

# *A Case Study of Financial Fraud in Listed Companies Based on GONE Theory—Take Kaile Technology as an Example*

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**Abstract:** As the "power source" of China's economic growth, listed companies have far-reaching significance to the long-term development of China's overall economy. However, with the rapid development of the securities market in recent years, the number of listed companies committing financial fraud by means of related party transactions, fictitious business and inflated profits is also increasing year by year. The financial fraud of listed companies destroys the market integrity, seriously damages the interests of investors, and becomes a "stubborn disease" that affects the healthy development of the capital market. As the first listed company delisted from A-shares in 2023, Kaile Technology is involved in A high amount of money and concealed fraud methods, which has representative significance for the research on financial fraud of listed companies. Based on the overall goal of improving the quality of listed companies, this paper analyzes the specific cases of financial fraud of Kaile Technology based on GONE theory, analyzes the motivation of financial fraud of Kaile Technology from the perspectives of G, O, N and E, and proposes governance measures to prevent financial fraud of listed companies based on the motivation of fraud, in order to provide references for governance of financial fraud of listed companies.

## **1. Introduction**

The steady development of listed companies has provided an important driving force for the rapid development of China's economy. It is of great significance to crack down on financial fraud of listed companies, improve the quality of listed companies, and make listed companies better and stronger for our economic development. However, in recent years, listed companies whitewash financial statements, favoritism and fraud cases emerge in endlessly. According to incomplete statistics. A total of 156 A-share listed companies or related parties have been investigated by the CSRC in 2023, involving listed companies, executives, controlling shareholders and so on. On February 8, 2023, the Shanghai Stock Exchange issued an announcement announcing that Hubei Kaile Technology Co., Ltd. would terminate stock trading, and the company's shares would be terminated and delisted on February 15. The curtain call of ST Kaile in A shares became the first company to delist from the capital market in 2023.

In May 2023, Kaile Technology, which was deeply involved in Sui Tianli's 90 billion "private network communication" scam, was investigated by the CSRC on suspicion of information disclosure violations. From 2016 to 2020, Kaile Technology used the fake private network communication business to increase revenue by 51.2 billion yuan and increase profit by 5.9 billion yuan, which is an eye-popping scale of fraud. Under the background of the gradual improvement of laws and regulations, what motivation is the trend of Kaile technology to take risks and embark on the road of financial fraud? Why was large-scale financial fraud not detected in time for five consecutive years? Did the regulator implement effective control procedures? Based on GONE theory, this paper analyzes the motive of financial fraud of Kaile Technology, and puts forward governance opinions to prevent financial fraud of listed companies. It is hoped that other listed companies can take this as a warning, put an end to financial fraud, and jointly build a good business environment.

## 2. Analysis of Financial Fraud Motivation of Kaile Technology Based on GONE Theory

GONE theory is one of the representative methods to analyze the motivation of fraud. The four letters of "GONE" indicate the four conditions for fraud. "G" stands for Greed. "O" stands for Opportunity; N indicates Need. "E" stands for Exposure. These four factors combine to influence and interact with each other, and jointly determine whether fraud will occur, that is, when a subject produces a "greedy" desire such as seeking huge wealth, and produces the "need" for fraud; And has a special status and power in the company, so that it can easily obtain the "opportunity" of fraud; The "exposure" mainly depends on the inspection and supervision ability of the company's internal and external regulatory agencies and the intensity of punishment after discovery. If the possibility of being discovered is not high or the cost is not high, then the subject is highly likely to commit fraud.

### 2.1 Greed Factor

Greed refers to the low moral level, which is a characteristic of the behavior subject itself, is a psychological factor. Executives and accountants who lack professional ethics are prone to commit financial fraud when they encounter various pressures and temptations [1]. The root cause of the financial fraud of Kaile Technology is the greed and weak moral consciousness of the management. From 2016 to 2020, Kaile Technology carried out "private network communication" business, during this period, only a small amount of private network communication business, other private network communication business are false, only in accordance with the contract to forge storage, warehousing and other documents, but there is no matching production and logistics, in order to inflate revenue and profits. After the signing of the private network communication business contract, Chairman Zhu Dixiong is responsible for approval, deputy general manager Duan Heping is responsible for the production of private network communication business, and Chief Financial Officer Liu Lianchun is responsible for the financial work of private network communication business. The senior managers involved in the examination and approval at each node in order to seek improper benefits, lose moral concept, and use their positions to collude in fraud.

There are false records in the annual reports disclosed by Kaile Technology from 2016 to 2020. As shown in Table 1, during the five-year period, Kaile Technology has falsely increased its operating income by 51.225 billion yuan, its operating costs by 44.352 billion yuan, and its total profits by 5.936 billion yuan. It is estimated that if the inflated data are excluded, the net profit of Kaile Technology from 2017 to 2020 is negative. By whitewashing the financial statements and creating the illusion that the company's experience was in good condition, the management of Kaile Technology deceived investors and damaged the interests of minority shareholders.

Table 1: Summary of fraud in financial statements of Kaile Technology from 2016 to 2020

| Item  | 2016  | 2017   | 2018   | 2019   | 2020   | Total  |
|---|-------|--------|--------|--------|--------|--------|
| Inflated operating income /billion yuan   | 41.26 | 110.98 | 146.38 | 136.17 | 77.46  | 512.25 |
| Inflated operating costs / billion yuan   | 39.49 | 101.77 | 126.70 | 114.68 | 60.88  | 443.52 |
| Total inflated profit /billion yuan   | 1.77  | 9.21   | 16.31  | 17.56  | 14.51  | 59.36  |
| The amount of inflated operating income accounted for the proportion of disclosed operating income of the year /% | 48.99 | 73.31  | 86.32  | 85.85  | 91.13  | -      |
| The proportion of inflated profits to the total disclosed profits of the year /%                                  | 64.97 | 99.99  | 144.84 | 183.71 | 247.45 | -      |

Data source: China Securities Regulatory Commission Administrative Penalty Decision No. 46 (2023)

## 2.2 Opportunity Factors

Opportunity factors include internal opportunity factors and external opportunity factors. The internal opportunity factor mainly depends on the internal environment of the fraud subject, such as the company's internal control defects, unreasonable ownership structure, etc. Its existence brings feasibility and convenience to the fraud to a certain extent [2]. The external opportunity factor depends on whether the supervision of the third-party audit institution is strict, whether the supervision of the CSRC is effective, and whether the punishment related to the securities market is serious. From the perspective of the internal environment of Kaile Technology Company, the company has serious internal control defects, and the management right of business activities of Kaile Technology is highly overlapping with the actual control right. From forging business to process approval to financial report fraud, all of them are carried out and completed by the senior management staff. During this period, the independent directors and members of the supervisory board of Kaile Technology did not raise objections in time and stopped the occurrence of financial fraud, providing opportunities for fraud. In addition, the private network communication business cannot publicly disclose the details of the main customers and suppliers, Kaile technology on the grounds of "confidential", does not disclose the name of the customer, which also provides a huge opportunity for the fraud of the business.

At the same time, the third-party auditors failed to be diligent and responsible and failed to detect errors and omissions in the financial statements, which allowed Kaile to conceal the fraud. Zhongtianyun Accounting Firm has been employed by Kaile Technology since 2014 as the company's financial auditor and internal control auditor. From 2016 to 2020, when Kaile was found to have committed financial fraud, Zhongtianyun Accounting Firm issued audit reports with standard unqualified opinions. Kaile Technology "private network communication" business fraud, but the auditor did not find a little error, indicating that in the audit work did not do the practitioners should be diligent and responsible. To sum up, the external third-party audit institution failed to conduct proper supervision and restriction on the fraudulent activities, which gave Kaile Technology the opportunity to obtain benefits through illegal operations.

## 2.3 Demand Factor

The need is reflected as the purpose that the fraud subject urgently wants to achieve, which actually constitutes the motivation of fraud [3]. As shown in Table 2, Kaile's operating income fell from 17 billion yuan in 2018 to 8.5 billion yuan in 2020. In terms of profit indicators, from 2018 to 2020, the net profit of Kaile Technology was 916 million yuan, 861 million yuan and 437 million yuan, respectively, which decreased by 6.01% and 49.22% year-on-year in 2019 and 2020, respectively. Even with the aforementioned downward financial data, there are even cases of fraud in Kaile technology. 2016 was the first year that Kaile Technology was accused of falsifying financial reports, and the total operating revenue alone increased by about 5.2 billion yuan compared with 2015. The false statements in this year were not detected by the CSRC, so the amount of Kaile technology's inflated profits became increasingly bold, and the proportion of Kaile Technology's inflated profits in the total disclosed profits of the year gradually climbed from 64.97% in 2016 to 247.45% in 2020. It can be seen that if Kaile technology does not carry out financial fraud, the company is likely to go bankrupt and liquidate, and face the risk of delisting. Therefore, in order to maintain the "surface prosperity" of the company, Kaile Technology Company uses the fake private network communication business to continue to fake, from which a steady stream of profits.

Table 2: Changes in major financial indicators of Kaile Technology from 2015 to 2020

| Item                                  | 2015   | 2016    | 2017  | 2018   | 2019   | 2020   |
|---------------------------------------|--------|---------|-------|--------|--------|--------|
| Net profit /billion yuan              | 1.200  | 2.462   | 8.064 | 9.155  | 8.606  | 4.370  |
| Total revenue / billion yuan          | 32.301 | 84.207  | 151   | 170    | 159    | 84.996 |
| Operating cost/billion yuan           | 31.515 | 81.717  | 143   | 158    | 149    | 75.847 |
| Net operating cash flow /billion yuan | 9.569  | -16.387 | 1.570 | 16.371 | 17.712 | 20.429 |

Data source: Annual financial report of Kaile Technology

## 2.4 Exposure Factor

The exposure mainly depends on the external environment of the fraud subject, which mainly consists of two parts: one is the possibility of the fraud being exposed by others; the second is the intensity and nature of punishment for the subject of fraud. It represents the cost of fraud and will influence the decision of fraud subjects to commit fraud.

Because the private network communication business of Kaile Technology cannot open the tender and do not disclose the customer information, this business has a large space for fraud operation, and it is difficult for auditors to get access to the real information deliberately covered up by them in the short audit process. In addition, there are a large number of listed companies, and it is difficult for the CSRC to conduct detailed and effective supervision on each company. The lax management of the regulatory authorities resulted in the company's financial fraud not being exposed for five years, and the company's independent directors and the board of supervisors also turned a blind eye to the fraud, so the fraud was not exposed until late. After the fraud was revealed, the punishment result of the China Securities Regulatory Commission for the case was: to order Hubei Kaile Technology Co., Ltd. to correct, give a warning, and impose a fine of 10 million yuan; Zhu Dixiong was given a warning and fined 5 million yuan; Liu Lianchun was given a warning and fined 1 million yuan; Duan Heping was given a warning and fined 500,000 yuan. The subject involved in the case obtained hundreds of millions of yuan in profits from financial fraud, the punishment was relatively light, the cost of making mistakes was too low, and the income brought

by fraud was far greater than the risk and punishment, which made Kaile Technology choose to take risks and go to the road of no return of financial fraud.

### **3. Financial Fraud Prevention Countermeasures of Listed Companies Based on GONE Theory**

Through the analysis of specific cases of financial fraud of Kaile Technology, the motive of financial fraud of listed companies is analyzed on the basis of GONE theory, and four preventive measures for financial fraud of listed companies are proposed based on the overall goal of improving the quality of listed companies.

#### **3.1 Implement Moral Quality Training, Curb Greed**

Listed companies should attach importance to the construction of moral level, improve legal awareness, implement the corporate culture of honesty and truth-seeking, create a positive and good corporate atmosphere, and guide employees to establish correct moral values. It can be started from the following aspects: First, the company should actively promote the corporate culture of honesty and trustworthiness, and encourage the pragmatic work attitude [4]. The company regularly holds lectures to improve the ideological and moral level, popularize legal knowledge, encourage employees to participate in training, and establish a good corporate image. Secondly, we need to establish a sound incentive and restraint system. Honesty and law-abiding will be included in the performance assessment standards of employees, and employees with excellent performance and high ideological quality will be rewarded to set an example. We need to implement an effective supervision mechanism, remain vigilant to the abnormal behavior of employees, and resolutely punish financial fraud and other illegal acts. The daily integrity assessment of the employee shall be recorded and publicized, which will be used as a reference in the promotion or transfer assessment. If the employee repeatedly commits fraud, the result of the promotion assessment will be affected. Finally, the top management of the company should play an exemplary role in leading and guiding the employees to improve their moral quality. Companies should monitor not only the behavior of employees from the top down, but also the work of top managers from the bottom up. The level of senior executives' professional ethics plays an important role in the healthy development of enterprises.

At the same time, the CSRC or other government regulatory agencies should develop ethical quality training programs, regularly organize listed company executives to conduct ideological and ethical training and publicize legal knowledge, and supervise companies to convey the spirit of the meeting to their employees after the meeting. Listed companies should regularly carry out moral quality training and examinations, form clear assessment standards, and report the training content and examination results to the regulatory authorities. In addition, the regulatory authorities should establish a credibility database to record the personnel involved in fraud, and those who engage in bad or repeated misconduct should be punished according to the seriousness of the case. This database should be open to the public, and listed companies can conduct background checks on candidates before hiring the integrity database and refuse to recruit employees with low credit levels.

#### **3.2 Improve the Effectiveness of Audit Supervision, Reduce the Chance of Fraud**

Effective audit is an important link to supervise the compliance of listed companies and ensure the healthy development of the securities market. The government should further strengthen the comprehensive supervision of listed companies, enrich the supervision and audit resources, and

improve the supervision and audit structure.

In order to prevent the occurrence of financial fraud of listed companies, the regulatory authorities should focus on the following two points: First, ensure the independence and fairness of audit institutions. The audit work of a listed company may be supervised by the regulatory department, which shall select an accounting firm to complete the audit work [5]. No interest relationship between the third-party accounting firm and the listed company can improve the independence of the audit and improve the audit quality. Second, the use of information audit technology to improve audit capabilities. With the development of computer technology, information audit has gradually replaced the traditional audit mode. Cloud audit can coordinate various audit resources through cloud storage of data, thus providing auditors with a more efficient and scientific audit process. The audit process and data can be queried through the system, and the possibility of fraud is high, and it is difficult for people to tamper with the data, thus reducing the chance of fraud.

### **3.3 Formulate a Reasonable Development Path, Reduce Undesirable Demand**

The development path of a listed company is the key to its future success. A reasonable development path can help a company achieve its strategic goals, reduce undesirable demand, and improve efficiency and profitability. After Kaile technology landed in the capital market, the company's business has been adjusted several times. From 2002 to 2008, Kaile Technology has entered optical communications, real estate, education, liquor and other fields, but the transformation effect did not meet expectations, Zhu Dixiong even intended to get involved in private banks, and finally failed to travel. The massive expansion of the business fragmented the company and led to its decline.

Reasonable development route plays an important role in the long-term development of the company. First of all, the company should be combined with its own business conditions, develop a strategic line in line with the company's long-term development needs, listen to the advice of professionals in the industry, and make reasonable decisions [6]. Secondly, the management should also pay attention to the changes in industry trends and market demand in daily operations, adjust the strategic route in a timely manner according to the demand trend, and avoid the deviation between the strategic direction and the market environment. Finally, the management should communicate with the financial personnel in a timely manner, pay attention to the financial data of each project, and find and correct financial errors and omissions in a timely manner.

### **3.4 Strengthen Supervision and Punishment, Increase the Probability of Exposure**

As a third-party audit institution, accounting firms should maintain absolute independence and integrity, and disclose the financial fraud of listed companies at the first time when they find it. Accounting firms should pay attention to the training of professional ethics of certified public accountants and maintain due diligence and professional vigilance. The CPA industry should establish a professional ethics evaluation and supervision organization, and the evaluation results can be used as a reference for the promotion of accountants, so as to constrain the professional ethics of accounting practitioners and increase the probability of financial fraud being exposed.

In this paper, the amount of punishment for the fraud of Kaile Technology is 10 million yuan, and the fine of the main personnel involved ranges from 5 million to 500,000. This penalty amount is simply a drop in the bucket compared to the hundreds of millions of yuan they obtained through fraud. Such a low criminal cost cannot serve as a warning to other companies. Regulators should strengthen the punishment of financial fraud and deter companies and individuals who intend to profit from financial fraud [7].

Small and medium-sized shareholders should strengthen the awareness of rights protection [8]. External investors should pay attention to corporate information disclosure. Investors actively understand the company's operation, clear their own interests, pay attention to the financial statements disclosed by the company, timely discover whether the company exists financial fraud, and pay attention to the long-term development of the company. Investors actively participate in the general meeting of shareholders, exercise the voting rights of shareholders on behalf of the interests of minority shareholders, form part of the supervisory role, raise objections when necessary, reserve their own opinions, and further bind the decisions of major shareholders accordingly [9].

#### 4. Conclusions

Based on GONE theory, this paper interprets the motivation of financial fraud of Kaile Technology from four factors, namely greed, opportunity, demand and exposure, and proposes corresponding management countermeasures according to the motivation of fraud: Listed companies should implement moral quality training to curb employees' greed; Third party audit institutions should improve the efficiency of audit supervision and reduce the chance of fraud of listed companies; Listed companies should formulate reasonable development routes to reduce the bad demand of enterprises; Finally, the regulatory authorities should strengthen supervision and punishment to increase the probability of fraud being exposed. Financial fraud is a deep-rooted problem in the capital market, listed companies, audit institutions, regulatory authorities need to work together to create a good business environment, help China's economy to develop rapidly.

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