



Case Study of Financial Fraud in HUBEI EASTERN GOLD JADE CO., LTD.

--Based on CRIME Five-Factor Theory

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Abstract. Financial fraud endangers the development of the capital market and damages the interests of the enterprise itself, creditors and other stakeholders. With the development of China's capital market, the prevention and punishment of financial fraud is strengthening, the implementation of the new "Securities Law" shows that the government has zero tolerance for financial fraud. The case enterprise in this paper is a Chinese listed company, but it terminated the listing due to alleged illegal information disclosure and financial fraud. This article applies the CEIME theory to analyze the financial fraud incident of Eastern gold Jade from multiple perspectives, and provides feasible suggestions for the company's internal, third-party accounting firms, and external regulatory agencies.

Keywords: financial fraud; Eastern gold Jade; the CRIME Five-Factor Theory.

1 Introduction

On March 1, 2023, Zhu Zhongming, deputy minister of Finance, emphasized that we should crack down on financial accounting violations and seriously find out financial fraud, accounting fraud and other illegal violations in the introduction of finance throughout the implementation of the party's 20 major decisions on the deployment of the press conference. In 2022, the finance department penalized more than 170 accounting firms, with the number of penalties exceeding the total of the previous three years, which shows the country's determination to control financial fraud. Since the reform and opening up, the number of listed companies has been increasing, followed by the complexity and diversity of fraud, which has damaged the rights and interests of investors and is not conducive to the stable and healthy operation of the capital market. (Deng & Wei, 2023) believe that financing needs, management power and position advantages are the main causes of corporate financial fraud.^[1](Guan & Zhu, 2014) explored the good application effect of CRIME five-factor theory on the identification of fraud.^[2]This paper takes Eastern gold Jade as the research object, which is the first listed jade company in China, analyzes the reasons for its audit failure and uses the CRIME model to describe its fraud and put forward preventive suggestions systemat-

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ically. The purpose is to explore the motivation behind the fraud, sound the alarm for listed companies and intermediaries. This paper hopes to put an end to such illegal acts as financial fraud.

2 Introduction to the Case of Financial Fraud in Eastern Gold Jade

2.1 Introduction to Eastern Gold Jade

Eastern gold Jade is the first jadeite listed company in China. It was established by directional fundraising in April 1993 and the stock code is 600086. It mainly supplying wholesale and retail of jadeite raw materials, the development of cultural tourism projects, and the sale of arts and crafts. * ST Jinyu terminated its listing on January 13, 2021.

As shown in Figure 1, Ruili Jinze Investment Management Co., Ltd. invested 21.72%, Yunnan Xinglong Industrial Co., Ltd. invested 12.96%, Zhao Ning has an absolute controlling stake because of its 98 % shareholding in Yunnan Xinglong, Wang Yingdian is his wife, 2% of the shareholding; Zhao Xinglong has 51 % equity of Runli Jinze Investment Management Co., Ltd., and Zhu Xiang ying holds 49 %. In summary, the internal control of Eastern gold Jade is basically Zhao Xinglong and his family members.

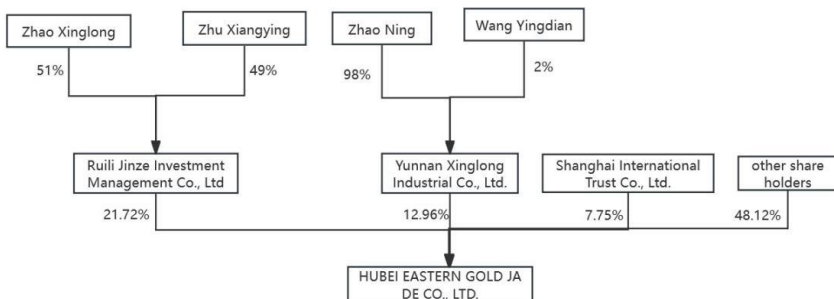


Fig. 1. Shareholding structure of Eastern gold Jade

Data source: Flush iFinD

2.2 Eastern gold Jade Financial Fraud Incident Combing

Zhao Xinglong established Yunnan Xinglong Industry Co., Ltd. in 2003, and became the major shareholder of Duojia shares in 2005, which was later renamed Eastern gold Jade; Eastern gold Jade carried out frequent capital operation frequently. In 2014, Xu Xiang's fraud case was revealed, and the stock price began to fall. Xu Xiang and Zhao Xinglong have reconciled two private placements and established Ruili Jinze Investment Management Co., Ltd. to achieve huge profits; in March 2016, *ST Jinyu with-

drew the application for non-public offering of shares; in May 2016, Xu Xiang was jailed.

Since 2018, Eastern gold Jade 's debts have not been paid off, its bank accounts and equity were judicially frozen in the first half of the year due to arbitration of contract breach; in January 2019, due to the alleged violation of information disclosure, Eastern gold Jade received a notice of investigation from the Securities and Futures Commission; in April 2020, Eastern gold Jade received advance notice of administrative penalty; in 2021 was found to be a transaction forgery category of financial in 2021, it was identified as a financial fraud of transaction fraud and terminated in January of the same year. In 2023, the Guangdong Provincial High People 's Court made a second-instance judgment on the dispute over the liability for false statements of ' delisting Jinyu ' securities. The actual controller Zhao Ning was convicted of full liability, and the delisting Jinyu case ended. Qi (2023).^[3]

According to the penalty decision, Eastern gold Jade inflated its operating income of 142 million yuan, 295 million yuan and 120 million yuan in 2016,2017 annual report and 2018 semi-annual report respectively; falsely increased operating costs by 47 million yuan, 110 million yuan, and 41 million yuan; the total inflated profits were 0.95 billion yuan, 1.84 billion yuan and 0.79 billion yuan, which accounted for 29.60%, 59.7%, and 211.0% of the total profit of the current period's consolidated profit statement, respectively. In addition, delisted Jinyu also inflated accounts receivable by 0.77 billion yuan in the 2018 semi-annual report. (Ye, Ye&Huang, 2021).^[4]

3 CRIME Theoretical Analysis of Financial Fraud in Eastern Gold Jade

3.1 Fraud Perpetrator Analysis

Lack of Management Ethics

Zhao Xinglong, the former chairman of the board of directors, was known as the king of stone gambling. He was tempted by interests to invest in stocks without authorization, which was illegal and unethical, For his own self-interest, he conspired with Xu Xiang to issue additional shares to operate the securities market, which eventually led to the collapse of the company 's stock price. After his son Zhao Ning took over Eastern gold Jade, he was regulated repeatedly for information disclosure issues, damaging the interests of stakeholders and concealing the company's financial situation by financial fraud and other means. The deputy general manager Yang Yuanyuan, Cao Xia took over the fictitious sales transactions, other senior managers knew the illegal behavior but did not report it. It can be seen that the executives of the weak legal and ethical awareness.

Highly Concentrated Shareholding Structure

Through the above analysis of the shareholding structure, it can be seen that Eastern gold Jade presents a 'dominant' situation, its main shareholders have a close relationship with each other. The initial actual controller of Ruili Jinze was Zhao Xinglong, which became Zhao Ning in 2016, Zhao Ning is the actual controller of Xinglong Industry, he is the son of Zhao Xinglong. Eastern gold Jade is completely controlled by them, it is easy to encounter a problem of tunneling between major shareholders and small and medium-sized shareholders.

3.2 Analysis of Fraudulent Means

Fictitious Revenues, Costs and Profits

From 2016 to 2018, Eastern gold Jade's currency funds decreased significantly and continuously, while the income and inventory of jadeite finished products and raw materials increased greatly, Eastern gold Jade used the difficult verification characteristics of jadeite to adjust the gross profit margin. In addition, Eastern gold Jade also forged sales contracts and fabricated operating income. Jiegao Hongning fictitiously traded with nominal natural persons and nominal suppliers in nominal accounts to increase operating income, accounts receivable and profits. The abnormal characteristics and phenomena of these fictitious behaviors are important evidence for the CSRC to investigate Eastern gold Jade.

Fictitious transactions for free circulation of funds

There is a blind spot in the substantive procedure of the audit. By building a free capital cycle transaction, Eastern gold Jade inflates a small proportion of income per year, each year inflated by a small percentage of revenue. Jiegao Hongning Jewelry Co., Ltd. controlled 19 bank accounts. Jiegao Hongning transferred the funds of Eastern gold Jade into the account of nominal suppliers through fictitious procurement transactions. These suppliers then transferred them to nominal customers and finally returned to Jiegao Hongning. A closed loop is formed. In 2016 and 2017, Jiegao Hongning inflated inventory by CNY 818.112 million, Eastern gold Jade chose to implement fraud through it, which may be because it is not a listed company so it can reduce the possibility of being audited for fraud.

Hiding Related Party Transactions

Eastern gold Jade does not disclose supplier and customer information to prevent the disclosure of commercial secrets, and only began to make specific disclosures after receiving the annual report inquiry letter in 2017. Through reviewing relevant information, it was found that there were problems between Eastern gold Jade's suppliers and customers. First of all, Eastern gold Jade's sales customer Shanghai Zhang Tiejun Jewelry Group Company Limited and procurement supplier Shanghai Master Jade Carving Company Limited jointly control a financing guarantee company, and the two sides may have a related relationship; secondly, the address of Ruili Shangyi Jewelry Company Limited is adjacent to the address of Jiegao Hongning Jewelry Company

Limited, and the establishment time of Ruili Laisheng Jewelry Store, Haobin Jewelry Store and Yuanhao Jewelry Store is the same.

3.3 Analysis of Fraudulent Motives

Increased Pressure on Debt Servicing

Eastern gold Jade not only has been expanding the procurement of jadeite raw stone, but also engaged in microfinance business, the demand for funds increased. Since 2016, the scale of Eastern gold Jade 's foreign debt has increased due to the demand for jadeite raw stone and the capital demand of small loan companies. Since 2017, Eastern gold Jade has borrowed from institutions of different amounts, increasing the pressure on debt repayment. At the same time, Eastern gold Jade also needs asset restructuring. In order to meet the financial needs of 1.9 billion yuan, Eastern gold Jade adopted a fixed increase and borrowing method, but it still could not meet the huge financial requirements. In order to deliver good news to the market and attract investment, Eastern gold Jade increased its fraud motivation under the pressure of debt repayment.

Avoiding a Delisting Crisis

When a company is put on the 'ST' hat, it means that its business has lost money for two consecutive years and has a delisting crisis, which has a great impact on the reputation of a company. As a leading jadeite enterprise, Eastern gold Jade 's net profit has been declining from 2016 to 2018. After inflating profits, the loss in 2018 was still as high as 1.718 billion yuan. In addition, its net operating interest rate fell from 3.81 % to - 58.04 %. In order to lose ST 's hat, Eastern gold Jade chose financial fraud to inflate profits.

3.4 Analysis of Regulatory Mechanisms

Failure of Internal Controls

Eastern gold Jade is a typical family business, with chaotic internal structure and serious collusion of interests, From the collusion of directors and supervisors to participate in fraud, it can be seen that internal control is virtually non-existent. Zhao Ning is not only the chairman and president of Eastern gold Jade, but also serves as an executive director and general manager in Jiegao Hongning, making the governance layer unable to effectively supervise the management. In addition, between 2014 and 2017, the Eastern gold Jade internal control self-evaluation report released to the public are shown to be "no significant deficiencies", did not find the fact of internal fraud or can be hidden, it internal control is so chaotic that can not prevent fraud occurs.

External Audit Failures

In 2016, Daxin Certified Public Accountants and Dahua Certified Public Accountants in 2017 issued unqualified audit reports on Eastern gold Jade. In the second half of 2018, Dahua Certified Public Accountants issued a qualified audit report. The accounting firm did not diligently perform its duties in providing audit services for

Eastern gold Jade 's financial statements, and the audit report issued contained false records. The auditors did not maintain professional skepticism, In the process of inventory audit and income identification, they did not find their abnormal behavior and false natural person transactions, and did not take further audit measures on abnormal income and profits.

3.5 Analysis of Fraud Results

Harming the Interests of Small and Medium-sized Shareholders

When the fraud of Eastern gold Jade was discovered, the stock price fell continuously, Eastern gold Jade's share price was 4.61 yuan per share at the end of 2018, and fell to 2.77 yuan per share at the end of 2019, and the share price fell to 1.51 yuan per share in 2020, the day after the receipt of the SEC's "Prior Notice", and after it became *ST Jinyu, the share price fell to 1.14 yuan on June 30, and by the time of the delisting on March 17, 2021 The share price per share is only 0.16 yuan, and the company's market value is only 216 million yuan. The fall in share price has harmed the interests of small and medium-sized shareholders.

Deteriorating Financial Situation

During the period from 2018 to 2020, the operating income of Eastern gold Jade dropped from 9.2 billion yuan to more than 3 million, and the amount of owner's equity in 2020 was only 1,858,309,500 yuan, with a net loss of 1,917,182,800 yuan, which is a very serious financial situation since it was proved to be fraudulent. In 2021, Eastern gold Jade issued a performance pre-deficit announcement. It is expected that the net profit attributable to the shareholders of the parent company will be lost in 2021. The main reason is that the debt default leads to a large amount of financial expenses for the whole year, the loss caused by the disposal of assets and debts by the department creditors, and the impairment of assets and credit.

4 Eastern Gold Jade Financial Fraud Governance Recommendations

4.1 Corporate Recommendations

Enhancement of Executives' Awareness of Legal Ethics

If the senior executives of Eastern gold Jade abide by the law and strengthen moral cultivation, it is difficult to have fraud. Enterprises should publicize legal knowledge, self-check and self-correct, and let employees supervise each other. Regularly carry out training and legal education work, establish a sense of integrity, for illegal and criminal employees, once found never hire.(Yami & Poletti, 2022).^[6]

Improving the Corporate Governance System

The establishment of a diversified shareholding structure can avoid the problem of "one share dominance" and fully realize the checks and balances of power and responsibility among shareholders, board of directors, supervisory board, independent directors and management. Clearly defining the responsibilities of the general meeting of shareholders, board of directors, supervisory board and management is conducive to the supervision of the day-to-day business activities of the enterprise. In addition, the company should also strengthen the control environment and improve the risk assessment mechanism to enhance the internal control ability. Through a series of processes and regulations to improve internal control, timely detection of management behavior inconsistent with the normal operation of the enterprise, is conducive to preventing financial fraud. (Hooda, Bawa & Rana, 2018)^[7]

4.2 Audit and External Regulatory Recommendations

Improving the Quality of Firm Audits

Accounting firms have joint and several liability, If the audited entity has a major problem and the certified public accountant does not find it, the accounting firm is liable. Auditors should learn professional knowledge, improve practical ability and comprehensive quality, always maintain professional skepticism, diligence and responsibility. And learn computer technology, use big data to efficiently review the data of audited units, and improve audit quality. At the same time, auditors should strengthen their communication skills under the requirements of the law in order to better supervise the audited units and assume social responsibility.

Increase in Fraud Penalties

Due to the laxity of our country's fraud, some enterprises always take a chance to implement fraudulent behavior. Therefore, it is necessary to improve the legal system and raise the threshold of fraud crimes. (Zhao&Han, 2023).^[5]For example, to increase the penalty for fraud companies and responsible persons, improve the professionalism and ethics of law enforcement officers. The new Securities Law also increases penalties for non-compliance with information disclosure and fraud.

5 Conclusions

This paper uses the Crime five-factor theoretical model to analyze the fraud behavior of Eastern gold Jade systematically. From the perspective of the actor, the senior executives of Eastern gold Jade lack the awe of the law, and there are problems with the company's shareholding structure. In addition, Eastern gold Jade's financial fraud is through the implementation of fictitious income, cost and profit, fictitious transactions to free capital circulation and hidden related party transactions and other acts. The motivation of fraud is that it has suffered losses in successive years and increased debt repayment pressure. Eastern gold Jade has taken extraordinary measures to avoid delisting. In this series of behaviors, the company's internal control system did not

operate effectively, accounting firms and certified public accountants did not fulfill their responsibilities. Eventually, the financial situation of Eastern gold Jade further deteriorated, which damaged the interests of stakeholders and was not conducive to the smooth operation of the capital market. Therefore, this paper suggests that the company should improve the legal awareness of employees and improve the internal control, the accounting firm should strengthen the quality of audit, the external regulatory agency should maintain the maintain the dignity of the law and strengthen supervision.

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