

A Case Study of Financial Fraud in Listed Companies

-- Taking Kunming Machine Tool as an Example

Yongxin Yang, Yanxi Zhou, Xueqi Gao, Li Zhang

School of Accounting, Anhui University of Finance and Economics, Bengbu, 233030, China

Abstract: With the continuous development of China's capital market, the deepening of the system reform, the national economy has achieved rapid development, but behind the prosperity of the market economy, some problems also arise; Some enterprises do not follow the financial accounting reporting standards, consciously use a variety of means to distort the reflection of business activities, making accounting information distortion, misleading information users' decisions. The frequent occurrence of financial fraud not only causes serious losses of investors' interests, but also causes a huge impact on the capital market, which undoubtedly hinders the development of China's national economy and is not conducive to the economic development of human society. Therefore, in this context, the analysis and research of financial fraud cases is particularly important. Based on the typical cases of financial fraud in the past two years, kunming machine tool as an example, the review case background, reveal its financial fraud means, based on business ethics and accounting professional ethics Angle, analysis of fraud motivation, and puts forward feasible financial fraud prevention suggestion and strategy, in order to promote the healthy development of capital market in China.

Keywords: Kunming machine tool, Financial fraud, Business ethics, Motivation of fraud, Countermeasures for fraud.

1. Introduction

Business ethics and accounting professional ethics has always been business faces a challenge, along with the rapid development of our country's economy, enterprises continue to grow stronger, financial fraud emerge in endlessly, and information technology today, the increasingly severe challenges, the type of financial fraud and increasingly diversified and makes the regulatory supervision more and more difficult; In order to pursue profits, all kinds of enterprises completely ignore business ethics, abandon professional ethics, and falsely disclose accounting information, which causes great damage to the interests of investors and has a far-reaching impact on the capital market. This paper attempts to analyze and think about the problems of business ethics and accounting professional ethics, and gives some solutions and suggestions, which have certain reference value, through a machine tool fraud event in Kunming which has great influence in the past two years and has very representative methods of fraud.

2. Kunming Machine Tool Financial Fraud Case Overview

2.1. Company Profile and Case Background

Kunming Machine Tool Co., LTD. (hereinafter referred to as Kunming Machine Tool) is the backbone enterprise of large precision machine tools in China, and has successively developed more than 140 "China's first machines". Company's main business is the development, design, manufacture and sale of horizontal boring machine and other large precision machine tools, as well as the processing center, precision testing equipment, precision displacement sensor, and other series of products, its leading products are mostly in the domestic leading level, has long been China's machinery industry, automobile manufacturing, aircraft manufacturing, aerospace industry and other preferred

products, The company's products have won more than 80 scientific research achievement awards, 18 times more than quality awards, known as one of the two pearls of China's machine tool industry. Founded in 1936, Kunming Machine Tool Co., LTD was formally registered in 1993. It is one of the first standardized joint-stock pilot enterprises listed in Hong Kong and the only A+H share listed company in Yunnan Province and the domestic equipment industry [1].

However, such a star enterprise has been exposed in March 20, 2017 since the financial fraud scandal, in the industry caused an uproar. In fact, as early as 2011, the machine tool industry ushered in a difficult period, due to the poor technology of domestic machine tool enterprises and the growing development of high-tech and intelligent, focusing on large precision machine tools, low automation kunming machine tool does not have any competitive advantage, several degrees in the edge of loss struggle; Since 2012, the economic benefit of Kunming Machine tool has been declining, with losses in successive years and financial fraud scandals constantly exposed.

The operating status of the company from 2011 to 2017 and the main business composition in 2017 are shown in Table 1 and Table 2.

Table 1. Operating Status of Kunming Machine Tool from 2011 to 2017(Unit: hundred million)

Results the year	Operating income	Operating cost	Net profit
2011	18.5	17.47	0.52
2012	10.86	11.99	-0.82
2013	10.29	10.59	0.10
2014	8.679	10.65	-2.095
2015	6.213	9.993	-3.516
2016	6.459	12.03	-3.413
2017	5.604	9.191	-3.521

Table 2. Composition of main business of Kunming Machine Tool in 2017

The main composition	Main business income (yuan)	Income ratio	Main business Cost (yuan)	Cost ratio	Main business Profit (yuan)	Profit share	Gross margin (%)
Machine tool	518 million	92.47%	546 million	93.72%	-27.5253 million	125.74%	-5.31%
Energy saving centrifugal compression service	42.2125 million	7.53%	36.5782 million	6.28%	5.6344 million	-25.74%	13.35%

Data source: According to Oriental fortune net delisting kunji financial report collation

From the operating conditions and the company's main business, kunming machine tool have losses for four years in a row, and the company's business mainly concentrated in the traditional manufacturing business of low automation, in the numerical control machine tools, under the background of intelligent industry has increasingly become the mainstream, kunming machine tool is difficult to run again, by various means of fraud, gradually took to the opportunistic, the path of fraud to protect shell.

2.2. Fraud Review

On April 1, 2016, due to the company's two consecutive years of losses since 2014, according to the relevant provisions of the Shanghai Stock Exchange, Kunming Machine Tool stock was delisted risk warning, and the listed trading was suspended after the disclosure of the 2016 annual report.

On March 20, 2017, Kunming Machine Tool issued a statement saying that "in the audit process of 2016 annual report, auditors found that the company had problems such as inaccurate inventory and delayed income in 2016." The company immediately carried out a self-inspection and found that there were many financial irregularities and irregularities in previous years, involving a sum of over 100 million yuan. The next day Kunming machine tool A shares fell by the daily limit, H shares fell 13.7 percent. Two days later, on March 22, the CSRC formally launched an investigation.

On May 23, 2017, due to three consecutive years of losses, Kunming Machine Tool was suspended from the Shanghai Stock Exchange and faced the risk of delisting.

On February 5, 2018, after nearly a year of investigation and research, China Securities Regulatory Commission (CSRC) officially issued a notice to impose administrative penalties on 23 responsible personnel of Kunming Machine Tool Co., LTD., Including Wang Xing (chairman of the board), Chang Baoqiang (general manager) and Jin Xiaofeng (chief financial officer). According to the CSRC, kunming Machine Tool's annual report from 2013 to 2015 falsely recorded 483 million yuan in revenue, 29.6086 million yuan in administrative expenses, 235 million yuan in cost, 506 million yuan in inventory and 228 million yuan in profit.

On May 22, 2018, according to the review opinions of the Listing Committee, it was decided to terminate the listing of Kunming Machine Tool, which was the first batch of enterprises to be delisted in the A-share market in 2018.

Four consecutive years of losses, listed companies are insolvent, years of financial fraud, a number of executives were banned from the market, Kunming Machine tool was terminated on May 22, 2018, a major financial fraud case finally came to an end. From the former glory to the fall of the altar, Kunming machine tool opportunistic, fake shell behavior did not let him return to the former glory, and finally only dug his own grave, self-destruction.

2.3. Fraud Analysis

According to the investigation, from 2013 to 2015, Kunming Machine Tool inflated its income by RMB 483 million through three ways: trans-period income recognition, false income calculation and inflated contract price. Inflated profits by 29.61 million yuan by underdrawing dismissal benefits and executive compensation; The inventory data disclosed in annual reports from 2013 to 2015 were falsified.

2.3.1. Inflated Income

From 2013 to 2015, Kunming Machine Tool recognized the income due from the performance of the contract by adjusting it to the next period or year. In 2013, 2014 and 2015, it recognized 56, 59 and 107 inter-period incomes respectively, involving about 76.27 million yuan, 41.23 million yuan and 141 million yuan.

In this process, Kunming Machine tool overstated its income through fictitious transactions. In order to avoid audit by auditors, Kunming Machine Tool dealt with its off-account inventory by setting up warehouses, issuing false invoices and fictitious transport agreements. In 2013, 2014 and 2015, kunming Machine Tool overstated 115, 46 and 34 items of income respectively, involving an amount of about 1.. 2.2 billion yuan, 79.46 million yuan, 20.2 million yuan.

In addition, from 2013 to 2015, Kunming Machine Tool artificially increased the contract price by 2.11 million yuan. After signing the contract with customers, Kunming Machine Tool unilaterally falsified and inflated the contract price. In 2013, the inflated contract price was 1.49 million yuan, involving 14 customers and 44 machine tools. In 2014, the inflated contract price was 620,000 yuan, involving 10 customers and 22 machine tools.

2.3.2. Inflated Profits

In accordance with the accounting standards in China, issued by the enterprise to the worker of termination benefits, compensation, etc., shall be recorded into the profits and losses of the current, in accordance with the labor contract relationship and the compensation standard, etc., shall be confirmed the current expenses and liabilities, and kunming machine tool don't abide by the relevant provision, by the way

is retreated inside the number, less termination benefits, inflated profits.

In terms of executive compensation, Kunming Machine Tool passed the company's annual executive compensation evaluation plan in 2015 and 2016 respectively, and the executive compensation of the year should be deducted according to the evaluation plan. However, the financial department did not fully deduct the executive compensation, and the administrative expenses of 2014 and 2015 were understated by 1 million yuan and 2.12 million yuan respectively. From 2013 to 2015, Kunming caused a total of 29.61 million yuan in inflated profits by underdrawing dismissal benefits and executive compensation.

2.3.3. False Disclosure

Since 2012, the operating condition of Kunming Machine Tool has been weakening gradually. With the help of the means of falsely increasing profits, the loss was disclosed as profit in the annual report of 2013. However, in the following two years, the company's performance was still in deficit. The data disclosed by Kunming Machine Tool in its annual report from 2013 to 2015 all had the problem of false record, which constituted the violation of information disclosure and involved 96 million yuan.

3. The Motivation Analysis of Fraud Is Based on Business Ethics and Accounting Professional Ethics

Nowadays, with the continuous development of Chinese enterprises, the accounting industry will also face various opportunities and challenges. Among them, business ethics and accounting professional ethics have always been a severe challenge faced by enterprises and accountants. As a key link in the market economy, the quality of accounting work will affect the rights and interests of operators, investors and the public, thus affecting the overall economic operation of the society. Therefore, accounting practitioners should not only abide by laws and regulations, but also have the corresponding professional ethics; The more the market economy develops, the higher the professional ethics level of accounting work is required.

3.1. Self-interest Needs to Conflict with Business Ethics

The compensation of the management of a company is often related to the economic status and profit level of the company. However, in order to maximize personal interests, some management often neglect or ignore the interests of shareholders and only focus on the short-term development of the company, putting their own performance in the first place. In order to achieve this goal, some management even use financial fraud to make their own performance "better". As the management of Kunming Machine Tool, Wang Xing and others' remuneration also depended on the enterprise's operating results. However, when the performance of Kunming Machine Tool declined, Wang Xing and others colluded to commit financial fraud out of personal interests, causing great damage to the interests of investors. The emergence of false accounting information in a company is due to the violation of moral principles and norms by the subject of human behavior, which is inseparable from the moral cultivation and spiritual quality of the management at that time[2].

3.2. The Accounting Personnel of the Company Are Not Highly Qualified

Accounting industry entry threshold is low, the company's basic level of accounting personnel not enough professional quality, conformist, not aspirant, inaction, passive, lack of professional dedication. They have low professional and technical level, lack of professional knowledge, no firm position, often do not learn the law, do not understand the law, lack of judgment ability, blindly listen to the upper management arrangement, when giving some interest temptation, easy to shake the inner position to participate in financial fraud. Secondly, the senior management of the company has poor performance in accounting and turns a blind eye to the principles of seeking truth from facts and objectivity. In order to achieve a certain goal, deliberate financial fraud, distortion of facts, for accounting information users to make decisions to bring great difficulties.

3.3. The Independence of Audit Work Is Problematic

Internal audit committee and the independent director system become a mere formality, according to the regulations of the company law, directors and senior managers shall not concurrently hold the position of the supervisors, and kunming machine tool of the board of directors and management personnel are highly overlap, cannot guarantee its audit work without interference, the auditing department can be evaded, difficult to play a role, it was an opportunity for fraud, Promote the further occurrence of fraud. At the same time, the independence of the external audit body of the company also has problems. Although the fraud means of Kunming machine tool are hidden, there are still clues to be found, while the external audit body did not comply with the accounting standards and questioned its financial statements[3]. Because the auditor is from the audited company to obtain audit fees, which will inevitably produce bad practices, and because the firm industry competition is fierce, accounting firms are easy to be "led by the nose", and the audited company in collusion, together in financial fraud.

4. Financial Fraud Prevention Suggestions and Strategies

Similar to the Kunming machine tool such financial fraud cases, these are leading to the distortion of financial data, its generation of many factors; Accounting information distortion is a large-scale systematic project involving coordination of all parties, such as strengthening accounting professional ethics education, reshaping a good external economic environment, improving the accounting professional system and moral norms, and improving the supervision mechanism of accounting professional ethics.

4.1. Strengthen Accounting Professional Ethics Education

The processing, generation and transmission of accounting information are the direct burden of accounting workers, and the authenticity of accounting information should be the main source of accounting information. At present, China's accounting profession threshold is relatively low, accounting profession skills and professional ethics consciousness can not be guaranteed, and the lack of professional research and professional ethics, strengthen professional ethics training

becomes very necessary. It is necessary to construct perfect moral education system, strengthen moral education, guide and guide accountants to establish correct professional ethics consciousness. Regardless of their own personal interests, maintain an objective and realistic working attitude, in business activities, abide by accounting laws and regulations, not subject to subjective and other people's will.

4.2. Purify the Accounting Profession Environment

Accountants not only work in the field of accounting, but also live in the social environment, and their professional ethics will inevitably be affected by various social factors [4]. The company's internal accounting personnel are limited by the company's system, or under the pressure of management, may not be able to play its original role; External audit market environment is also not optimistic, fierce competition among firms, they do not hesitate to take the way of price war in the hope of gaining an advantage in the market, it is easy to lose the right to speak and be subject to the audited enterprises. In order to eliminate the influence of these negative factors on the accounting industry, we should optimize the accounting environment, improve the internal control system of the company, and make the audit committee no longer exist in name only; To improve the audit market environment, the supervision department can formulate price standards to avoid price problems disturbing the market order, and strengthen supervision and punishment, purify the environment of accounting industry, so as to make the market economy develop benign.

4.3. Improve the Accounting System and Legal System

"The more the economy develops, the more important accounting becomes." Such a simple sentence expresses the close relationship between accounting and economic development[5]. With the continuous development of China's economy, the market economic system has changed. In the transition period of the old and new systems, the traditional accounting theories and methods have been unable to adapt to the requirements of the new economic system, and should be improved and perfected under the original system to meet the needs of the development of market economy. At the same time, the low cost of illegal activities is also a major factor contributing to fraud. In order to ensure the accuracy and credibility of information circulating in the market, it is necessary to have a complete legal system. The system of accounting laws and regulations should not only regulate the accounting behavior, but also adjust the external performance and pay attention to the internal spiritual realm. In the process of amending the Accounting Law, we should combine it with accounting professional ethics, make it play the complementary function, make it permeate each other in

connotation; Promote each other in effect, so that accounting professional ethics and accounting legal system organic combination of thought to be fully implemented.

4.4. Improve the Accounting Professional Ethics Supervision Mechanism

Financial fraud has always been a difficult problem faced by the economy and society. Although many fraudulent enterprises have been investigated and dealt with, they still have the opportunity to take advantage of the weak supervision of relevant departments. In the face of this situation, we should improve the theoretical mechanism of accounting professional ethics, improve its reward and punishment evaluation mechanism. To strengthen the punishment for bad behavior, improve the cost of fraud; The advanced enterprises that abide by accounting professional ethics should be encouraged and commended to set up industry models. In short, accounting is an information system that can reflect economic activities. The unsound accounting system will also hinder the development of the economy and aggravate the disorder of the economic system. In this study, Kunming machine tool for many years by manipulating stock, inflated revenues, decreased costs, practice fraud, false disclosure means for enterprises, investors and the whole market has brought bad influence, visible defects in the internal system, on the other hand, the independence of external audit institutions and the relevant departments of supervision are flawed. Therefore, it is particularly important to establish and improve the internal control system, strengthen the accounting personnel skills and professional ethics education, improve the accounting system and legal system, and improve the relevant supervision system in promoting the development of the national economy.

References

- [1] Deng Xiao-zhu, LIU Ke-li. The potential impact of internal control failure on corporate governance: Based on the Case of *ST Kun Machine fraud [J]. Contemporary Economics, 2019 (3) : 130-132.
- [2] Jiang Xuan. Research on Financial Fraud behavior and Countermeasures of Manufacturing Enterprises -- Taking Kunming Machine Tool As an example [D]. Master thesis of Beijing Jiaotong University, 2019:29-31.
- [3] Yang Hainan. Case Study of Kunming Machine Tool Financial Fraud [D]. Master's Thesis of Jilin University, 2019:23-25.
- [4] WAN Qing. On the Problems and Countermeasures of accounting Professional ethics [J]. Economist, 2010 (3) : 160-161.
- [5] Chen Guohui, CHI Xusheng. Basic Accounting [M]. Dalian: Dongbei University of Finance and Economics Press, 2018:287-288.