

# Research on the Identification and Prevention Mechanism of Accounting Fraud in Listed Companies

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**Abstract:** This study aims to deeply analyze the phenomenon of accounting fraud in listed companies, and build a set of effective identification and prevention mechanism through the comprehensive discussion of their causes, means and influences. This paper analyzes the common form and concealment characteristics of accounting fraud, and reveals the serious damage of fraud to the companies financial situation, investors interests and market order. Furthermore, from the dimensions of internal control, external supervision, legal punishment and so on, targeted preventive measures and suggestions are put forward, in order to provide strong theoretical support and practical guidance for listed companies, regulatory agencies and investors, and jointly maintain the healthy and stable development of the capital market.

**Keywords:** Listed company, accounting fraud, identification mechanism.

## 1. Types of Accounting Fraud in Listed Companies

### 1.1. Management Type and Non-Management Type

From the essential level, accounting fraud can be subdivided into two categories: management fraud and non-management fraud. Management fraud mainly involves the deliberate fraud of senior managers of listed companies, whose purpose is to fabricate profits, income and assets, mislead creditors and investors with the help of false accounting information, and create the illusion that the company has huge development potential and bright prospects. Instead of management fraud, it is the behavior of the company to illegally obtain the financial resources of the company by the employees of non-management positions through fraud or improper means.

### 1.2. The Diversity of Accounting Information Fraud

In recent years, some listed companies have taken more hidden and complicated ways in accounting fraud, especially through accounting information fraud. These companies either use illegal means to directly tamper with accounting information, or skillfully use of accounting regulations and policy loopholes for accounting manipulation. Some accountants take advantage of the policy loophole to delay revenue recognition, and postpone the sales revenue of this year to the next year, in order to falsely increase profits and help the company package listing.

### 1.3. Subdivision of Statements and Matters

From the level and perspective of accounting information, accounting fraud can be further subdivided into statement fraud and accounting fraud. Statement fraud occurs in the process of preparing accounting statements, by deliberately falsely reporting certain financial value, in order to deceive investors, creditors and other stakeholders. For example, some listed companies to gain trust, exaggerated assets and profits in the accounting statements, constitute accounting

fraud. And accounting fraud involves fictitious economic business or accounting matters, such as the use of related transactions to adjust profits, which is a common accounting fraud method. Due to the complexity of related relations, listed companies may deliberately whitewash financial reports through related transactions, seek short-term benefits by restructuring or other means, or even build a complex related party transaction network, and mislead creditors and investors with the help of their concealment and complex fictitious profit statements [1].

### 1.4. Other Types of Accounting Fraud

In China, the accounting fraud of listed companies presents diversified characteristics, among which the use of financial instrument fraud and relying on the support of local governments for accounting manipulation is particularly striking. With the rapid development of global financial business and information technology, the products and services of the financial market are increasingly rich and diversified, which not only expands the financing channels of listed companies, but also hides huge risks and temptations. Some illegal enterprises take advantage of the complexity of financial instruments, such as derivative financial products, asset securitization and other means, to carry out carefully designed financial fraud to defraud investors of funds or evade supervision, which seriously damages the fairness and transparency of the capital market. On the other hand, the local governments support policies for the listing of companies aim to promote the development of local economy and enhance the competitiveness of enterprises, but to some extent, some listed companies serve as the "umbrella" for accounting fraud. In the context of scarce listed resources, local governments, in order to attract and retain listed companies, local governments often provide a number of preferential policies, including tax relief and financial subsidies, in order to raise funds through listed companies to promote the prosperity of local economy. However, this support sometimes becomes an incentive for listed companies to manipulate profits and whitewash their financial statements. Some poorly managed companies take advantage of local governments to avoid delisting risks or being specially treated

to manipulate profits through fictitious transactions, exaggerating revenue, concealing costs and other ways, and even form a tacit understanding with local governments, jointly weave financial lies, in order to obtain more government subsidies and investors letters [3].

Some listed companies also collude with intermediaries, especially accounting firms, to use their professional knowledge and skills to carefully package financial reports, cover up the true financial situation, and provide technical support and cover for accounting fraud. This behavior not only seriously destroys the independence and credibility of the accounting industry, but also makes investors have deep doubts about the fairness and transparency of the market. If this goes on in the long run, it will seriously hinder the healthy development of the capital market and damage the legitimate rights and interests of the majority of investors [4].

## 2. Accounting Fraud Status

China's securities market has experienced wind and rain, and although gradually growing, it is still in the growth stage, and its maturity needs to be improved. In this environment, business operators are faced with both internal and external challenges: not only to deal with the rigorous assessment of internal operating benefits, but also to meet the ardent expectations of external investors on investment returns. Under such pressure, some business operators choose accounting fraud, an improper means to beautify their business performance, in order to stand firm in the fierce market competition.

Accounting fraud phenomenon is common in China's securities market, and the amount of large amount is staggering. Taking China Grand Logistics as an example, through carefully forged delivery data, confirming real estate business income in advance, the operating revenue in 2022, accounting for 57.65%, the total profit also increased by 622 million yuan, accounting for 78.52%; and the 2023 annual report was also seriously inflated. Zeda Yisheng, a science and technology innovation board enterprise, has made up a huge revenue of 565 million yuan in six years, and the profit increase has reached a shocking 296 million yuan. In the sales business of cobalt wet smelting intermediate products with customers, Shengtun Mining recognized the revenue without substantially transferring the control of goods, resulting in suspected overcounting and undercounting huge operating income and total profits in the annual reports of 2021 and 2022 annual reports respectively. This appalling fraud behavior, not only seriously violated the requirements of information disclosure regulations, but also brought immeasurable economic losses to the majority of investors. These amazing figures undoubtedly reveal the seriousness of accounting fraud in China.

The variety of fraud and its constantly updated tactics has brought great challenges to regulation. To the Ministry of Finance released the latest accounting information quality inspection announcement as an example, Asia America holding group co., LTD. Was found to have serious financial irregularities, the company 2022 less confirmed credit impairment loss of 28335840 yuan, more combined net profit corresponding amount, but also will be part of the technical personnel wages wrongly included in research and development expenses, lead to less the main business cost 3,960,426.19 yuan. In the market, there are still some listed companies, private and foreign-funded enterprises, which attempt to falsely increase profits and avoid tax liability by

means of falsely listing expenses, delaying payment and less tax. The various means of fraud are impossible to prevent [2].

More worryingly is that the wide number of participants in accounting fraud, almost covering the entire enterprise ecological chain. Due to historical reasons, the phenomenon of a dominant listed company in China is more common, and the major shareholders are often able to manipulate the accounting fraud. This behavior does not exist in isolation, but also requires the audit behavior of external certified public accountants and the cooperation of internal accounting personnel to be implemented.

## 3. Analysis of Accounting Fraud Causes of Listed Companies

### 3.1. Interest-driven Development

Interests, as the core driving force of market economic activities, have also become the most essential and direct inducement of accounting fraud of listed companies. In the fierce market competition, enterprises are facing multiple challenges such as performance pressure, stock price fluctuations and financing needs. In order to maintain a good market image, attract investors, or meet specific financial indicators to achieve financing, mergers and acquisitions and other purposes, some listed companies do not hesitate to take risks to whitewash financial statements through accounting fraud, exaggerate performance and cover up problems. Although this short-sighted behavior may bring temporary benefits, but in the long run, it will seriously damage the reputation and long-term development of the enterprise, and even cause legal disputes, leading to the crisis of the enterprise [5].

### 3.2. The Quality of Relevant Personnel is Low

In addition to the profit-driven, the low quality of relevant personnel is also one of the important reasons for accounting fraud. The relevant personnel here include not only accounting personnel directly involved in accounting work, but also certified public accountants responsible for audit supervision. The professional quality of some accountants is not high, and the understanding of accounting standards and regulations is not deep enough, and they may go astray due to ignorance or misunderstanding. Their moral concepts may also be biased, lack of professional ethics and responsibility, vulnerable to external temptation to participate in fraud. As an important gatekeeper of the capital market, the professional quality and professional ethics of CPA are equally important. In reality, although some certified public accountants have obtained professional qualifications, they lack practical audit experience, and it is often difficult to make accurate judgments in the face of complex business conditions. What is more serious is that some certified public accountants may give up their principles and issue false audit opinions due to the lure of the interests of the enterprise, so as to put on the "legal" cloak for the fraud of the enterprise.

## 4. Identification of Accounting Fraud of Listed Companies

### 4.1. Identify Content Clearly

#### 4.1.1. Identification of solvency indicators

To scientifically and effectively identify accounting fraud in listed companies, solvency indicators should be considered as core elements. The continuous operation of listed

companies relies on their fundamental ability to pay off debts when due, and the quick ratio, as a key indicator that directly reflects a company's short-term solvency and the protection of creditors' rights, is crucial for measuring the financial status of enterprises. Therefore, to ensure accurate identification of accounting fraud, it is necessary to comprehensively analyze solvency indicators and develop a complete identification plan. As shown in Figure 1. The foundation for the survival and development of listed companies lies in ensuring the repayment of debts when due. The quick ratio, as an important indicator for measuring a company's solvency, is crucial for assessing the financial stability of the company. The level of the debt-to-asset ratio directly reflects the company's long-term solvency and the level of protection of creditors' rights, with a high debt-to-asset ratio often indicating higher risk. When assessing the risk of accounting fraud, it is necessary to deeply analyze the debt-to-asset ratio to accurately grasp the company's solvency. The interest coverage ratio reveals the extent to which a company's profitability supports its solvency by calculating the ratio of earnings before interest and taxes to interest expenses: when this ratio is greater than 1, it indicates that the company has a strong solvency; conversely, it means that the company's solvency is questionable.



**Figure 1.** Identification of the solvency of listed companies

#### 4.1.2. Identification of profitability indicators

Profitability is not only a direct reflection of the value of listed companies but also the starting point and ultimate destination of their growth and expansion. It profoundly reflects the company's ability to achieve its business objectives. When assessing accounting fraud, profitability analysis becomes a core indicator for measuring the company's comprehensive capabilities, providing an important basis for determining whether the company has a solid debt-paying capacity. Analysis of the sales profit margin can deeply understand the type, characteristics, and market performance of the company's product sales. By accurately calculating the ratio of the profit from the sale of core products to sales revenue, one can intuitively assess the market potential and competitiveness of the products, thereby judging the company's profitability. Analysis of the material conversion rate reveals the efficiency of material use in the production process. A high conversion rate means effective cost reduction and increased economic benefits, which requires us to carefully analyze the ratio between material input and product output to accurately evaluate the company's profit potential. The analysis of the cost and expense profit margin is also not to be overlooked. It reflects the company's ability to control production costs and various expenses. A high profit margin means the company performs well in cost control, and the cost incurred for profit is relatively low, which directly reflects the company's management efficiency and risk resistance capability.

#### 4.1.3. Identification of management ability indicators

When evaluating the effectiveness of financial controls in listed companies, the strength of management capabilities becomes a core consideration. An efficiently managed team can accelerate capital turnover and stimulate the potential for business development by implementing a series of effective strategies, thereby optimizing operational performance. It is

particularly important to deeply analyze the management capability indicators of listed companies when identifying potential risks of accounting fraud. First, attention should be paid to the pass rate of product quality sampling inspections, as this serves as a direct reflection of the company's technical strength and management level. A high pass rate not only wins consumer trust but also reflects the company's rigorous quality control processes. Examining the total asset turnover rate, this indicator directly reflects the efficiency and effectiveness of asset use. A high turnover rate means that assets are operating smoothly, while a low turnover rate may suggest financial difficulties and increase the risk of accounting fraud. A comprehensive assessment of the company's development capabilities, including technological innovation, technology management, product management, market expansion, and other dimensions, these capabilities collectively build the company's core competitiveness and also reveal the health of its financial management. Through detailed analysis of these management capability indicators, not only can a comprehensive grasp of the operational status of listed companies be achieved, but it also provides a strong basis for predicting and preventing accounting fraud.

#### 4.1.4. Identification of development capacity indicators

When evaluating and analyzing the development capabilities of listed companies, we need to comprehensively consider their total asset growth rate, which typically reflects the company's active expansion of capital scale through various channels during its growth phase. A high growth rate indicates a positive expansion trend, but it also comes with potential risks, thus requiring a comprehensive analysis. We should focus on the growth rate of R&D expenses, which reflects the company's investment intensity and development level in independent innovation and technological research and development; however, high R&D investment is accompanied by the consumption of human and material resources, and we must also be vigilant against the risk of accounting fraud. In addition, the growth rate of sales revenue is an important indicator that directly reflects the company's growth and economic conditions; its high level not only means that the company's economic development momentum is good, but also reduces the probability of accounting fraud to some extent.

## 4.2. Improve the Identification Method

### 4.2.1. Empirical identification method

As The experience identification method, as an effective means, encompasses core application strategies including fundamental level analysis, audit opinion analysis, and elimination methods. These methods collectively form a multi-dimensional, in-depth identification system. The fundamental level analysis focuses on the macro and micro environments of listed companies. By examining the current industry status, development prospects, and macroeconomic conditions, and combining the company's position within the industry, market share, reputation, as well as the management capabilities and strategies of senior management, a comprehensive assessment of key elements is conducted. This lays a solid foundation for identifying accounting fraud. The promulgation of new auditing standards further emphasizes the importance of fundamental environmental analysis, requiring auditors to identify any significant inconsistencies between accounting statements and the results of fundamental analysis as key areas for investigation. They must delve deeper to uncover potential signs of fraud, ensuring the

accuracy and warning nature of the analysis results. Audit opinion analysis, on the other hand, focuses on interpreting audit reports issued by certified public accountants, especially the type of audit opinions, such as unqualified opinions with emphasis on matters, standard opinions, or opinions that cannot be expressed. These opinions directly reflect the reliability of the accounting reports and the degree of fraud risk. Through a detailed analysis of the audit report, one can gain insight into the true state of the listed company's accounting information, promptly identify and systematically recognize potentially fraudulent activities, providing important references for investors and regulatory bodies. The elimination method is more specific in its application, mainly including three strategies: elimination of non-performing assets, elimination of related-party transactions, and elimination of abnormal profits. The elimination of non-performing assets reveals the company's operational stability and the authenticity of its previous profits by comparing the amount of non-performing assets to net assets, preventing the concealment of "asset bubbles." The elimination of related-party transactions aims to strip away the impact of related parties on the company's performance, truly reflecting the company's independent profitability, assessing its dependence on related enterprises, and ensuring the stability of the profit base. The elimination of abnormal profits involves removing non-recurring items such as investment income and government subsidies to restore the profitability of the company's core business, identifying the true driving force behind profit growth, and avoiding being misled by superficial prosperity.

#### **4.2.2. Data mining and identification method**

Data mining technology becomes the core means with its unique advantages. Through the automatic application of electronic data technology, this technology effectively eliminates human interference, deeply excavates the hidden and unpredictable anomalies in accounting data, relies on the rich knowledge reserve of large databases and data warehouses, and builds a comprehensive data set. On this basis, through the in-depth analysis of the nature and internal characteristics of the data, systematic reveal the clues of accounting fraud. Data mining not only integrates the advanced technologies of data statistics, computer science and artificial intelligence, but also subverts the traditional data analysis mode. By generating data models and verifying the actual data, it realizes the inductive reasoning from special to general, ensuring the hypothesis minimization and maximum objectivity of the analysis process. Data sampling processing, carefully select the sample subset closely related to fraud identification, avoid the comprehensive processing of massive data, significantly improve the efficiency and save resources. The data search steps focus on refining key data reflecting accounting laws, trends and associations, laying a solid foundation for subsequent analysis. In the data adjustment stage, through the close cooperation between the experts and the data mining team, we can deepen the understanding of the data, accurately screen and classify it, and innovatively construct new variables to optimize the state description. In the process of model construction, data mining experts design the mining model according to the actual situation, and have in-depth communication with experts in the accounting field to jointly optimize the model structure. In the model evaluation and analysis stage, experts not only have a deep understanding of the model mechanism, but also strictly evaluate its identification efficiency. They accurately

predict the accounting fraud risk of listed companies through the model, which provides a strong technical support and decision-making basis for timely response and properly handling the accounting fraud problem.

## **5. Suggestions for Preventing Accounting Fraud in Listed Companies**

### **5.1. Improve the Internal Control System of Listed Companies**

To improve the internal control system of listed companies, it is necessary to start from two major aspects: performance evaluation and internal supervision. It is essential to innovate the traditional performance evaluation mechanism, abandoning the measurement method of a single financial performance indicator. This one-sided approach not only makes it difficult to accurately assess the actual effectiveness of managers, but it may also induce fraudulent behavior to beautify performance. A comprehensive evaluation system should be constructed, integrating financial and non-financial indicators to ensure the comprehensiveness and fairness of the evaluation. In terms of internal supervision, it is necessary to continuously optimize the independent director system, strengthen its independence, and ensure the effective functioning of the supervisory function; enhance the comprehensive ability training for senior management personnel, cultivating compound talents who understand both production and management. Establish and improve an information disclosure system covering the entire chain from procurement, production, to sales, replacing the previous fragmented and arbitrary operation modes, and enhancing the transparency and standardization of corporate operations. Through these measures, listed companies can build a more sound and efficient internal control system, laying a solid foundation for the company's steady development.

### **5.2. Improve the Quality of External Audit Supervision**

Compared to ordinary companies, the complexity of auditing for listed companies is significantly higher. While strengthening the internal control system, optimizing external audit supervision is equally important. It is necessary to tailor the audit process according to the characteristics of the enterprise, ensuring the relevance and effectiveness of the audit work. Use analytical review methods to monitor the dynamics of enterprise inventory and accounts receivable in real-time, promptly identifying potential issues; verify abnormal accounts receivable through confirmation letters, strictly examining for the existence of false accounts or other irregularities, to accurately assess the financial status of the enterprise, comprehensively improving the quality of audits, and protecting the steady development of listed companies.

### **5.3. Increase the Cost of Accounting Fraud for All Stakeholders**

Supervisory authorities should strengthen regulatory efforts, rapidly and strictly implement penalties for verified fraud incidents, thereby forming a strong deterrent. Relevant provisions of China's Securities Law also urgently need improvement, increasing the penalties for fraud by managers and accounting personnel of listed companies, making the law a "Sword of Damocles" hanging over their heads. It is also

necessary to focus on improving the professional ethics and moral standards of certified public accountants and government officials, taking the protection of investors' interests as the core goal of regulatory work, and thoroughly implementing and enforcing it. The joint liability of certified public accountants should be increased, and the difficulty and threshold for obtaining audit qualifications should be raised, prompting relevant personnel to continuously improve their moral integrity and professional capabilities.

## 6. Conclusion

Accounting fraud of listed companies is a complex and severe problem, with various types and hidden means, which has caused serious damage to investor confidence and market order. Through in-depth analysis of the types, status quo, motivation and identification methods of accounting fraud, it can be found that to effectively prevent accounting fraud, we must start from many internal and external aspects. On the one hand, listed companies need to improve the internal control system, optimize the performance appraisal mechanism, strengthen internal supervision and improve the operation transparency; on the other hand, the quality of external audit supervision also needs to be improved, so the audit process should be customized according to enterprise characteristics, and advanced audit methods should be adopted to ensure the effectiveness and pertinence of audit work. Increasing the punishment of fraud and raising the cost

of accounting fraud of various stakeholders are also the key to curb fraud. Only with the joint efforts of the government, enterprises, audit institutions and investors, can we build a fair, transparent and healthy capital market environment, protect the legitimate rights and interests of investors, and promote the sustainable development of listed companies.

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