies has a serious impact on China's capital market, instantly making the hard-established market environment and operation mechanism in China's capital market vulnerable. The reform efforts over the years have become meaningless. Figuring out measures to curb the financial fraud of listed companies is imminent.

2. Theory Introduction Related to Financial Fraud Motivation Analysis

2.1 Iceberg Theory of Financial Fraud

Iceberg theory analogizes financial fraud to an iceberg at sea level. The only part of financial fraud that people can identify is just like the tip of iceberg that can be seen above sea level. Iceberg theory shows that the motivation of accounting fraud a company may have is not only related to whether the internal control system is sound and rigorous, but also has something to do with whether there is financial pressure or a potential possibility of fraud, which needs to consider the attitude, feelings, values and other factors.

2.2. Triangle Theory of Financial Fraud

The theory was put forward by the President of the American Accounting Association, Steven Albrecht, who believes that financial fraud is made up of three elements: pressure, opportunity and self-rationalization. Without any of the above elements, it is impossible to make financial fraud. Pressure element is to conduct financial fraud behavior motivation. Opportunity element is the chance to be able to conduct fraud and not to be found. The element of self-rationalization refers that the personnel involved in financial fraud must find a reason to make financial fraud behavior consistent with their own values and code of conduct.

2.3. GONE Theory

G stands for Greed; O means Opportunity; N is for Need, and E represents Exposure. The theory says that enterprise financial fraud is made up by four factors G, O, N, and E, which works together and affects each other. And none of the single factor is more special or more important than the

others.

The need factor (N) is also called motivation factor; the opportunity factor (O) is related to the power of potential financial counterfeiters in the company; the exposure factor (E) includes two parts: the possibility of financial fraud behavior and the degree of punishment for financial counterfeiters; while the greed factor (G) is given a broader meaning: low moral level.

2.4. Fraud Risk Factor Theory

The Fraud Risk Factor Theory is developed by G.Jack.Bologna and others on the basis of GONE theory, which divides fraud risk factors into individual risk factors and general risk factors.

Individual risk factors are determined by the characteristics of different companies and are not subject to internal control, including moral quality and motivation. General risk factors refer to the factors that a company can control, and include the opportunity to commit fraud, the possibility of fraud being exposed and the nature of the penalty if fraud is discovered. Financial fraud occurs when two risk factors exist at the same time, with the potential financial fraudsters believing that fraud is profitable.

3. The Harm of Financial Fraud

Due to the uniqueness and usefulness of financial information, false financial information has great social harmfulness, which seriously damages the interests of the company's stakeholders, and is not conducive to the orderly development of the capital market or the construction of an honest society. The specific analysis is as follows:

3.1 Harm the Interests of Investors

In the capital market, there are not many ways for investors to learn about the investment subject company when they make investment decisions. Financial statements are the main source of information for investors. Investors will predict the future development of the enterprise according to the performance and related business indicators provided in the financial statements, form their own judgment on the company's overvaluation or undervaluation, and then make relevant investment decisions. Therefore, the false financial report will affect investors' prediction of the future situation of the company, thus letting them make wrong investment judgment and causing investors to suffer serious losses.

3.2 Harm the Interests of Associate Businesses and Employees

Financial fraud will not only affect the enterprises but also bring losses to the upstream and downstream affiliates, including suppliers and customers. The company's financial fraud will make the upstream and downstream affiliates make a wrong judgment on the fake enterprise. For example, the supplier may not give the fake company too much credit line and the customer will not pay the deposit to the fake enterprise too early. After the company's financial fraud event is exposed, the fake enterprise may face severe administrative punishment, investor litigation, bankruptcy liquidation and other situations, which will affect the recovery of the creditor's rights of the affiliated business and cause economic losses. What's more, it may lead the public to produce the speculation that associate business participates in the financial fraud of listed company, which will seriously affect the reputation of associate business, giving rise to the performance decline and other serious consequences.

Similarly, financial fraud will harm the interests of employees, who may lose their jobs and may not be paid on time.

3.3 Harm the Interests of the Country

Because of the system characteristic of our country public ownership economy, the pillar company on the market is state-owned enterprise. The embezzlement of assets, corruption and other acts often follow with financial fraud, which will cause a large number of losses of state-owned assets, seriously harm the interests of the country.

The purposes of financial fraud of a large number of companies may be tax evasion. Therefore, financial fraud will cause a reduction in national tax and affect the national tax revenue.

3.4 Affect the Orderly Operation of the Economy

Numerous incidents of financial fraud would seriously damage the confidence of investors, and is not conducive to the healthy development of the capital market. It will affect the financing function of the capital market, reduce the resource allocation ability of the capital market, influence the development of enterprises in real need, as well as the ability of the state to use the capital market for macro-control and the orderly operation of the economy.

3.5 Influence the Construction of an Honest Society

Now the country is vigorously building a good faith society. Emerging financial fraud events will seriously affect the process of building a good faith society and bring bad influence to the society.

4. Measures and Suggestions to Curb Financial Fraud of Listed Companies

4.1 Optimize the Company's Internal Controlling System

Companies that engage in financial fraud often have internal controlling systems that are not scientifically designed or effectively run. Optimization of internal controlling system can effectively curb the occurrence of financial fraud. The internal controlling system has three kinds of functions, such as guaranteeing the reliability of the financial report, the management efficiency and the effect as well as to the laws and regulations compliance and so on. The scientific effective internal control system may manage the company risk, reduce the opportunity of the management layer and the internal personnel to carry on the fraud, and can greatly improve the credibility of the financial statements of listed companies.

An enterprise can optimize its internal controlling system in the following ways:

4.1.1 Learning from advanced enterprises. The enterprise should establish a standardized corporate governance structure, clarify the authority of each post, and build an effective power balance mechanism, as well as strengthen the independence of audit committee and the role of internal audit, give priority to the promotion of employees with good moral quality, and strengthen legal education and professional ethics education.

4.1.2 Improving various systems. The enterprise should establish and perfect incompatible separation of duties control system, authorization and approval system, accounting control system, property protection system and performance appraisal system, etc.

4.1.3 Strengthening internal information communication. The enterprise should timely report problems in communication, improve the anti-fraud mechanism; focus on key areas such as embezzlement and misappropriation of assets, false financial information, and abuse of power by management.

4.1.4 Strengthening supervision. The enterprise should regularly monitor the effectiveness of the operation of the internal control system, timely find the defects of the internal control system, and regularly evaluate the internal control system.

4.2 Strengthen Supervision and Punishment

The frequent occurrence of financial fraud is related to the weak regulatory environment and low illegal costs. Therefore, the government should strengthen supervision, increase penalties, and increase the illegal costs of the company, so that the listed company has no chance and dare not commit financial fraud.

4.2.1 Improve the Market Supervision Mechanism

It is necessary to establish a perfect market supervision mechanism and strengthen the coordination and cooperation among various departments. For example, a department responsible for the supervision of accounting information can be set up to strengthen the supervision of financial information in the capital market. At the same time, it is necessary to grasp the intensity of supervision and not hinder market innovation.

4.2.2 Strengthen the supervision and punishment of intermediary organizations

We should strengthen oversight of accounting firms, law firms, securities firms and other intermediaries. Regularly inspect the business execution quality of intermediary organizations; Strengthen the legal education of intermediary agencies; Inspect the system compliance of intermediary organizations; Adopt one vote veto system, in which the intermediaries who do not comply with the system would be suspended to undertake business or even out of the market. To increase the amount of punishment for intermediary organizations involved in financial fraud, we can consider the system of intermediary organizations bearing unlimited joint and several liabilities for the losses of investors.

4.2.3 Accelerate the legislation of laws and regulations on protection of investors' interests

Accelerate the legislation of laws and regulations related to the protection of investors' interests, so that investors can not only claim compensation for the amount of losses, but also get corresponding compensation. Modify relevant laws and regulations to increase the amount of punishment for companies involved in financial fraud. All those involved in financial fraud will be banned from the market for life. Add clauses related to financial fraud into the criminal law, and all personnel involved in financial fraud should be given corresponding criminal penalties according to the seriousness of the circumstances. Strengthen the capital market delisting mechanism, and adopt a veto that companies found to have falsified their financial statements would take measures to terminate their listing, and set a 3-5 year observation period for re-listing.

4.2.4 Strengthen professional ethics education for accounting practitioners

Strengthen the follow-up education of accounting practitioners and pay attention to the cultivation of professional ethics of the practitioners. At the same time, we should encourage the accounting staff to expose the company's financial fraud, give certain material rewards to the staff that expose the company's financial fraud, and stipulate that the company cannot fire or unfairly treat the accounting staff that exposes the company's financial fraud.

4.3 Change the employment relationship between the accounting firm and the company

The company law of China clearly stipulates that the shareholders' meeting or the board of directors has the power to hire or dismiss the accounting firm. But since the company's management is often also part of the company's shareholders or management layer, it leads to the fact that the power of hiring or dismissing the public accounting firm is actually owned by the company's management. Since audit income is the main source of income for accounting firms, under such employment relationship, the independence of accounting firms is greatly weakened, so some parts of accounting firms have to participate in corporate financial fraud. Therefore, it is necessary to change the employment relationship between the accounting firm and the company. The following system can be established:

4.3.1 Establish an audit insurance system

The construction of the system refers to compulsory motor vehicle traffic accident insurance. The first thing is to establish a scientifically graded accounting firm database and strengthen the classification of accounting firms. Audit institutions are hired by insurance companies instead of the auditee. Insurance companies select appropriate audit institutions in the accounting firm database according to the scale and risk of the auditee. When audit fails, accounting firm should compensate certain amount to insurance company, and the specific standard is stipulated by the country (can entrust Chinese institute of certified public accountants to investigate and issue plan).

Insurance company evaluates the insurance premium of the auditee according to its scale, risk and other factors. The auditee can choose insurance company freely, the country establishes specific audit insurance company specially, and the listed company that did not find appropriate insurance company compulsively buys audit insurance service.

Each insurance company establishes his special audit insurance funds. The premium that collects after deducting certain service charge are brought into audit insurance special fund. When investor produces a loss because of financial fraud incident, he must be paid first by audit insurance special fund, while some of the remaining investors can claim compensation from the company and the

insurance company. The two companies are jointly and severally liable for investors' losses, and the specific share proportion between two organizations is stipulated by the country.

4.3.2 The China Securities Regulatory Commission (CSRC) appointed an accounting firm

According to the scale and risk of the auditee, the China Securities Regulatory Commission (CSRC) will send out invitation for bidding to qualified accounting firms, and the accounting firms will offer their own quotations according to their own risk assessment results. If the bidder wins the bid with a low price, the CSRC shall collect audit fees from the audited entity and pay them to the accounting firm. This system also needs to do a good job in the hierarchical management of accounting firms. When an audit fails, the accounting firm and the company concerned are jointly and severally liable for the investor's losses.

5. Conclusion

The authenticity of financial information is the cornerstone of the securities market. In the current development of the capital market, we should strengthen supervision, increase punishment, form a huge deterrent to the "financial fraud" of the securities market, and finally make the financial fraud no longer occur, so as to promote the healthy development of the securities market in China.

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