

Zhenlong Specialty Financial Fraud Analysis and Thinking

-- Based on the perspective of business ethics and accounting professional ethics

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Abstract: In recent years, many companies through IPO, want to obtain huge economic benefits in a short period of time, but many do not meet the standards of listed companies trying to achieve the purpose of listing through some financial fraud, at the same time, certified public accountants also failed to effectively control of IPO audit business, often IPO audit failure, in the long run, will make investors doubt the capital market and professional certified public accountants. This paper takes the financial fraud incident of Zhenlong specialty products published in 2016 as an example, analyzes the reasons for financial fraud, then reflects on financial fraud from the perspective of business ethics and professional ethics of accountants, and analyzes the existing deficiencies from the perspectives of internal accountants and auditors, and finally puts forward corresponding suggestions.

Keywords: Financial fraud; Zhenlong specialty; business ethics; professional ethics.

1. Introduction

Zhenlong specialty in 2013 to 2015 four times to the CSRC submitted the prospectus, why did not find its financial fraud? Which departments or which of them went wrong? In June 2015, when the CSRC carried out a special inspection on the IPO, it found that Zhenlong Specialty had a large amount of abnormal loss of inventory, and then Zhenlong Specialty withdrew its IPO application. In July, the CSRC decided to file an investigation for its violation of securities laws and regulations. In September of the same year, after less than two months of investigation, Zhenlong Specialty received the administrative punishment decision issued by the CSRC, and found out that the four prospectuses submitted had false records of financial fraud. Therefore, the CSRC to Zhenlong specialty related directors, supervisors, deputy general managers were punished.

Financial fraud and business ethics have been studied on domestic and foreign literature:

1.1. Reasons for the financial fraud of the company

ShengLu Huo (2018) By analyzing the cases of Kangmei Pharmaceutical, we found that the reason for the audit failure was the lack of professional suspicion ability and the incorrect analysis procedures; Jan Svanberg, Peter Ohman (2014) The degree of independence of auditors is directly proportional to the distance between auditors and customers; Fang Nana (2021) believes that the failure of the IPO audit of Zhenlong Specialty is mainly due to the auditors' failure to observe professional ethics and audit principles; Chen Xiaoru (2022) believes that the excuse factor in the fraud motivation is a reasonable excuse found by the management to make their moral bottom line not be crossed.

1.2. Existing business ethics issues of enterprises

Gao Lifang, Qu Xiaohui (2022) found in the form of

questionnaires that only about 40% of students have learned business ethics and professional ethics, and university teachers may ignore the teaching of students' ethics foundation; Guo Ailin (2019) points out that more accountants pursue personal interests, which leads to the marginalization of professional ethics; Li Ruiyu (2017) believes that the unethical behavior of many enterprises in their business activities has seriously affected the development of the market economy; Pei Juanjuan (2020) believes that out of interest, accounting firms are highly likely to compromise on issues that affect their independence. Xiong Zhen (2019) believed that due to the particularity of agricultural enterprise inventory, the auditors of Ruihua Office could not get enough understanding in a short time, but they did not hire relevant experts to understand, which led to the failure of IPO audit.

1.3. How to improve the business ethics and professional ethics of accounting practitioners

Liu Wenwen, Tao Yijia, and Chen Qian (2017) pointed out that the moral level of management is directly proportional to the moral level of employees; Luo Wenxuan (2021) took Luckin's financial fraud incident as an example and put forward corresponding countermeasures for the governance of financial fraud in China from the perspective of business ethics, including the strengthening of self-discipline governance of enterprises, the government strengthening supervision and management, and the third-party intermediary agencies play the role of gatekeeper; Ben Xudong (2015) believes that a professional certified public accountant should have excellent professional qualities, including professional quality and professional ethics; Liu Yingfei, Ni Yuanyuan (2016) proposed that attention should be paid to the education of certified public accountants and accountants.

Through the analysis of the relevant information in the prospectus of Liaoning Zhenlong Special Products Co., Ltd.,

it is found that it uses the inventory to fabricate the production process, and brings to us from the perspective of business ethics and accounting professional ethics.

2. Zhenlong Specialty Financial Fraud Basic Situation Introduction

2.1. Brief introduction of Liaoning Zhenlong Specialty Co., LTD

The full name of Zhenlong Specialty: Liaoning Zhenlong Special Products Co., Ltd., formerly known as Fuxin Zhenlong Special Special Products Co., Ltd., was established in October 2000. In September 2011, it completed the shareholding reform and was renamed Liaoning Zhenlong Specialty Co., Ltd. (hereinafter referred to as Zhenlong

Special Products). The initial registered capital of the company is 80 million yuan, and it is highly competitive in the seed kernel production and processing industry, and it is the leading enterprise in the industry.

The company's main business is the acquisition, processing and sales of edible vegetable oil, pumpkin seed series products and other kernel products. The main products include pumpkin seeds, pumpkin seed kernel, almond (rated as high-quality famous brand agricultural products in Liaoning Province), and various seed kernel baking products, etc. As shown in Table 1, they are the operation situation of Zhenlong's main products. And the products are not only sold in China and even exported to more than 20 countries and regions, and mainly to foreign sales, in the home and abroad have formed a relatively perfect sales network system.

Table 1. Operation situation of products accounting for more than 3% of the company's operating income

Unit: 10,000 yuan

	2011		2012		2013	
	sales income	proportion (%)	sales income	proportion (%)	sales income	proportion (%)
Pumpkin seed kernel	23137.76	41.80	22390.84	35.95	33212.35	42.36
Pine seed kernel	8537.20	15.42	21628.16	34.73	26522.71	33.83
pistachio	11243.37	20.31	5695.71	9.15	4331.50	5.52
pumpkin seed	3128.27	5.65	4597.30	7.38	4124.23	5.26
almond	3579.43	6.47	2359.73	3.79	2633.83	3.36

Since the main business of Zhenlong specialty is mainly a variety of seed products, its inventory is mainly these products, and the inventory is mostly biological assets (with its own particularity), so there are many problems in the inventory inventory, which provides the possibility for the company to make use of the inventory. Zhenlong specialty also takes advantage of the characteristics of inventory inventory difficulties to increase profits, in order to achieve the purpose of IPO listing.

2.2. Zhenlong specialty financial fraud event cause analysis

In order to achieve IPO, Zhenlong specialty in the four prospectus delivered to the CSRC have inflated profits, inflated inventory and other behaviors, and was finally fined by the top of 600,000 yuan from the CSRC. However, as an audit institution, Ruihua Accounting Firm issued a standard unqualified opinion, so it was also asked by the CSRC to suspend business for rectification, and imposed a fine of 2.6 million yuan.

2.2.1. The Zhenlong specialty industry practices fraud

From 2011 to 2014, the raw materials of Zhenlong specialty accounted for a large proportion in the operating cost, and even reached 91% in 2014. Therefore, the employees of Zhenlong specialty artificially modified the purchase price list of raw materials and raw materials, making it lower than the actual purchasing unit price to reduce the operating cost and thus inflated profits. As shown in Table 2, pumpkin seeds, pine seeds and sunflower seeds are all raw materials with small particles that are difficult to conduct quality testing. Moreover, the raw materials of Zhenlong specialty are concentrated in stacking inventory, while the inventory of seed kernel is susceptible to the temperature and humidity of the storage environment, and mildew and deterioration occurs. The personnel of Zhenlong specialty products have found mildew and deterioration in the inventory inventory, but did not do the corresponding accounting treatment and confirm the loss, but stacked them in the stacking center to hide the fact of moldy inventory and achieve the situation of inflated inventory and profit.

Table 2. Changes in raw material prices

Unit: yuan

raw and processed material	2011	2012	2013
pumpkin seed	1.13	0.96	1.28
pine nut	1.96	2.24	3.08
pistachio	3.70	3.43	4.40
apricot pit	0.46	0.68	0.65
sunflower seeds	0.40	0.37	0.36
wheat flour	0.34	0.36	0.39

Data source: prospectus of Liaoning Zhenlong Specialty Co., Ltd., IPO

Long specialty also invented its production process, the prospectus said the company is the purchase of pumpkin seeds, sunflower seeds as raw materials, after reprocessing

and deep processing of foreign sales, but actually purchase lung specialty is directly after the packaging sales, such fictional production process of raw materials low unit price

but high price to make a reasonable explanation. The fictitious production process leads to the increased production cost, Zhenlong specialty said because of the advanced production and processing technology to achieve the high capacity

utilization rate, but in fact the company does not have these processing technology.

2.2.2. The help of Ruihua Firm

Table 3. Changes in the proportion of foreign sales revenue to the total sales revenue of Zhenlong specialty products

sales mode	In 2011,		In 2012,		In 2013,	
	income (10,000 Yuan)	scale (%)	income (10,000 Yuan)	scale (%)	income (10,000 Yuan)	scale (%)
foreign sales	39152.95	70.73	45619.67	73.25	66166.1	84.4
Total sales	55359.16	—	62275.35	—	78399.45	—

Data source: prospectus of Liaoning Zhenlong Specialty Co., Ltd., IPO

Most, first of all, according to table 3, vibration long specialty export sales revenue in the proportion of the total sales revenue, the proportion is 70.73% in 2011, and in 2013 increased to 84.4% (up 13.67%), but the international market industry as a whole form is not warming, the relevant auditors of vibration long specialty sales revenue and the international trend of increasing trend has no due professional skepticism, and not seriously.

Second, according to the CSRC of the punishment of vibration long specialty, vibration long specialty by the way of inflated accounts receivable to adjust fictitious overseas sales contract to increase sales revenue, and the certified public accountants in 2011-2013 operating revenue audit has no professional doubt, performance in vibration long specialty contracts with overseas customers in the obvious lack of some basic elements of foreign trade contract, such as the terms of payment, packaging standards, etc., especially auditors have found vibration long specialty in 2012 before and after 2 export contract format is not the same has not paid special attention to these abnormal situation.

Finally, ruihua auditors through confirmation to the majority of customers to verify the final accounts receivable balance and the current sales amount, but the auditor did not control the letter, and even let vibration long specialty staff to issue, which provides the opportunity to cheat, vibration long specialty so staff will forge the letter sent to the firm, the auditor will believe the letter, violated the audit criteria must be issued by project team members and sign for the principle of confirmation.

3. False Reflection —— Based on The Perspective of Business Ethics and Accounting Professional Ethics

3.1. Internal accounting personnel Angle

3.1.1. Insufficient working quality of accounting personnel

Due to the temptation in the business environment and conflicts of interest, some accounting personnel may because of personal greed and give up the moral principle, the pursuit of personal interests, thus ignoring the commitment to the public interest and business ethics, such as management commitment to accounting personnel high salaries, bonus incentive if assist its financial fraud, some accounting personnel will be attracted by immediate interests.

Secondly, if the organization lacks a culture to emphasize ethics, or the leadership itself lacks a moral example, the accountants may be affected by the adverse environment, thus affecting their moral behavior. As vibration long specialty fictional production process, artificial modification price list,

accounting for inventory and a series of illegal behavior, fictional production process is not a person or a department can easily do things, because it involved in a production cycle, visible vibration long specialty to management, down to grass-roots personnel are more or less affected by the bad environment.

3.1.2. Accountants' lack of independence

If there is a close relationship between accountants and the management or customers of the enterprise, accountants may be influenced by the management or customers in decision-making and reporting, and will be unable to act independently. In addition, the accounting personnel may rely on the information and resources provided by the enterprise or customers when performing their work. This dependence may lead the accounting personnel to feel subordinate to the enterprise or customers and difficult to think and act independently. They may have excessive trust in the source of the information provided without the necessary independent verification and review. Finally, accounting personnel may be affected by the enterprise or customers, hoping to meet their expectations or meet their interests, thus affecting their independence. The temptation of economic interests may lead accountants to deviate from moral principles and fail to maintain an objective and independent position.

3.1.3. Imperfect external laws

The imperfect external legal system and the lack of strong administrative punishment also restrict the accountants to abide by and form a good professional ethics. According to the administrative penalty decision document on the failure of IPO audit in recent years, it can be found that they are punished according to the relevant provisions of the Securities Law, basically fines, warnings, confiscation of income, and then the serious point is the ban of the certified public accountant market and the closure of the firm for rectification. It is further found that these punishments are punishments after the violation of the law, and these illegal costs are not worth mentioning compared with the profits in the IPO audit, and the punishment of the firm that repeatedly broke the law is the main certified public accountant. Several firms made mistakes after the punishment, indicating that it was not a deterrent to them and even encourages not being detected or making a profit after being discovered.

3.2. Perspective of external auditors

In the process of financial fraud, not only the long specialty has a problem, the relevant auditors ruihua certified public accountants also failed to diligently, although the long specialty financial fraud means special, but there are still some signs and clues for audit institutions, but auditors did not keep the professional skeptical attitude and follow the

principle of professional caution.

3.2.1. Dereliction of duty of external auditors

Due to the complexity of IPO audit and the long cycle, some auditors may ignore the internal control test when designing the audit procedures in order to reduce the audit procedures, thus becoming a mere formality. First of all, in view of the large number of overseas customers, overseas trade has become the focus of the risk of major misstatement, but the CPA did not remain doubts about the information provided by the audited units and conducted careful inspection. In addition, before the confirmation process, the certified public accountants did not check the relationship between the related parties and ensure that the letters were sent and signed by the auditors in person, but were sent and signed by the staff of the audited unit.

Secondly, before the implementation of the inventory procedure, the project team members did not ask the warehouse staff about the inventory storage, inventory scope, warehouse quantity and warehouse storage environment, and evaluated whether the inventory plan of the enterprise is reasonable. For agricultural enterprises such as Zhenlong specialty, certified public accountants do not pay special attention to raw materials, and do not maintain a professional skeptical attitude towards abnormal fluctuations.

3.2.2. It is difficult to remain independent

Independence is related to the following two aspects, first of all, auditors and the auditee is independent of each other, auditors are in a neutral position to audit and issue a report, but vibration long specialty has the right to decide certified public accountants and pay audit fees, which makes the auditors affected by the auditees, independence will be damaged.

Secondly, the audit cost, the audit business is the two main factors affecting the independence, and the higher the audit cost, the higher the economic dependence of certified public accountants on them. IPO audit cost generally higher than ordinary audit costs, if successful make enterprise listed will bring good reputation to the accounting firm, of course for certified public accountants will also produce a good reputation, this will directly affect the back of the undertake business, so some certified public accountants in order to obtain considerable income or get more IPO business, may sign an agreement with customers privately to help customer fraud.

3.2.3. Inventory taking is difficult

Because agricultural biological assets have vital characteristics and natural growth processes, their quantity, quality, and value may change over time. Therefore, many factors need to be considered in an accurate inventory inventory. First of all, agricultural production usually involves large areas of land and a large number of biological assets. This large scale and diversification makes inventory taking complicated and requires a lot of human resources. In addition, the measurement and valuation may be somewhat subjective and uncertain. For example, Zhenlong specialty pumpkin seeds, pine seeds and so on are some small particles, difficult to conduct quality testing of raw materials. In addition, agricultural production is vulnerable to weather and natural disasters. For example, the raw materials of Zhenlong specialty products are moldy, and extreme weather events such as drought and flood may lead to crop production or loss. These uncontrollable factors have increased the uncertainty of the inventory of agricultural biological assets.

4. Countermeasures and Suggestions

4.1. To improve the professional competence and professional quality of certified public accountants

In the case of financial fraud of Zhenlong specialty, the CPA failed to maintain enough professional skeptical attitude towards the audit process and ignored the abnormal situation, leading to the failure of the audit. Therefore, it is necessary to improve the professional ability and professional quality of certified public accountants.

First of all, certified public accountants should take integrity and transparency as their core values, always maintain honesty, integrity and reliability, and ensure that the financial report can truly and accurately reflect the financial situation of the enterprise. This requires frank communication with stakeholders and disclosure of all relevant information without concealing or misrepresenting the truth.

Secondly, certified public accountants should strictly abide by the code of professional ethics, such as international CPA standards and relevant industry standards. They should always maintain independence, objectivity and prudence, not affected by any conflict of interest, resolutely resist financial fraud, fraud and misconduct, and have the courage to report any illegal behavior.

Finally, CPA should cultivate a good professional conscience, always be aware of their responsibilities and influence, and perform their duties with a high sense of responsibility and professionalism, and constantly improve their professional knowledge and skills to adapt to the increasingly complex and changing business environment.

4.2. Establish and improve the accounting legal system

For China, the punishment mechanism adopted by the government supervision is irrelevant for accounting firms and IPO enterprises. For example, the CSRC usually warns, fines and fines illegal enterprises and firms to confiscate business income, but these are far lower than the illegal profits.

Therefore, first of all, the accounting legal system should establish a clear code of conduct and professional ethics to restrain the behavior of certified public accountants. This includes maintaining independence, objectivity and integrity, and prohibiting financial fraud, fraud and misconduct. Accountants who violate professional ethics shall be investigated by law and punished accordingly.

Secondly, it is necessary to establish an effective supervision mechanism and strengthen the supervision and law enforcement of accounting behavior. The regulatory agencies should strengthen the supervision of accounting firms and certified public accountants to ensure that they comply with professional ethics and regulations, and also strengthen the supervision of audit work and conduct regular evaluation and review of audit quality. At the same time, we should strengthen the investigation of violations and more severe punishment, discover and correct improper behaviors, and maintain market order and a fair playing field.

4.3. Strengthen the moral education of accounting practitioners

Moral education is of great significance to accounting practitioners. It is not only about individual professional ethics and responsibility, but also about the reputation and

social responsibility of the whole industry. Through moral education, the moral awareness, professional quality and decision-making ability of accounting practitioners can be improved, so as to establish a more honest and reliable business environment.

The moral education of accounting personnel can be strengthened from the following aspects. First of all, the organization and industry of the CPA firm should establish a good ethical culture. This includes the development and implementation of strict ethical norms and codes of conduct to provide clear guidance and support to accountants. The organization should emphasize the importance of professional ethics and encourage accountants to participate in ongoing ethical training and discussions.

Secondly, special lectures and seminars will be organized to invite industry experts and practitioners to share their experiences and views on ethics. This can increase the understanding and understanding of accounting practitioners on ethical issues, and inspire them to think about and discuss related ethical issues. Finally, the professional responsibility and social responsibility of accounting practitioners are emphasized, so that they can realize their important role in protecting the public interest and maintaining the stability of the financial market, and cultivate their professional ethics and sense of mission.

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