

Analysis of Financial Fraud Cases from the Perspective of Corporate Governance—Taking Kingenta Company as an Example

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Abstract: In recent years, with the rapid growth of the number of listed companies, financial fraud has become increasingly prominent, which has seriously affected the stable development and healthy operation of China's capital market. Financial fraud in listed companies is inseparable from internal and external factors. Among many influencing factors, corporate governance has a particularly significant impact. This article takes the chemical fertilizer company Kingenta as an example and analyzes the causes of financial fraud and defects in corporate governance of Kingenta from the perspectives of equity structure, board of directors decision-making mechanism, supervisory board supervision mechanism, my country's laws and regulations, external governance, and corporate status quo. In response to the above analysis, this article provides measures to prevent financial fraud from the perspectives of internal and external corporate governance, and proposes corresponding governance strategies to serve as a warning to listed companies, thereby better maintaining the order of the capital market and promoting the sustainability of listed companies.

Keywords: financial fraud, corporate governance, causes of fraud, Kingenta

1. Introduction

In recent years, my country's economy has continued to decline due to many factors, and all walks of life have been hit hard. In this case, some listed companies whitewash their statements in order to conceal their true operating conditions, stabilize stock prices, continue financing, and protect their corporate image. Therefore, financial fraud has been highly valued by the business community, academia, and regulatory agencies in recent years. For example: the financial fraud cases of Luckin Coffee, Kangmei Pharmaceuticals, and Kangdexin, their fraud methods are becoming more and more hidden, and their fraud methods are becoming more and more diverse. Using related parties to fabricate economic business and committing financial fraud by forging accounting documents will not only seriously harm the rights and interests of investors and destroy the reputation of the company, but will also seriously affect the stability of the securities market and undermine the harmonious order of the social economy. Therefore, how to prevent the occurrence of financial fraud has become an urgent matter. Starting from the basic theory of corporate governance, this paper analyzes the financial fraud case of Kingenta based on the company's equity structure, board of directors' decision-making, supervision of the board of supervisors, and incentives of senior managers, and proposes relevant preventive countermeasures from the corporate governance level to promote the continued health of the capital market[1-2].

2. Case background introduction

2.1 Company background

In August 1998, KINGENTA ECOLOGICAL ENGINEERING GROUP CO.,LTD.(hereinafter referred to as Kingenta) was born. It was listed on the Shenzhen Stock Exchange in 2010, raising 1.5 billion yuan, and its market value once exceeded 50 billion. The company's core business includes the research, production and sales of compound fertilizers, slow-controlled release fertilizers and some new fertilizers. Kingenta compound fertilizer has ranked first in the industry in sales for nine consecutive years. It is a key high-tech enterprise in my country. In addition, it also has the largest slow-release fertilizer production base in Asia. Kingenta has received numerous commendations from the government, as well as multiple provincial and national awards. We have established production bases in Shandong,

Henan and other places for production. Not only that, we also have branches abroad. However, in 2022, the official website of the China Securities Regulatory Commission announced that Kingenta had received the "No. 1 Penalty Order." Specifically, Kingenta had inflated income and profits through fictitious trading business, and failed to disclose the existence of related parties and related transactions, assets and liabilities as required. The company was fined 7.55 million yuan for false records and other violations, and eight relevant persons in charge were also punished. Three of the main responsible persons will face market bans from 3 to 10 years[3].

2.2 Case review

With the arrival of 2015, China's fertilizer industry has experienced a huge contradiction between supply and demand. The total output value of the industry that year could reach 200 million tons, but the actual sales volume of the industry was only 60 million tons. As an industry with overcapacity, the country has gradually canceled preferential policies. This made Kingenta's financial situation in 2016 very bad, with operating income falling from 15.285 billion yuan in the previous year to 10.263 billion yuan, and net profit from 955 million yuan to a loss of 28.2435 million yuan. Since the industry environment is not optimistic, Kingenta has tampered with financial data in order to cover up the fact that its operating conditions are poor. From 2015 to the first half of 2018, Kingenta committed financial fraud through false records, fictitious business, and failure to disclose related party transactions as required, accumulating inflated revenue of 23.0734506 million yuan, inflated costs of 21.0838488 million yuan, and inflated total profits of 198.96018 million yuan. However, Kingenta's financial fraud has not been discovered by the China Securities Regulatory Commission until April 2019. Daxin Accounting Firm, which has served Kingenta for many years, gave a qualified opinion on Kingenta's 2018 annual report. Subsequently, the China Securities Regulatory Commission issued a warning letter and began an investigation into Kingenta's financial situation. In May 2021, the China Securities Regulatory Commission announced an administrative penalty against Kingenta, and the fact that Kingenta had committed financial fraud was made public.

3. Analysis of the causes of financial fraud from the perspective of corporate governance

Kingenta committed financial fraud through complex means such as fabricating economic businesses, failing to disclose related parties and related transactions as required, and falsely recording assets and liabilities. This article comprehensively analyzes the motivations of Kingenta's financial fraud from the perspective of corporate governance, divided into internal governance perspective and external governance perspective[4].

3.1 Analysis of the causes of fraud from the perspective of internal governance

3.1.1 The shareholding structure is too concentrated

Table 1: Shareholding ratio and number of the top five shareholders of Kingenta in 2019

Shareholder name	Shareholding ratio	Number of shares held
Linyi Kingenta Investment Holdings Co., Ltd.	35.30%	1,156,686,529
Wan Lianbu	18.04%	592,743,874
China Agricultural Industry Development Fund Co., Ltd.	1.52%	49,794,238
Beijing Dongfu Huitong Investment Management Center (Limited Partnership) - Dongfu Huitong (Tianjin) Equity Investment Fund Partnership (Limited Partnership)	1.52%	49,794,238
Shantou Huisheng Investment Co., Ltd.	0.78%	25,570,000

The ownership structure is the top-level design for corporate governance. The ownership structure will directly affect the decision-making efficiency and decision-making results of the company's shareholders' meeting. Equity ratio is the main factor for investors to obtain company management rights, and reasonable equity distribution is the cornerstone of company stability. If the degree of equity checks and balances is high and the equity is too concentrated, there will be a situation where one company is the dominant shareholder. Major shareholders may abuse their power and force management to make decisions that are beneficial to themselves and harmful to the interests of small and medium-sized shareholders. As shown in Table 1, after reviewing Kingenta's 2019 annual report (after correction), we

can find that the largest shareholder is Linyi Kingenta Investment Holding Co., Ltd., with a shareholding ratio of as high as 35.30%; the second largest shareholder is Wan Lianbu, its shareholding ratio is as high as 18.04%; however, the shareholding ratios of the third and fourth largest shareholders have plummeted, only 1.52%. By reviewing relevant information, it can be found that the actual controller of Linyi Kingenta Investment Holding Co., Ltd. from 2015 to 2019 was Wan Lianbu. Therefore, the imbalance of Kingenta's ownership structure resulted in major shareholders having absolute say, making it difficult for small and medium-sized shareholders to play a check and balance role. This makes it easier for major shareholders to commit financial fraud through related transactions and other means.

3.1.2 Independent directors failed to perform their functions

Since Kingenta's ownership structure presents a dominant situation, independent directors are mainly nominated by major shareholders, and their remuneration depends on major shareholders and management. This phenomenon makes it difficult for independent directors to maintain true independence when performing their supervisory responsibilities. In other words, since the nomination and remuneration of independent directors are closely related to major shareholders and management, they are likely to be affected by conflicts of interest when supervising company decisions and cannot truly act from the perspective of the interests of small and medium investors and creditors. The possibility of discovering the company's financial reporting and management loopholes is even slimmer.

Looking at Kingenta's 2019 annual report (after correction), we can find that its independent directors are composed of Wang Rong (professor-level senior engineer), Li Jieli (equity partner of Zhonglun Law Firm), and Qin Tao (doctoral supervisor of Beijing Forestry University), Wang Xiaofeng (professor-level senior engineer). Judging from the personal resumes and social experiences of the four independent directors, they all have strong professional skills and high professional qualities. However, at the six board meetings held by Kingenta in 2019, the four independent directors did not raise any objections. It can be seen that the independent directors of Kingenta have not fully exerted their supervisory role in the quality of accounting information. Then, there are reasons to doubt the independence of its independent directors and sit back and ignore the fraud for personal gain.

3.1.3 Weakening of functions of the board of supervisors

As the company's internal supervisory body, the board of supervisors supervises and inspects the company's business activities. Its main responsibilities are to supervise the performance of duties by the board of directors or managers and to correct or stop illegal and illegal behaviors of directors and managers. After checking Kingenta's 2019 annual report (after correction), it was found that the company's supervisory board consists of three members, of which Yang Yan serves as the chairman of the supervisory board. In addition, Yang Yan also serves as a director of Linyi Kingenta Investment Holding Co., Ltd., the largest shareholder. It can be seen that the functions of the board of supervisors have been greatly weakened, making it difficult to ensure that it can exercise its supervisory power independently and effectively, making financial fraud easier.

After reviewing the 2017 and 2018 annual board of supervisors resolution reports before Kingenta was *ST, as shown in Table 2, it can be found that the three members of the board of supervisors unanimously approved the internal control self-evaluation report and the annual report. However, after the China Securities Regulatory Commission imposed penalties on Kingenta, Kingenta admitted in its 2019 annual report (updated) that there were major flaws in its internal control system. Therefore, it can be seen that members of the Kingenta Supervisory Board have not performed their supervisory duties well.

Table 2: Opinion results of important voting matters of the Board of Supervisors

years	Voting matters	Opinion
2017	"2016 Internal Control Self-Evaluation Report" and "2016 Annual Report"	3 votes for yes
2018	"2017 Internal Control Self-Evaluation Report" and "2017 Annual Report"	3 votes for yes

3.1.4 Executives violate professional ethics

From the sexual characteristics penalty decision issued by the China Securities Regulatory Commission, it can be found that senior executives such as Li Jiguo, Tang Yong, Cui Bin, Gao Yiwu, and Yan Mingxiao were involved in fictitious trading business, transfer of non-operating funds to Nobifeng, and inflated fraudulent behaviors such as issuing goods and falsely reducing bills payable. Due to the weak awareness of professional ethics and legal awareness of Kingenta executives, they are easily

tempted to pursue personal interests and thus embark on the path of financial fraud. In addition, in the equity incentive plan released by Kingenta in May 2014, 19.99 million units were authorized for the first time, and the exercise price was 19.88 yuan. However, the prerequisites required that the stock options granted for the first time should be within each exercise period. The company's performance conditions are as shown in Table 3. As shown in -3, however, in 2015, the Ministry of Agriculture of my country proposed a zero-growth action for chemical fertilizers. Under the guidance of this national policy, it was obviously a fatal blow to companies like Kingenta, which mainly engaged in chemical fertilizers. Then, in order to obtain equity incentives, the management made a series of financial frauds when the performance appraisal targets could not be met.

Table 3: Exercise and assessment conditions for Kingenta Equity Incentive Plan

Exercise period	performance appraisal objectives
first exercise period	The growth rate of net profit in 2014 is not less than 28% compared with 2013; the growth rate of operating income in 2014 is not less than 10% compared with 2013
second exercise period	The growth rate of net profit in 2015 compared with 2013 is not less than 64%; the growth rate of operating income in 2015 compared with 2013 is not less than 21%
The third exercise period	The growth rate of net profit in 2016 compared with 2013 is not less than 110%; the growth rate of operating income in 2016 compared with 2013 is not less than 33%
The fourth exercise period	The growth rate of net profit in 2017 is not less than 168% compared with 2013; the growth rate of operating income in 2017 is not less than 46% compared with 2013

3.2 Analysis of the causes of fraud from the perspective of external governance

3.2.1 External audit institutions fail to perform their duties

External audit institutions play a key role in connecting enterprises and investors. They should fulfill their "gatekeeper" duties and help investors achieve better allocation of resources. They should not be reduced to "leakers" of false operations of enterprises. In the Kingenta fraud incident, the certified public accountants failed to remain vigilant and professionally suspicious of abnormal data. After reviewing the Kingenta annual report, they found that the operating income from 2014 to 2017 was 13.554 billion yuan, 17.741 billion yuan, 18.725 billion yuan, and 20.761 billion yuan. The Ministry of Agriculture of my country has proposed the goal of achieving zero growth in chemical fertilizers and abolished preferential policies. In the context of an unoptimistic environment for the chemical fertilizer industry, Kingenta's operating income has shown steady growth. In the face of potentially abnormal data, Daxin Accounting Firm was not vigilant, nor did its CPAs carefully verify its authenticity, issuing standard unqualified opinions for many years in a row. It can be seen that the auditors of Daxin Accounting Firm did not perform their duties during the audit of Kingenta.

3.2.2 The cost of breaking the law is low

After considering all aspects, managers believe that the benefits brought by fraud are much higher than the costs paid. At this time, financial fraud will occur. Due to the low fines and weak penalties for financial fraud in the Securities Law, even if the Securities Law was revised in 2019, the penalty limit of 600,000 yuan was increased to 10 million yuan, which was implemented in 2020. This is very important for curbing financial fraud. Market fraud, rectifying the market atmosphere is a good start. However, this number may still be negligible for larger listed companies. In the 2002 "No. 1 Fine" announced by the China Securities Regulatory Commission, Kingenta was fined 7.55 million yuan. However, the fine of RMB 7.55 million is simply a negligible punishment compared to its cumulative inflated income of RMB 23,073,450,600. This gave Kangdixin the confidence to commit financial fraud.

3.2.3 Weak external supervision

In addition, due to the imperfect market supervision mechanism and weak supervision by the China Securities Regulatory Commission, this kind of illegal behavior has been repeatedly prohibited, which makes Kingenta not afraid of financial fraud. For three and a half years, Kingenta's financial fraud has not been discovered. Until 2020, when it was time to disclose the previous year's financial report, Kingenta's 2019 annual report has not yet been disclosed. After two postponements, Kingenta disclosed its financial report on June 30 of that year, and the auditing agency Daxin Accounting Firm issued a "no

(refusal) opinion". The financial fraud was exposed. It was not until September 15, 2020, that the China Securities Regulatory Commission opened an investigation into Kingenta. There is no doubt that the China Securities Regulatory Commission's work efficiency is low, which objectively creates a breeding ground for fraud for interested companies.

4. Financial fraud management measures from the perspective of corporate governance

4.1 Financial fraud control measures from the perspective of internal governance

4.1.1 Optimize equity structure

The internal equity imbalance of Kingenta is the fundamental reason why financial fraud is difficult to detect. In order to avoid the imbalance of power within the company and the phenomenon of "one company dominates", firstly, it is necessary to optimize the ownership structure and split the shares of major shareholders and related parties to narrow the gap between them and small and medium shareholders in shareholding ratios and achieve joint decision-making.

4.1.2 Clarify the responsibilities of independent directors

Although my country's independent directors maintain absolute independence in form, the results in the actual performance of their duties are unsatisfactory. It is better to focus more on the independence of independent directors in the performance of their duties. Corresponding independent director associations can be established to give independent directors more confidence to speak. At the same time, independent directors attach great importance to their own reputation. The company can announce the specific performance of independent directors' duties to the outside world, allowing the market and the public to supervise the performance of independent directors' duties. In order to form a good reputation, the independent board of directors should be more diligent and responsible. When investigating the responsibilities of independent directors, the violations of laws and regulations of independent directors should be clearly classified and divided into different levels according to the degree of damage to the company and the market, and then the responsibilities should be determined. Anyone who participates in illegal or illegal activities in the company's related-party transactions and brings losses to the company and the market should be subject to severe legal sanctions; for those who fail to perform their duties of diligence and due diligence, leading to false statements in key information disclosed, independent directors should bear corresponding liability. In the case of unintentional dereliction of duty, the consequences of such behavior should be considered, and the diligence and due diligence of independent directors in performing their duties should be taken into consideration.

4.1.3 Optimize the job responsibilities of supervisors

First of all, the independence of the board of supervisors should be ensured, the association between it and the management should be reduced, the supervisory board's supervisory role on the company and management should be fully utilized, and the occurrence of financial fraud should be curbed. Secondly, the responsibilities and powers of the board of supervisors should be clarified. The company should formulate detailed regulations on the responsibilities and powers of the board of supervisors and write them into the company's articles of association to ensure that the board of supervisors can fully play its role in corporate governance. Finally, external professionals should be introduced. In order to enhance the professionalism of the board of supervisors, the company can consider introducing external professionals, such as financial experts, legal experts, etc. As members or consultants of the board of supervisors, their professional knowledge and experience can help the board of supervisors to better performance of duties.

4.1.4 Strengthen the moral cultivation of management

First of all, management members can be evaluated regularly. This evaluation can be multi-faceted, including personal life, work attitude and professional ability. From the evaluation results, a preliminary judgment can be made as to whether there are signs of low moral standards in managers; secondly, based on the management can carry out targeted moral education. It can classify the moral risk levels of management personnel based on the evaluation results, carry out classified education, and focus on training for personnel with obvious signs of low moral standards; including conventional ethics principles, laws and regulations, and professional ethics training. Knowledge matches industry regulations; members with excellent moral evaluations can be encouraged and promoted to form a good moral atmosphere within the company and optimize the company's internal governance environment; employees who have low moral standards or even cheating can be promptly recorded and reported within

the company Notify criticism, cancel welfare benefits, reduce salary levels, publicize unethical behavior to the outside world, let investors know of personnel misconduct in a timely manner, and remind other listed companies to pay attention and learn lessons from it.

4.2 Financial fraud control measures from the perspective of external governance

4.2.1 Strengthen the responsibilities of external audit institutions

Kingenta's behavior of not changing the audit agency for 10 years has caused the audit agency to have too close economic contacts with the audited unit, making it difficult to ensure the independence and professionalism of the audit agency. Therefore, a more stringent rotation system should be adopted to improve the accuracy of audit results. Intermediaries should also strengthen their own internal control, mutual restraint, strict supervision, and effective accountability. Regulatory authorities must increase penalties for intermediaries that lose the bottom line of the industry and emphasize joint and several liability to increase the cost of violating the law. When necessary, we will intensify efforts to delist intermediaries for major violations of the law, purify the market ecological environment, and inject positive energy into the healthy development of the market. In addition, a training plan for certified public accountants should be formulated, regular training should be used as an assessment standard, continuous learning should be done to increase the CPA's audit knowledge reserve, enhance the CPA's own capabilities, improve business processing capabilities, and cooperate with the quality control department of the firm to ensure that the audit project Double guarantee of efficiency and quality.

4.2.2 Increase the cost of violating the law

Relevant laws and regulations should be further improved, penalty standards should be refined, penalties should be intensified, and the cost of violations should be increased. Corporate fraud should never be tolerated, so as to provide effective guarantees for the implementation of regulatory actions. Fraud cases of listed companies have been repeatedly banned, and it is not uncommon for companies such as Kingenta and Kangmei to do things they know they cannot do, which shows that under existing laws, the cost of violating the law is far less than the illegal profits, and the commonly used punishment measures are not enough to serve as a warning, making it difficult to punish counterfeiting companies. cause substantial impact.

4.2.3 Strengthen external supervision

Regulatory agencies should further optimize the market supervision system, severely crack down on illegal and fraudulent activities, and provide all-round supervision of companies that may have committed financial fraud. At the same time, we will focus on companies that have had negative news, such as bribery, tax evasion and other behaviors. Their management quality is poor and they may be lucky and constantly challenge the red lines of regulatory authorities. For this type of enterprise, focus should be placed on supervising data disclosure. Many listed companies such as Kingenta have been committing financial fraud for many years, which shows that it is a planned and premeditated behavior by the management. Regulatory agencies should conduct random inspections of corporate operations from time to time, implement supervisory responsibilities in place, and ensure that illegal and fraudulent activities can be exposed in a timely manner.

5. Conclusion

Kingenta has committed financial fraud by inflating income and profits through fictitious trading business, failing to disclose related parties and related transactions as required, and making false records of assets and liabilities, etc., which has affected the judgment of investors and had an adverse impact on the healthy development of the capital market. This article analyzes the causes of Kingenta's fraud from the perspective of corporate governance and puts forward suggestions, which will help other companies better restrain themselves, operate with integrity, comply with laws and regulations, and jointly maintain the healthy development of the capital market. Even though financial fraud incidents of listed companies still occur from time to time, the standardization of internal supervision of companies, the professionalism of external audit institutions and the effectiveness of market supervision have all made qualitative leaps. We always believe that in the "transparency era" where digital technology prevails, corporate financial fraud will eventually disappear in the interoperability supervision mechanism of internal and external multi-party entities, creating a pure land for the commercial market!

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