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Research on the Accounting Fraud Approaches of Listed Companies in China

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ABSTRACT

After more than 20 years of vigorous development, there are more than 2,800 Chinese domestic listing companies by 2015, however, there is still endless stream of accounting fraud. Every year a number of companies have been punished by China Securities Regulatory Commission (CSRC) because of kinds of accounting fraud. This paper (1) define violation of information disclosure; (2) set conceptual framework of accounting fraud; (3) presents a profile of accounting fraud approaches by reviewing the selective sample of alleged accounting fraud cases from 2011-2015 by CSRC; (4) demonstrates that Chinese listed companies show an obvious preference to the violation of information disclosure other than financial statement fraud; and (5) violation of integrality played a very important role within violation of information disclosure, such as disclosure information incompletely of guarantee, relation transaction and wayward stock trade etc.

We examine the characteristics and typical methods of accounting fraud at this stage by the routine descriptive statistics. The sample comes from the penalties of CSRC over the five-year period from 2011-2015. This paper shed light on the facts that accounting fraud has not been controlled effectively, although there are sound system with respect to accounting standards, corporate governance, internal control, business operation and risk management, in fact, it has just been switched to violation of information fraud from financial statement fraud.

Key words: Listed Company; Accounting Fraud Approaches; Statistical Analysis; Violation of Information Disclosure

I. Introduction

Difficult problem

After more than 20 years of vigorous development, there are more than 2,800 Chinese domestic listing companies by 2015, however, there is still endless stream of accounting fraud. Every year, a number

of companies have been punished by China Securities Regulatory Commission (CSRC) because of kinds of accounting fraud. The occurrence of accounting fraud has seriously undermined the trust of investors and made serious impact on the normal order of Chinese and international capital markets.

New situations

Furthermore, the approaches of accounting fraud of Chinese listing companies are changing quietly, that the occurrence of violation of information disclosure, not financial statement fraud, is getting more

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and more. Violation of information disclosure refers to the fraud of information disclosure which the listed companies publish on the interim reports, prospectus, listing memorandum, listing announcement etc, rather than financial statements, which is one of the difficult control issues of accounting fraud control system.

Study purpose

Under these new circumstances, how to detect the accounting fraud effectively to improve the regulation of listed companies is of much more significance. Then, in terms of micro views, this paper is probe into the types, the aims, the approaches of accounting fraud through statistic analysis to find out the characteristics and typical methods of accounting fraud at this stage. The purpose is to offer a better reference for accounting fraud detecting and regulation. And our sample is based on the penalty of CSR over the five-year period from 2011-2015.

II. Literature Reviews

The prior studies that analyzed the accounting fraud are mainly focus on financial statement fraud. Beasley (1998), Abbott, Parker and Peters (2004), Persons (2006) have studied the regularity of financial statements fraud. They found that the main approaches of financial statements fraud are forge or alter accounting documents, account book or other accounting material, distorted or intentional omission financial events and trading, misuse of accounting principles. A significant internationally empirical report come from COSO(shorted for Committee of Sponsoring Organization of the Treadway Commission), which selected 347 listed companies fraudulent financial reporting from 1998 to 2007 as a sample, it showed that the most common means of accounting fraud were revenue recognized improperly and assets overvalued.

On the other hand, great advances have been made by Chinese scholars in accounting fraud, however,

most of the scholars concentrated on the financial statement fraud, while only few of them investigated the issues of violation of information disclosure. J.P. Qin (2005), W.M. Han (2005), J.X. Huang (2006), S.Z. Huang (2006), Q.X. Yang and L. Yu (2009), X. Hong (2012) studied approaches, motivations, detecting of accounting fraud and the effect of Board of Directors on accounting fraud, etc. J. S. Yu and S. S. Gao (2007), D. M. Yue (2009) expanded the scope of accounting fraud, and pay more attention to violation of information disclosure.

D. M. Yue (2009), who was supported by National Natural Science Foundation (China), divided the accounting fraud into three types: financial statements fraud, violation of information disclosure and other types. Basing on the penalty in 2002-2006 from CSRC, he analyzed the approaches of accounting fraud of China's listed companies, and found that there were no preference between violations of accounting information and financial statements fraud in China's listed companies. In his study, financial statements fraud refers to the items manipulation in the financial statements; it refers to the accounting statement itself. Violations of information disclosure includes all violations of accounting information disclosure except the financial statements fraud; and other types refer to manipulation of individual behavior, which excluded financial statements fraud and violation of information disclosure, for instance, conducting securities trading.

In conclusion, the problem of violation of information disclosure is being ignored by scholars, because there are few study articles about this issue. In fact, most of the studies focus on only how to detect and control financial statement fraud. Although Mr Yue's study provides us a new view of accounting fraud research, but it is clear that the research on detecting and controlling accounting fraud is still insufficient.

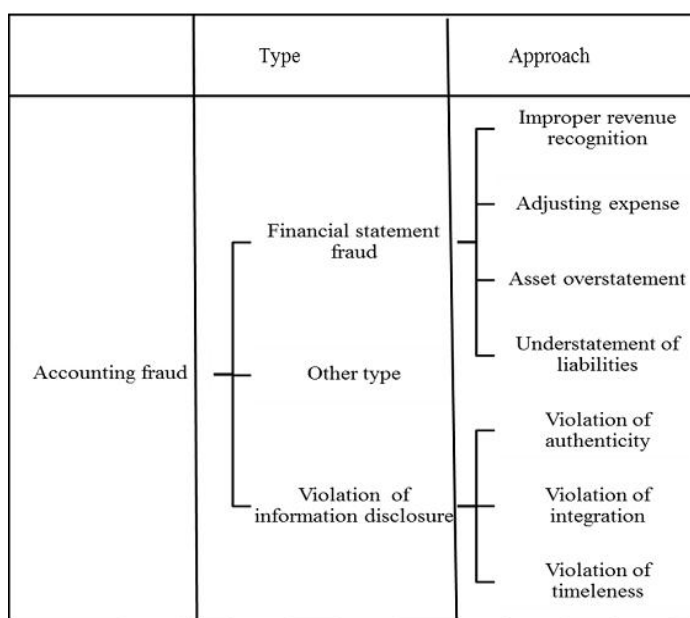


Figure 1. Analytic Framework of Accounting Fraud

III. Research Design and Sample

A. Analytic Framework of Accounting Fraud

To examine the approaches of accounting fraud, the following framework be set up in this study. Accounting fraud, based on this framework, is divided into three: financial statement fraud, violation of information disclosure and other type; Next, financial statement fraud is divided into four: improper revenue recognition, adjusting expenses, assets overstatement of and understatement of liabilities; Then, violations of accounting information is divided into three (Administrative responsibility confirmation rule of violation of information disclosure (2011)): violation of authenticity, violation of integrality (complete) and violation of timeliness. Figure 1 illustrates the constructs and relationships in the framework.

What the concepts of this framework as follow: Accounting fraud is the purposive behavior that accounting entity takes in order to gain illegal benefits through using illegal approaches (R.H. Li, 2002); Financial statement fraud refers to the item manipulation in the financial statement, it refers to

the accounting statement itself; violation of information disclosure includes all violations of accounting information disclosure except the financial statement fraud; Violation of authenticity, violation of integrality(complete) and violation of timeliness refers to violation the GAAP requirements of authenticity, complete and timeliness.

This is the reason we made such classification: As we know, Information disclosure documents of the company mainly include the prospectus, listing memorandum, listing announcement, regular reports and interim reports, therefore, accounting fraud could occur at any points along the accounting information chain. It might be happened not only at points of financial statement, but also at points of interim report, the prospectus, listing memorandum and listing announcement.

B. Sampling and Method

Base on the penalties of China Securities Regulatory Commission over the five-year period from 2011-2015, 101 listed companies are selected

manually as final samples which excluded accounting firms, securities companies and futures companies.

One of the reasons we take the sample from year 2011-2015 is that the latest regulations (The Regulations of Information Disclosure of Listed Companies, 2007) in accounting information disclosure, taking effect from year 2008, had great change with the old. One change is that credibility file system is set up for every company, and we believe that this credibility file system would exert an influence on accounting fraud. Besides, it is right the period of 12th Five-Year plan, when Chinese government have issued a series of response measures of accounting fraud.

We examine the characteristics and typical methods of accounting fraud at this stage by the routine descriptive statistics. We take the year the punishment announcement issued as the statistical year, instead of fraud occurrence year. We adopt the idea of S. B. Accounting to You (2001) and D. M. Yue (2009), if one kind of approaches occurs more than once in an announcement of a company, we take this approach as one time. Moreover, to avoid repeated counting, in case of fictitious both revenue and cost, we take only one time of improper revenue recognition.

IV. Empirical Results

A. Statistical analysis about type of accounting fraud

As shown in Table 1, China's listed companies show a distinct preference for violation of information disclosure. Violation of information disclosure appears 154 times, and financial statement fraud 48 times, each of their frequency of occurrence is 152.48% and 47.52%, and each of their proportion of total fraud types are 70.32% and 21.92%. Proportion of violation of information disclosure (70.32%) raised obviously, up from 50% percent of total number of frauds in 2002-2006 (D. M. Yue, 2009).

Moreover, most of the violation of information disclosure appears in interim report of significant issues announcement. In other words, companies prefer to gain benefit through violating in major events disclose, which include guarantee, relation transaction, lawsuit, wayward stock trade and so on.

Table 1. Types of accounting fraud in china's listed companies

Types of accounting fraud	Number of occurrence	Percentage in the sample companies	Percentage in the total fraud
Financial statement fraud	48	47.52%	21.92%
Violation of information disclosure	154	152.48%	70.32%
Other types	17	16.83%	7.76%
Total	219		100%

Note: Due to accounting fraud at the same listed companies often involves more than one approaches of fraud, thus the sum of the percentages exceeds 100 percent.

Table 2. Approaches of financial statement fraud in China's listed companies

Approaches of financial statement	Number of occurrence	Percentage in the sample companies	Percentage in the financial statement fraud
Improper revenue recognition	29	28.71%	60.42%
Adjusting expenses	8	8.91%	16.67%
Overstatement of assets	9	8.91%	18.75%
Understatement of liabilities	2	1.98%	4.16%
Total	48		100%

B. Statistical analysis about the approaches of financial statement fraud

As shown in Table 2, China's listed companies perform a distinct preference for improper revenue recognition, it appears 29 times and proportion of it is 60.42%.

C. Statistical analysis about violation of information disclosure

As shown in Table 3, Chinese listed companies show a distinct preference for violation of integrity. Violation of integrity appears 108 times, the ratio reached 70.13%, which is far above two others.

D. Statistical analysis about violation of integrity

Because the violation of integrity held the great share in violation of information disclosure, this study conducted an in-depth study on violation of integrity

by using descriptive statistics method, and looking forward to understanding what contents it covers. Then we got Table 4.

As shown in Table 4, there is no obvious preference for all contents of violation of integrity. And no disclosure related party relationships and transactions (17.82%), no disclosure guarantee (15.84%) and no disclosure information on stock trading (16.83%) are the main methods of violation of integrity.

V. Conclusions

The main findings of this paper are as follows: First, there has been apparent change at the approaches of accounting fraud from case of 2002-2006 (D. M. Yue, 2009). Chinese listed companies allegedly engaging in accounting fraud show an obvious preference to the violation of information disclosure other than financial statement fraud. So, violation of information disclosure is the main approaches of

Table 3. Approaches of violation of information disclosure in china's listed companies

Approaches of violation of information disclosure	Number of occurrence	Percentage in the sample companies	Percentage in violation of information disclosure
Violation of integrity	108	106.93%	70.13%
Violation of authenticity	26	25.74%	16.88%
Violation of timeless	20	19.80%	12.99%
Total	154		100%

Table 4. Contents of violation of integrity in china's listed company

	Number of occurrence	Percentage in the sample companies	Percentage in the violation of information disclosure
Guarantee	16	15.84%	14.81%
Lawsuit	10	9.90%	9.26%
Relation transaction	18	17.82%	16.67%
Occupying capital by related party	11	10.89%	10.19%
Contracts and agreements	9	8.91%	8.33%
Debt and other information	5	4.95%	4.63%
Wayward stock trade	17	16.83%	15.74%
Important files affecting stock price	10	9.90%	9.26%
Actual controller changes	5	4.95%	4.63%
Equity pledge case	7	6.93%	6.48%
Total	108		100%

accounting fraud, and among which the violation of integrity played a very important role.

Detailed studies conclusively showed guarantee, relation transaction and wayward stock trade are the main approaches among violation of integrity, and most of them belong to interim report. In other words, most of the Chinese listed companies allegedly engaging in accounting fraud gain illegal benefits through disclosing incomplete information of guarantee, relation transaction and wayward stock trade deliberately.

Second, both the number and proportion of financial statement fraud have fallen. And the improper revenue recognition is still the main approach of financial statements fraud.

The reasons are chiefly as follows:

1) All of the fraud of violation of information disclosure is not easy to identify and classify accurately compare with fraud in statements which been controlled by strict regulations of accounting standard. Interim report especially is a relatively slack regulation area, because of information asymmetry and the lack of explicit criterion and professional judgment standard. Therefore, companies choose the approaches of violation of information disclosure that are not easy to spot them.

2) On the other hand, punishment is too light. Violation of information disclosure similarly lead to share price manipulation, and the benefits of fraud far outweigh the fine. Relative to the benefits of share prices improvement, the fine do not pose any real pressure to the companies at all. So it is a kind of temptation to companies.

Having sound systems with respect to accounting standards, corporate governance, internal control, business operation and risk management, however, it seems that accounting fraud control in our country is of no optimism in the 11th and 12th Five-Year period. It still exists and warrants continued attention. During the 11th Five-Year Plan (2006-2010) and 12th Five-Year Plan (2011-2015), government passed some significant regulations to control the accounting fraud, like “the regulations of information disclosure of listed companies” (2007), “Information disclosure rule

violations identified administrative responsibility” (2011), “Base specifications of enterprise internal control” (2009), “Form a complete set of internal control guidelines” (2010) and “Auditing standards of enterprise internal control” (2010), but, in fact, accounting fraud has just been switched to violation of information fraud from financial statement fraud.

Thus, it is suggested that related agency should make kind of rules to make the detecting and confirming of violation of information disclosure more simple, explicit, and convenient. On the other hand, the education of moral and ethical is a problem that can't be overlooked. Good professional ethics and corporate culture of loyalty and honesty should be vigorously promoted.

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