

# Study of Financial Fraud Based on Crime Theory

-- An Example of YiHua Lifestyle Technology Co.Ltd.

Yaling Chen, Shan Xiong, Ting Duan

College of Management, Sichuan University of Science & Engineering, Sichuan 10622, China

**Abstract:** Capital markets have flourished in recent years, and while regulatory forces have continued to advance, there is no shortage of leakages that have caused major shocks to capital markets. It has seriously threatened the confidence of market participants in financial information and deteriorated the quality of the audit function. In order to safeguard the interests of all parties in the capital markets and to promote a thriving industry and business, the fraud problem needs to be curbed more effectively. In this paper, we will focus on five aspects of the case, namely the characteristics of the fraudster, the secret of fraud, the mechanism of incentivising fraud, internal and external monitoring and the results of fraud, from the Crime theory, taking YiHua Lifestyle Technology Co.Ltd. as an example, and offer fraud prevention advice on internal corporate governance, business strategies and external auditing.

**Keywords:** Financial fraud, Crime theory, YiHua Lifestyle Technology Co.Ltd.

## 1. Introduction

Under the new economic normal, although manufacturing technology and production lines are constantly innovating, there is a lack of core competitiveness in terms of manufacturing upgrading needs and innovation capabilities. Coupled with the weakening cost advantage, profit growth is slightly sluggish. Under numerous pressures, fraudulent manufacturing companies are frequent, which has a serious negative impact on the overall development of the industry. In the absence of managerial ethics and changes in business models, there are numerous fancy means of corporate practice fraud. Therefore, it is necessary to study the direct features of

fraud cases such as counterfeiters and secrets and to address them effectively.

## 2. Case review

The main business of YiHua Lifestyle Technology Co.Ltd.(Hereinafter referred to as YiHua) is the production and sale of wooden furniture, wooden flooring and other wooden products, integrating forestation, harvesting, processing, manufacturing and sales. The exposure of the problems with YiHua first came from the Shanghai Stock Exchange's inquiry into its 2018 annual report, ending with a penalty from the CSRC. Table 1 shows the full course of this incident.

Table 1. Case Background

Time	Content
2019	Questioned for high debt but purchase of high property properties and high savings and loans.
2020.4.24	Received a report from the SFC on the investigation of a case.
2020.4.28	"Unable to express an opinion" report issued by Asia Pacific Certified Public Accountants Co., Ltd. due to internal control of monetary funds.
2021.2.22	Share price dropped below one yuan for 20 consecutive days.
2021.3.19	Delisted from the Shanghai Stock Exchange
2021.10.14	Administrative penalty decision of CSRC announced.

## 3. Analysis of financial fraud in YiHua based on Crime Theory

In his book Study guide for Financial Statement Fraud, Zabihollah Rezaee (2005) proposed the "CRIME" theory after a detailed analysis of Enron, WorldCom and other typical falsifications as a whole to better identify falsifications and analyse the motives for falsifications. Crime theory is a study of financial fraud from five perspectives: C (Cooks), R (Recipes), I (Incentives), M (Monitoring) and E (End Results)[1] [2]. Companies are motivated to cheat by various incentives, and in the case of monitoring failures, ambitious cheaters use various cheating recipes to commit fraud, with serious consequences. With the interaction of these five factors, falsification is highly likely to occur. Financial fraud is highly likely to occur.

### 3.1. Cooks

Most companies' financial frauds are planned and executed by the managers and controllers of the company. Usually the falsification is carried out with the participation, acquiescence and approval of the company's executives[1] [2]. The ambition and prestige of YiHua's controller, coupled with his dominant share of control, led to failed expansion decisions as well as the decision to falsify.

1.The inherent characteristics of the actual controller

(1) The "King of the Wood Industry" Becomes the "Godfather of Capital"

Since the establishment of YiHua, the actual controller has been Shaoxi Liu, who plays a decisive role within the company. Shaoxi Liu has a talent for doing business, from the timber business in the beginning to the ecosystem of YiHua Home, living up to the title of "timber king", but Shaoxi Liu's

ambitions go far beyond that.

In 2010, YiHua began to transform its business to expand the domestic market, and Shaoxi Liu began to open premium home living experience centers in major urban centers across China. In addition, he acquired a company in Gabon that held 350,000 hectares of forest land, improving the upstream chain of furniture production. By this time, the company had achieved a step change, but before he could consolidate the existing business, Shaoxi Liu was again attracted by the Internet trend. In order to keep up with the concept of

paradigm furniture, strategic cooperation with a number of technology companies, and successive participation in Meilele and other online entrances. A series of investments, mergers and acquisitions and expansions in the capital market within a short period of time have stirred the entire home furnishing industry and clearly reflected Shaoxi Liu's personal ambition. This ambition and the unrealistic pace of transformation turned the "King of Wood" into the "Godfather of Capital" and led to the YiHua fraud.

**Table 2.** Investment/M&A Activity, 2014-2016

Time	Investment/M&A
2014.4.22	Investment of 35 million RMB, holding 25% equity in Designwelt.
2014.10.31	Increase capital by 25.5 million RMB, holding 51% equity in Douwei Shangshu.
2014.10.15	Proposed RMB 57,000,000 to acquire 100% equity interest in Henganxing.
2015.1.27	Increase capital by 62.5 million yuan, holding 25% equity interest in Myhome3D.
2015.6.25	Investment of 237.6 million RMB, indirectly held 15.84% equity interest in Qingdao Haier by Qingdao Xinqu Gang Management Consulting Enterprise
2015.6.25	Invested RMB40 million to hold 8% equity interest in Qingdao Youzhu Information Technology Co.
2015.8.20	Investment of USD84.02 million, holding 18.21% equity interest in Meilele.
2015.8.20	To invest RMB 51 million and hold 25% equity interest in Beijing Investment and Finance Youdao Technology Co.
2016.1.20	Investment of RMB1.830 billion to hold 100% equity interest in Huadali International Holdings Ltd.

## (2) Reputation

The "maintenance effect" of reputation is that individuals with good reputations will continue to work hard for these honors because they will face greater losses if they give up. Shaoxi Liu has been the president and chairman of several influential associations, and has a certain status in China and internationally. He was also a deputy to the National People's Congress and a member of the Guangdong Political Consultative Conference. And has received honors related to charity, model worker, entrepreneurship and so on. From his resume, it seems that he not only has a high status in the business world, but also has a foothold in the political world. With this kind of reputation, even if the company has any problems, as long as his reputation is there, it can temporarily stabilize the confidence of the capital market in the company

and thus get a chance to breathe. Therefore, in order to maintain his good image, in a desperate situation he has an incentive to create the illusion of good corporate development by violating market rules. In fact, he did use overstatement of sales of export goods and other ways to inflate profits and maintain the illusion of good income.

### 2. Absolute control of a family business with "one share"

The actual controller plays a major role in the fraud case, but different shareholding composition and concentration of shareholding will affect how easy it is to accomplish the fraud. A common measure of equity checks and balances is the Z-index (shareholding of the second to fifth largest shareholder / shareholding of the first largest shareholder), and the larger the index, the better the checks and balances are[2].

**Table 3.** Shareholdings of major shareholders

Year	Top five shareholders						Degree of balance of shareholding
	1	2	3	4	5	Total	
2016	24.85%	1.53%	1.47%	1.37%	1.19%	30.41%	22.37%
2017	29.02%	3.49%	2.99%	2.43%	2.09%	40.02%	37.90%
2018	29.02%	3.49%	3.49%	2.99%	1.18%	40.17%	38.42%
2019	29.02%	3.44%	2.99%	0.90%	0.55%	36.90%	27.15%

From 2016-2019, the controlling shareholder of YiHua is YiHua Enterprises (Group) Limited with a 29.02% stake (24.85% in 2016). From the perspective of equity checks and balances, the Z-index of listed companies should be maintained at around 70%, while the Z-value of YiHua is less than 40%. the Z-value is obviously low, indicating weak equity checks and balances and high equity concentration. Moreover, YiHua is a family-owned company. Shaoxi Liu holds 24.12% of the equity in YiHua directly or indirectly, while Shaosheng Liu (brother) and Zhuangqing Liu (son) hold 2.9% of the equity in YiHua indirectly. This shows that Shaoxi Liu has a high level of control over YiHua, and YiHua has become a one-talk shop for the Liu family, in charge of the company's management and major decisions.

## 3.2. Recipes

Recipes, refers to diverse and complex fraudulent techniques. The main fraudulent means in the manufacturing industry are inflated revenue, fictitious inventory, inflated currency funds, and fraudulent related party transactions [1] [2].

### 1. False increase of operating revenue and profit

From 2016 to 2019, YiHua inflated operating revenues and profits by overstating sales of export goods and other means. The total inflated operating revenue and profit were 7.091 billion yuan and 2.779 billion yuan, respectively. Among them, the highest inflated operating revenue was 2.298 billion yuan in 2016 and the highest inflated profit was 906 million yuan in 2018.

**Table 4. Inflated Revenue**

Year	Inflated operating income (Billion yuan)	Inflated operating revenues as a percentage of total disclosed operating revenues for the period	Inflated profits (Billion yuan)	Inflated profits as a percentage of total disclosed profits for the period
2016	22.98	40.32%	7.73	88.24%
2017	21.4	26.68%	8.69	98.67%
2018	20.12	27.18%	9.06	192.78%
2019	6.41	12.22%	2.31	99.37%

According to CCTV financial news, when the inspectors conducted the inspection, YiHua cleaned up almost all the

information of the import and export business department and "unplugged" the power to fight the investigation.

**Table 5. Operating Income**

Year	External sales revenue (100 million yuan)	Domestic sales revenue (billion yuan)	Total operating income of the furniture industry	Ratio of foreign sales to total operating income
2016	43.55	12.09	55.64	78.27%
2017	59.41	19.43	78.84	75.36%
2018	47.21	25.88	73.09	64.59%
2019	34.59	16.69	51.28	67.45%

From Table 5, the proportion of the company's export sales is around 70%, and the inflated revenue is mainly done through export business. In the past, when trading companies cheated, the goods were not really declared and exported, so the auditor could find the anomaly more easily. YiHua's fraudulent tactics were subtle, as the exported goods were actually shipped out of the customs territory, but the company only faked the customs declaration price and secretly ran a different business system. The real and fake systems made two sets of accounts, one for customs declaration to inflate prices, and the other for reconciliation with overseas customers. According to the investigation, the difference between the two sets of accounts for one cargo was nearly six times. The amount of counterfeiting was so high, yet it was

discovered only after four years. This was mainly due to the relative difficulty of auditing import and export operations, including geographical restrictions, language barriers, and difficulty in verifying overseas affiliations[4]. Moreover, the company has never disclosed specific information about its foreign customers. Various reasons give companies the opportunity to exploit the loopholes.

#### 2. Inflated monetary funds

From 2016 to 2019, YiHua inflated monetary funds by non-bookkeeping, false bookkeeping, and falsifying bank documents, totaling 8.66 billion yuan. Among them, the largest amount was 2.607 billion yuan in 2018, accounting for 76.93% of the total disclosed in that year.

**Table 6. Inflated monetary funds**

Item	Inflated monetary funds (billion yuan)	Actual monetary funds (billion yuan)	Inflated monetary funds to total disclosed monetary funds	Inflated monetary funds to net assets
2016	24.40	35.52	68.69%	32.95%
2017	15.98	42.29	37.79%	20.04%
2018	26.07	33.89	76.93%	31.17%
2019	20.15	27.67	72.82%	23.84%

In fact, issues related to YiHua's monetary capital have been controversial, with the first major exposure coming from the Shanghai Stock Exchange's questioning of its 2018 annual report: why does it need high debt when it has ample funds compared to comparable peers? Why do you have high debts and still buy high amount of properties? Why did the company raise a large amount of debt when it had idle funds

to buy a high amount of properties? The company replied: Taking into account the operational needs, the use of funds and the financial environment, the amount of money held is conducive to long-term development. Such a reply does not dispel our doubts. It does not make sense that long-term high savings and loans are beneficial to the sustainable development of the company.

**Table 7. Monetary funds and interest-bearing liabilities**

Item	Money capital (Billions yuan)	Interest-bearing liabilities (billion yuan)	Cash coverage ratio of interest-bearing liabilities	Monetary funds to total assets	Interest-bearing liabilities to total assets	Average annual return on monetary funds
2015	34.26	42.54	80.54%	26.92%	33.43%	0.55%
2016	35.52	56.22	63.18%	22.23%	35.19%	0.62%
2017	42.29	61.81	68.42%	25.32%	37.01%	0.43%
2018	33.89	64.03	52.93%	18.98%	35.86%	0.89%
2019	4.07	61.9	6.58%	2.51%	38.24%	7.62%

From 2016-2018, the cash coverage ratio of interest-bearing liabilities of YiHua is higher than 65%, indicating that the company has sufficient funds to repay its borrowings and its ability to repay is not weak. However, the company's

average annual return on money funds is not even 1%, and holding money funds barely generates income, which is extremely inconsistent with the laws of the capital market. And, the company also kept raising debts for several years,

and the amount of interest-bearing liabilities was as high as 6.403 billion yuan by 2018. 2019, the company's monetary funds fell precipitously to 407 million yuan again, a decrease of 2.982 billion yuan compared with the previous year. The company disclosed that the reason was due to the repayment of interest-bearing debts and payment for material purchases. However, the company's interest-bearing liabilities remained at around 6.1 billion yuan, a decrease of only 213 million yuan compared to the previous year, so the decrease could only be due to the payment of material purchases.

The materials purchased by the company are generally used to produce furniture or flooring. 2019, the company's sales were not good, and the amount of direct materials consumed decreased by 1.12 billion yuan compared to the previous year. Then the monetary funds used by the company to pay for material purchases are likely to be reflected in the increase in inventory, but the company's inventory only increased by 171 million yuan. YiHua's monetary funds of 2 billion yuan are like evaporating, and there are great doubts about their authenticity.

**Table 8.** Materials consumed for major products and inventory

Year	Direct material cost of main products (billion yuan)				Inventory (billion yuan)			
	Furniture	Flooring	Logs	Total	Raw materials	Expendable biological assets	Products	Total
2016	26.08	2.12	0.08	28.28	12.17	2.87	11.73	26.77
2017	36.27	1.66	1.95	39.88	13.97	2.84	11.1	27.91
2018	35.02	1.83	4.15	41	21.99	2.66	9.41	34.06
2019	22.05	0.54	7.21	29.8	20.91	2.55	12.31	35.77

3. Failure to disclose financial transactions with related parties as required

From 2016 to 2019, Shaoxi Liu, President of YiHua Group, directly directed relevant persons to transfer funds through 10 accounts in a total of 6 banks under the name of YiHua to 3 accounts in a total of 2 banks under the name of Shantou

Honghui and Shantou Liangguang, transferring a total of RMB 15.711 billion and returning RMB 16.421 billion in funds. Both Shantou Honghui and Shantou Liangguang are subsidiaries of YiHua Group, but neither of them has been disclosed in YiHua's statements in recent years.

**Table 9.** Undisclosed fund transactions of affiliated companies

Item	Shantou Honghui (billion yuan)	Shantou Liangguang (billion yuan)	Total (billion yuan)
2016	91.40	—	91.40
2017	116.40	—	116.40
2018	87.88	2.06	89.94
2019	16.95	6.63	23.58

### 3.3. Incentives

Incentives, which refer to the motivation of financial fraudsters to commit fraudulent acts, are mainly to satisfy their own interests, compelling need for profitability, and pressure[1] [2].

#### 1. Management's self-interest

The illusion that the company has a good development future can stabilize the company's share price, enhance the company's market value, and attract more people to invest; at the same time, because of the enhanced market value, the equity pledge can obtain more loans to meet personal capital needs. The controller as well as the affiliated companies

pledged most of their equity, totaling up to 360 million shares. However, the funds were still not enough for turnover, and the manager began to illegally misappropriate the company's deposits privately. The SEC disclosed that YiHua used the affiliates to transfer non-operating funds of 32.121 billion yuan for stock transactions, advances to unpledge payments and acquisition premiums to obtain more funds. However, the misappropriated funds could not generate income immediately, and the accounts of the long-term illegally occupied funds could not be adjusted and remained on top of "monetary funds", so the company's "high deposit" was an illusion.

**Table 10.** Equity pledges

Year	YiHua Group		Shaoxi Liu		Shantou Yahua	
	Pledged shares	Percentage	Pledged shares	Percentage	Pledged shares	Percentage
2016	258210000	70%	13378493	100%	—	—
2017	310710000	72%	13378493	100%	35962679	100%
2018	285000000	66%	13378493	100%	44462679	86%
2019	285000000	66%	13378493	100%	44462679	87%

#### 2. Financing needs

Furniture industry competition becomes fierce, whether upgrading and transformation or develop the market need sufficient funds to do support, the company generally take the issue of bonds and stocks to raise funds. The better the operation and lower the risk, the higher the probability that the bonds issued by the company will be recovered on

schedule, and the more promising the stocks. In order to attract more people to invest, companies will show better solvency, higher operating profits and more promising share prices.

Since 2015, YiHua's quick ratio has been on a downward trend, compared to similar furniture companies (Sofia's lowest was 1.54 in the same period), and the quick ratio

remains at a low level, indicating a low short-term solvency; after 2014, the company kept raising debt due to repeated equity investments, resulting in a rapid rise in the equity ratio, which reached 105.28% in 2019, and the company's financial structure at this time The risk is extremely high, the long-term solvency is weak, and creditors' funds cannot be protected by shareholders' rights and interests; during 2017-2019, the net profit growth rate plunged to a negative number, and the net profit shrank faster, indicating that the company's profitability

is not high; the company's accounts receivable turnover ratio has not been high, and began to plunge again after a brief rise in 2107, indicating that the sales return ability is not good, and this will lead to capital turnover in the long term This will lead to capital flow problems in the long run. In order to obtain the necessary financing to solve the problem of capital turnover, YiHua has the necessary financing needs, and does not meet the financing conditions to get financing opportunities by fabricating false data.

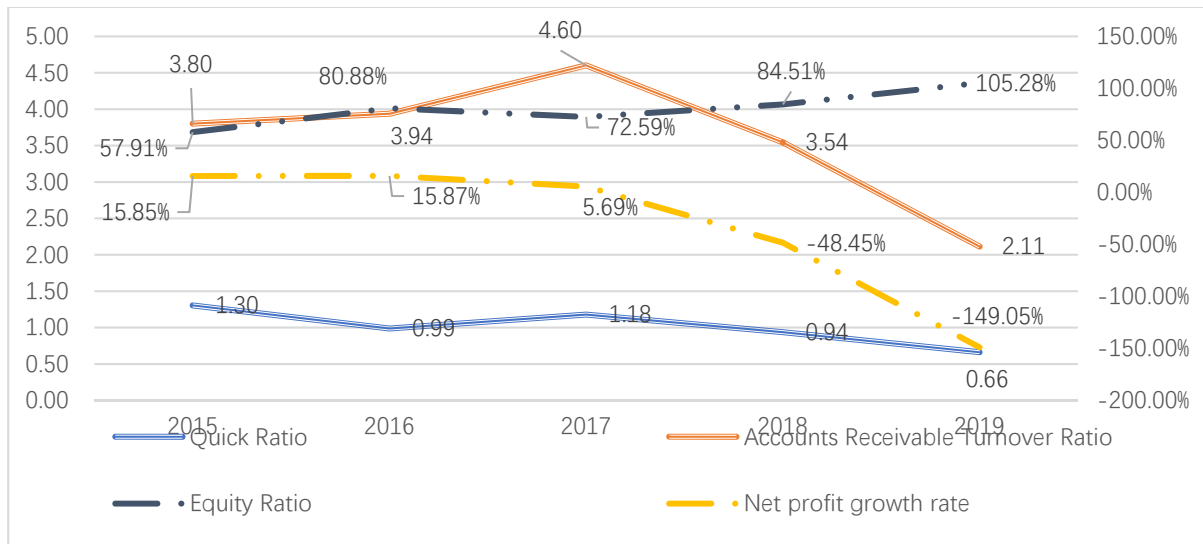


Figure 1. Financial Ratios

In 2016-2019, YiHua issued 2 medium-term notes and short-term financing bonds respectively, with a total capital of 2.1 billion yuan. In addition, after whitewashing the 2016 statements, the company was eager to prepare for the share placement, planning to use part of it to repay loans and the rest to improve its sales network. However, the company was

unsuccessful in several proposed offerings, raising less than one at a time, until it finally failed to successfully place its shares. Due to the lack of sufficient liquidity, the pressure of repayment increased, and the lack of business, the company repeatedly received inquiry letters from the Shanghai Stock Exchange, and the CSRC also intervened in the investigation.

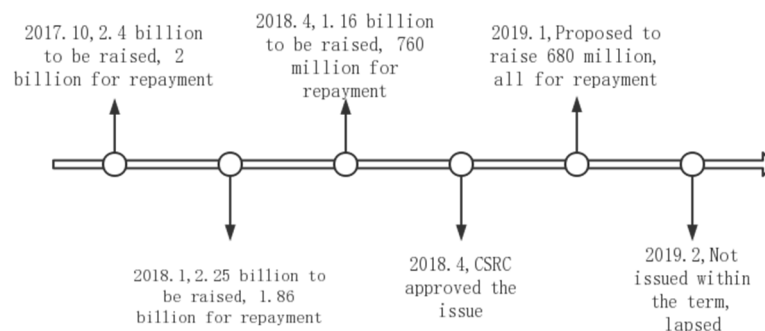


Figure 2. Timeline for allotment of shares

### 3. Pressure

Since 2016, the downward pressure on the world economy has increased, and many companies that rely heavily on exports are facing huge operational pressure and financial risks. 2019 Furniture Industry Report points out that the U.S. is China's largest furniture target export market, and the U.S.-China trade friction has a large impact on furniture exports. In addition, with the rapid development of intelligent manufacturing, the core competitiveness of furniture companies has changed to technology, products + services, and home system services. The competition of furniture enterprises extends to the whole industrial chain[4].

In 2014, YiHua followed the concept of Fan Furniture to

build a technology service enterprise, and successively reached strategic cooperation with several online platforms and information companies, and gathered the industry chain resources of 10 companies such as Meilele and Haier, aiming to build the "YiHua Y+ Ecosystem". In addition, the company also spent a lot of money to establish home life experience centers across the country, constituting a one-stop service for online orders and offline experiences. However, this series of operations did not bring significant profits to YiHua. On the contrary, so much investment was made in only two years, and the rapid expansion almost emptied the company's capital. Not only did YiHua not survive the pressure of industry changes, but it also put pressure on its own capital chain.

### 3.4. Monitoring

Monitoring includes both internal and external monitoring systems. Internal mainly refers to corporate governance structure, review mechanism, rules and regulations, etc.; external includes regulators, auditors, etc.[1] [2]. Internal and external reasons such as low equity checks and balances and low independence of the board of directors give fertile ground for fraud and allow counterfeiters to take advantage of it.

#### 1. Internal reasons of the company

##### (1) Excessive concentration of shareholdings

The fact that one share of YiHua is dominant has always existed and the checks and balances index of the top five shareholders is low, leading to opportunities for the major shareholders to abuse their power and their decisions may be biased towards personal interests rather than the long-term development of the company, while it is difficult for other stakeholders to participate in corporate decision-making and supervision. In terms of corporate governance, Shaoxi Liu, the actual controller, is the chairman of the company and his son Zhuangchao Liu is an executive and shareholder of the company. Liu's father and son are able to hold absolute say in both governance and management. If the major shareholder concentrates on investing in projects that are not cost-effective, the company will waste a lot of capital and resources. The company's leapfrog expansion from 2014 to 2016 is an example of this. It looks like YiHua's capital empire has risen from a tall building, but in fact it is a superficial scenery that empties the capital and also has a lot of debts.

##### (2) Lack of independence of the board of directors

**Table 11.** Members of the Board of Directors in 2016

Shaoxi Liu	Chairman
Zhuangchao Liu	Vice Chairman, General Manager
Guoan Huang	Director, Deputy General Manager
Shunwu Wan	Director, Deputy General Manager, Chief Financial Officer
Weihong Liu	Director, Deputy General Manager, Secretary to the Chairman

Based on the matters of directors and senior management disclosed in the 2016 statement, there is a situation where one member of the Board of Directors holds three positions, and such a setup highlights the weak internal supervision of the Company. A board member serving as an officer reduces the checks and balances between the two, and most decisions can

be implemented as long as the board agrees. This can lead to the controller making unfair decisions or pushing decisions in his or her favor rather than the long-term interests of the company. It may also lead to improper risk management and remove significant "obstacles" to fraud.

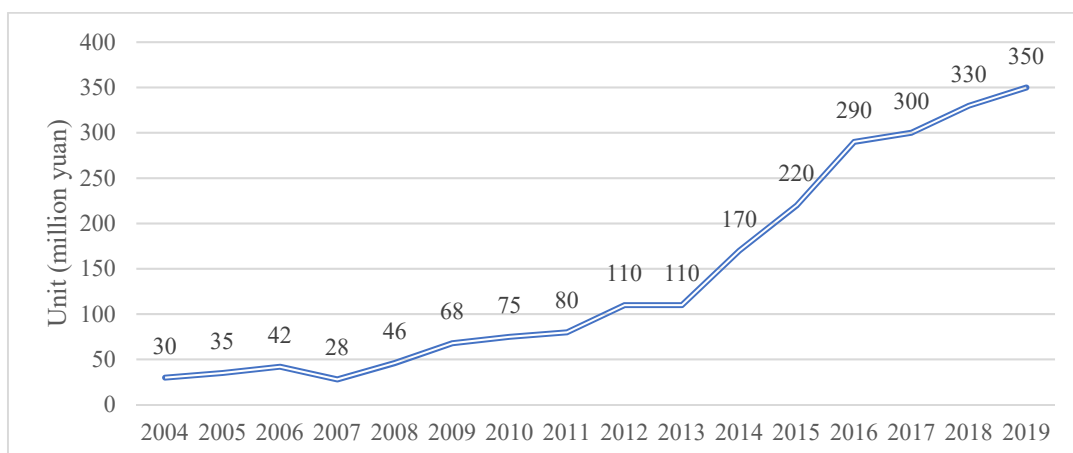
##### (3) Lack of Diligence by Independent Directors

The responsibilities and duties of independent directors include monitoring management, participating in key decisions, reviewing reports, evaluating governance structures, and protecting shareholders' interests[6].

In terms of reviewing reports, for the long-questioned phenomenon of "high loans and high deposits" and the matters that have been asked by the CSRC for many times, independent directors should take the initiative to understand the relevant situation, ask questions, request the company to reply and make recommendations on this basis. However, it did not pay due attention to the anomalies, not to mention the necessary and prudent verification, before signing the confirmation opinion on the relevant report. In terms of assessing the governance structure and operations, the company had problems with its governance structure and little improvement over the years. In terms of protecting the interests of shareholders, the company's systematic financial fraud went undetected for five years, which was a serious violation of discipline and infringed on the rights and interests of shareholders. These are all manifestations of the failure of the independent directors of YiHua to exercise diligence and responsibility.

##### 2. Auditors' failure to fulfill their responsibilities

During 2004-2019, Guangdong Zhengzhong Zhujiang Accounting Firm (Special Ordinary Partnership) has been undertaking the audit of YiHua, issuing standard unqualified opinions on all its statements. 16 years, several auditors were involved in consecutive audits, for example, Shaohua Wang was involved 11 times and Wenwei Hong was involved 8 times. Shaohua Wang was involved during the fraud. After more than ten years of cooperation, the auditors should be more clear about the relevant situation of the company and the problems that existed all year round. However, suspicious issues regarding the existence of monetary funds are only listed in the firm's key audit matter for 2018. For this purpose, the auditor implemented audit procedures, including: validity of monetary funds, obtaining bank reconciliation flow on site, correspondence on bank deposits, and verification of large bank transfer back slips. It is puzzling that after this series of procedures, the auditor did not find any problems with the company.



**Figure 3.** Audit Fees

In addition, Guangdong Zhengzhong Zhujiang Accounting Firm (Special Ordinary Partnership) receives increasing audit fees year after year, from 300,000 yuan in 2004 to 3.5 million yuan in 2019, and it is difficult not to speculate whether there is a possibility of collusion between the company and the auditor, after all, the audit fee of Sofia, which ranked top in the home furnishing industry during the same period, was only 1.465 million yuan[8].

Accordingly, it is speculated that there may be two reasons for the failure of this audit: one is the constraint of human and material resources, the difficulty of verifying the authenticity of foreign operations, and the serious limitation of some investigations, resulting in the external audit not fully playing its functional role; the other is the auditor's failure to be diligent and independent, and the possibility of collusion with the company, resulting in the absence of the gatekeeper role.

### 3.5. End Results

Financial fraud in listed companies can lead to serious consequences, including falling share prices, damaged image, and lower earnings[1] [2].

#### 1. Companies and responsible persons are punished

YiHua is one of the first cases to be punished by applying the new securities law, and the company deserves to be punished due to the violation of the corresponding regulations. The administrative penalties imposed on the listed company are: ordering corrections, giving a warning and imposing a fine of 6 million RMB. The administrative penalties for Shaoxi Liu, the de facto controller, include a warning, a fine of RMB 9.3 million, and a lifetime market ban. The other responsible persons, Zhuangchao Liu, Wan Shunwu and Weihong Liu, were given a warning, fined 150,000-4,500,000 yuan and taken a maximum 10-year securities market ban. The total penalty is RMB 38.85 million.

#### 2. Plunge in stock price leads to delisting

In December 2020, CCXI downgraded the main and bond credit ratings of YiHua from B to CCC and continued to place it on the watch list for possible downgrade. In February 2021, the closing price of the company's shares was below RMB 1 for 20 consecutive trading days. In March 2021, the Shanghai Stock exchange decided to terminate the listing of the company's shares.

#### 3. Impact on the Group's brand reputation

The fraudulent behavior of YiHua involved the group's internal, and the president of YiHua Group disregarded the independence of the listed company by misappropriating YiHua's funds and not recording the relevant financial transactions in the accounts. Such egregious behavior not only hurts the interests of creditors and small and medium-sized investors, but also makes consumers question the products of the YiHua family and undermines employees' confidence in their work. Customers retain loyalty to brands they trust and do not change easily. Relatively bad behavior, on the other hand, can reduce their credibility and have a greater impact on the future development of the company.

## 4. Prevention and Recommendations

### 4.1. Reasonable company business strategy

For rapid transformation, the company spent a lot of money in a short period of time to gather furniture development platform with forestry and experience center, and built a super luxurious layout of YiHua ecosystem. However, because of

the increasing costs of various investments, the new strategy did not create the desired profits in its business activities. The blind expansion combined with the lack of attention to risk management and budget management led to a decrease in liquidity, increasing borrowings, and unsuccessful stock fundraising. Finally, the luxury layout dragged the company down instead.

Therefore, when the business environment changes and faces transformation pressure, companies should not rush to achieve expansion through a large number of mergers and acquisitions, but should be based on long-term development goals, on the one hand, to develop a sound business and financial strategy, on the other hand, to fully explore their own product advantages, and not simply rely on aggressive marketing strategies to achieve the purpose of maintaining market share.

### 4.2. Improve corporate governance structure

#### 1. Decentralize the power of "one share"

This is not the first time that "one share is too big" has affected a company. The fraudulent case of Kangmei Pharmaceutical Co.,Ltd is still fresh in our minds and has caused a huge impact on the capital market, the industry and the firm[8]. Now, with YiHua thundering again, the absolute power of "one share" deserves the attention of the relevant parties, and the company should adjust and decentralize its power appropriately. For example, the company can introduce strategic investors, who generally have strong capital, industry experience, technology and resources, and can support the company in all aspects of developing new markets. Letting strategic investors become shareholders of the company not only helps to establish an internal governance structure with mutual checks and balances, but also improves the value of the company, increases its competitiveness and attractiveness, and brings more opportunities and resources to the company.

#### 2. Enhancing the function of independent directors

The election of independent directors is usually recommended and decided by the major shareholders, and their remuneration is usually decided by some major shareholders or managers, so it is difficult for independent directors to remain independent in many matters anymore. In order to strengthen the function of independent directors, relevant laws and regulations can be established. Not only should the obligations of independent directors be clarified, but also their powers should be protected from persecution. Let independent directors have the right and actively form a more comprehensive understanding of the company, as well as the ability to question the company and demand a response from the company.

### 4.3. Improve the overall level and quality of auditors

The five-year-long fraud at YiHua is inevitably the responsibility of the auditors. As an external monitor who is familiar with the company's situation and failed to detect the company's problems for several years, it can be seen that the professional quality of auditors does need to be improved. Auditors should not only participate in continuous training, but also focus on developing critical thinking and independent thinking skills, constantly reflecting and summarizing their experience in offshore operations, and looking for ways to improve the quality and efficiency of their audit work. Most

importantly, auditors need to establish the right values, uphold the principle of independence and stick to their bottom line.

#### 4.4. Strengthen the effectiveness of regulators

The release of the new securities law did aggravate the various penalty bars, but the benefits of violating the law are really ridiculously high. YiHua was punished with a total of 0.39 billion yuan, but the amount involved was over 40 billion yuan and the fraud took longer. Regulators should continue to actively participate in and promote the implementation, development and revision of relevant laws and regulations to further ensure the timeliness and effectiveness of regulation.

Increase penalties, increase criminal penalties, focus on punishing those responsible, and raise the cost of violations. Strengthen the application of regulatory technology tools and make full use of big data, artificial intelligence, blockchain and other technical means to improve the accuracy and efficiency of regulation. Broaden the scope of supervision, strengthen the coordination and cooperation between supervision and other departments and agencies (customs, taxation, etc.), and improve the disclosure mechanism for offshore business so that no one can exploit loopholes. Strengthen the professional quality and team building of supervisors, focus on training and introducing professional, high-quality and innovative supervisors, and provide a solid personnel foundation for the supervisory authority.

### 5. Conclusion

In this paper, we start from five aspects of Crime theory to do research on the characteristics of fraud fakers, fraud secrets, what is motivating companies to commit fraud, fraud monitoring and fraud results. Through the analysis of the fraud case of YiHua Life, we propose suggestions and

recommendations for identifying financial fraud and preventing financial risks in similar companies. Contribute to the prevention of similar frauds in advance, which can effectively reduce the loss of relevant stakeholders and maintain the order of the capital market.

### References

- [1] Yangwei Guan, Dong Wei. Identification of financial fraud in ST companies based on the five-factor theory of CRIME [J]. Finance and Accounting Monthly, 2014.(8 down): 12-16.
- [2] Sun F, Zhang F. Analysis of financial fraud events in Luckin coffee based on Crime model [J]. Productivity Research, 2021, No.343 (02): 152- 156.DOI:10.19374/j.cnki.14-1145/f.2021.02.032.
- [3] Qiusheng Wu, Mengyao Pang. CEO market-based selection and recruitment, equity checks and balances, and investment efficiency[J]. Friends of Accounting, 2022, No.673(01):90-96.
- [4] Jianxin Wang, Zhongwei Li, Jianlin Li. Research on the audit of cross-border business of listed companies: the case of audit failure of YaBaite as an example[J]. Friends of Accounting, 2020, No.648(24):8-12.
- [5] Xiaomin Han. Research on the current situation and problems of China's furniture exports[J]. Contemporary Economy, 2018, No.469(01):64-66.
- [6] Jiyin Zhong. The mystery of Chinese companies' "enthusiasm" for one share [J]. Board of directors, 2019, No.172(07):40-43.
- [7] Qiqi Xue, Yujia Yan. Literature review on the impact of audit tenure on audit quality [J]. China township enterprise accounting, 2018(09):205-206.
- [8] Yinghao Xia. Where should independent directors go-- Thinking about the "Kangmei case"[J]. Technology and Market, 2023,30(01):115-118.