

Identification of Financial Fraud in Listed Companies and Analysis of Preventive Measures - A Case Study of Kangmei Pharmaceutical

Liqin Dai

University of Hong Kong
email: dailq1205@163.com

Abstract. In recent years, China's capital market has continued to develop. However, some companies are still fabricating business facts in pursuit of illegal interests, resulting in more and more common financial fraud under the new "Securities Law". Therefore, this paper takes Kangmei Pharmaceutical as the research object, and sorts out the cases of corporate financial fraud as a whole. The inventory and monetary funds are used to analyze its counterfeiting methods. Subsequently, risk factor theory is used to analyze the fraud motivation of Kangmei Pharmaceutical. In general, this paper puts forward suggestions on the prevention and management of financial fraud for listed companies in my country, which provides necessary guarantees for maintaining the market environment and strengthening corporate supervision.

Keywords: Kangmei Pharmaceutical, Financial Fraud, Fake Motivation, Preventive Measures.

1. Introduction

The development of global capital markets has driven the rise of the domestic market, leading many companies to obsess over going public to raise capital. In September 2020, the number of A-share listed companies in China has exceeded four thousand. However, the problem of mismatch between the development of the capital market and the corresponding system and monitoring system has led to the continuous emergence of financial fraud in China's capital market, undermining the order of the capital market and affecting the healthy development of China's market economy. At the same time, the introduction of the new Securities Law in 2020 meant that the era of strict regulation had arrived. 2020 began with a sharp rise in the SEC's crackdown on financial fraud, with more than 50 shares being filed for investigation within a year.

A series of analyses and studies have been carried out at home and abroad on the drivers, means and governance of financial fraud. Omurgonlse has attributed the causes of financial fraud to the weakness of external regulation, and concluded that the incidence of fraud is negatively related to the strength of external regulation[1], while the functional expression "incidence of financial fraud = opportunity factor * action factor * cultural factor * interest trade-off factor" is a quantitative expression of the causes of fraud[2]. The expression "incidence of financial fraud = opportunity factor * action factor * cultural factor * interest trade-off factor" is a quantitative expression for the analysis of the causes of fraud [2]. Chen Shaohua and Huang Shizhong attribute the causes of fraud to the imperfect internal governance structure of enterprises, and believe that the internal governance structure of enterprises is related to financial fraud, and when the internal governance is not sound, it will easily lead to internal fraud [3][4]; regarding the means of financial fraud, Albrecht believes that the main means of fraud are increasing profits, inflating income and deceiving matters [5]. While in China, scholars generally believe that the means of falsification have the characteristics of fictitious transactions, the use of income and expenses can be manipulated[6][7]; regarding the governance of financial falsification, Dyck et al. believe that the governance should not only involve the participation of multiple subjects, but also strengthen the control of the company internally, strengthen external supervision and other means[8]. In addition, the key to preventing corporate financial fraud is to establish sound laws and related provisions [9]. In the domestic context, the use of promotion incentives between different levels of executives [10], media coverage [11] and a sound

internal control embodiment and shareholding structure [12] can effectively strengthen internal oversight and discourage fraudulent behaviour.

In general, there is a strong consistency in the study of financial fraud at home and abroad, as reflected in the techniques used by scholars to analyse financial fraud and the related models used. However, because the capital markets in developed countries are relatively more developed, China has lagged behind in the development and application of financial fraud theories.

As the first pharmaceutical company with a total market capitalisation of over RMB100 billion on the A-share market, Kangmei Pharmaceutical has created many legends and moving stories in the Chinese pharmaceutical industry. However, in this case of financial fraud, not only did Kangmei Pharmaceutical forge bank certificates of deposit, manipulate the stock market secretly and inflate its cash by tens of billions of yuan, but it also brought down auditors and brokerage firms as well. Therefore, this paper uses Kangmei Pharmaceutical as a case study, based on a summary and overview of the domestic and international literature in the relevant field. Firstly, it aims to gain an in-depth understanding of the fraudulent incident at Kangmei Pharmaceuticals and identify its fraudulent tactics; secondly, it draws on the fraud risk factor theory to analyse the motives behind the incident; and finally, using the Kangmei Pharmaceuticals fraud case as a guide, it proposes specific measures to prevent and remediate the company's financial fraud at various levels in a targeted manner.

2. Case presentation on financial fraud at Kangmei Pharmaceuticals

In 1997, Ma Xingtian, the founder of Kangmei Pharmaceutical, set up an expert committee consisting of research institutes, hospitals, pharmaceutical companies and medical schools; in 2001, Kangmei Pharmaceutical was listed on the SSE and successfully achieved a listing. In 2002, Kangmei Pharmaceutical invested RMB 100 million to build the largest modernised base for Chinese medicine tablets in China at that time. In 2005, Kangmei Pharmaceutical took the lead in developing and putting into the market the small-package model of Chinese medicine tablets, which greatly promoted the standardization of Chinese medicine production and indirectly promoted the scientific development of Chinese medicine.

Kangmei Pharmaceutical is involved in all aspects of control in the upstream, midstream and downstream of the industry chain (Figure 1). At the same time, although Kangmei Pharmaceutical has set up its organisational structure in accordance with the Securities Law, the Company Law and other relevant laws and regulations, the actual controller is Kangmei Pharmaceutical, and this illusion of "decentralised management" is a disguise for the fact that Ma Xingtian holds 99.68% of the shares. Ma Xingtian not only has de facto control of the company, but also leads the managers and the board of directors (Figure 2).

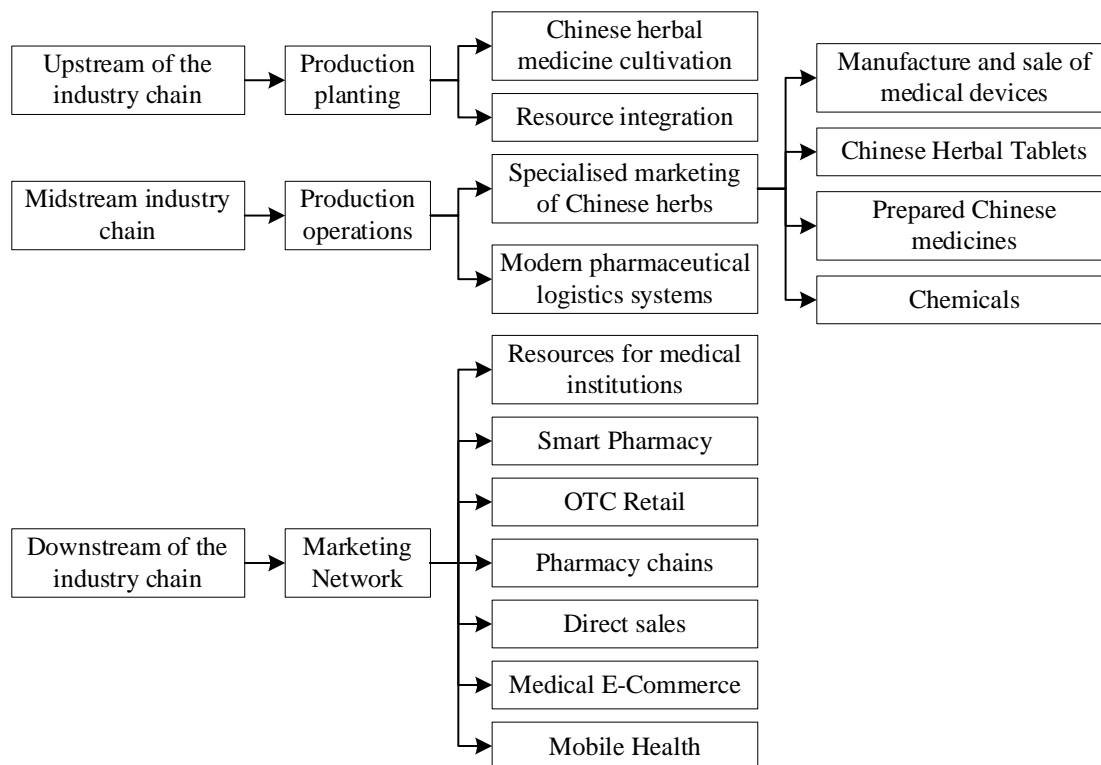


Figure 1 Enterprise whole industry chain integrated operation mode

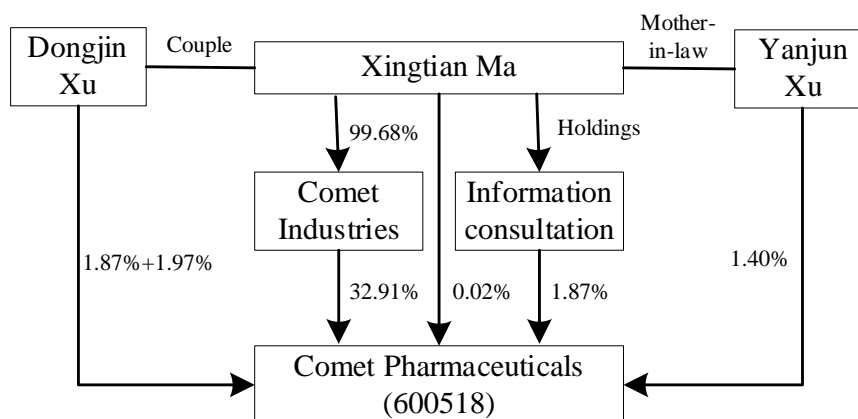


Figure 2 Substance behind shareholder holdings as at the end of 2018

2.1 Overview of financial fraud cases at Kangmei Pharmaceuticals

In July 2018, "Doubtful financial report of Kangmei Pharmaceuticals: interest expenses over \$1.2 billion, \$36 billion cash on the books just for show? Starting from the phenomenon of Kangmei Pharmaceutical's double-high deposit and loan, strong doubts were cast on its financial report.

On 25 October 2018, "The Truth About Kangmei Pharmaceutical's Plunge - Mysterious Trader or Arrested Two Weeks Ago" unveiled part of the inside story of the rapid collapse of Kangmei Pharmaceutical's share price. Wang Lianjun worked at Kangmei Pharmaceuticals from 2001 to 2010 and rose from a manager in the general securities department to the position of chairman of the supervisory board. He was suspected of manipulating the stock market and engaging in insider trading just before the collapse of the share price of Kangmei Pharmaceuticals.

At the end of December 2018, the Securities Regulatory Commission questioned the reliability and authenticity of Kangmei Pharmaceutical's financial reports and pointed out that Kangmei had made false statements and other irregularities. The Shanghai Stock Exchange asked Kangmei Pharmaceutical to provide an explanation as soon as possible.

On 30th, April, 2019, Kangmei Pharmaceutical disclosed its financial results in response to the public's queries, and at the same time published its correction announcement. In fact, the announcement was not only an insult to the field of accounting, but also a derogatory rebuke to those practicing in the secondary market. The SSE directly pointed out to Kangmei Pharmaceuticals that your company should accurately identify the difference between misinterpreting accounting standards and the nature of management's deliberate acts of falsification of finances. At the same time, the SSE even raised 30 questions directly with Kangmei Pharmaceutical, making a request to Kangmei Pharmaceutical to make its own enquiries into each business segment and each item on its balance sheet.

On 9th, May 2019, Zheng Zhong Zhujiang Accounting Firm, which was responsible for auditing Kangmei Pharmaceuticals, was issued an investigation notice by the SFC and was asked to open a case for investigation.

On 17th, May, 2019, Kangmei Pharmaceutical was notified by the SFC of the fact that its financial statements for the years 2016-2018 were materially false. K Enterprises committed the following irregularities: between 2016 and 2018, operating revenue was increased by a total of approximately RMB 29 billion, while monetary funds were also increased by approximately RMB 89 billion. Within less than four days, K Enterprises became ST K Enterprises.

On 17th, August, 2019, the SFC issued a penalty decision of "a total fine of \$5.95 million for the company and individuals" in relation to the financial fraud of K Enterprises.

2.2 Identifying signs of financial fraud at Kangmei Pharmaceuticals

2.2.1 Double-high inventories

From the uncorrected 2017 annual report of Kangmei Pharmaceuticals, it can be understood that its ending balance of monetary funds was about RMB 34 billion, of which bank deposits accounted for 99.74%, while the percentage of bank deposits readily available was as high as 99.95%. A review of Kangmei Pharmaceutical's 2018 semi-annual report reveals that the ratio of Kangmei Pharmaceutical's monetary funds balance to net assets was actually as high as approximately 120%, and the ratio of the company's interest-bearing liabilities to net assets was actually as high as approximately 105%. Since 2010, these two ratios have been rising together all the way up, as if they were twin brothers, going in and out together. At the same time, the interest expense ratio in the income statement of Kangmei Pharmaceuticals is increasing.

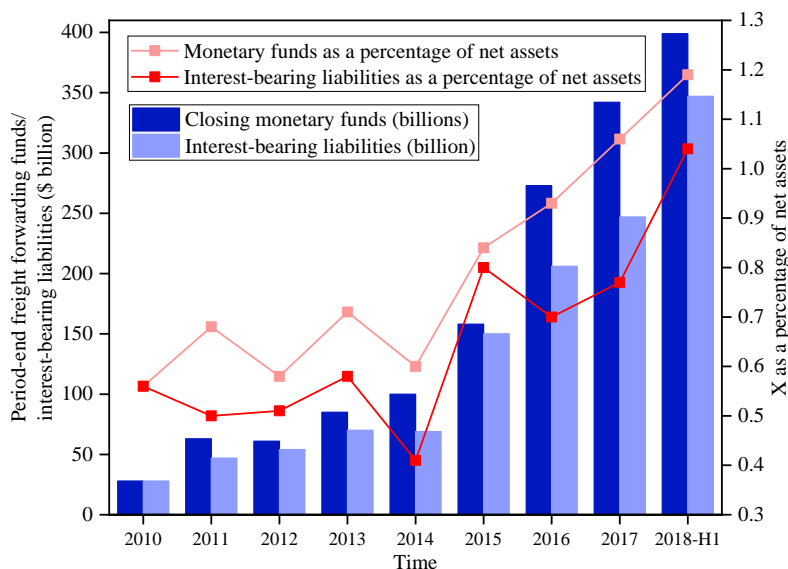


Figure 3 Data graph of Kangmei's double-high deposit and loan figures

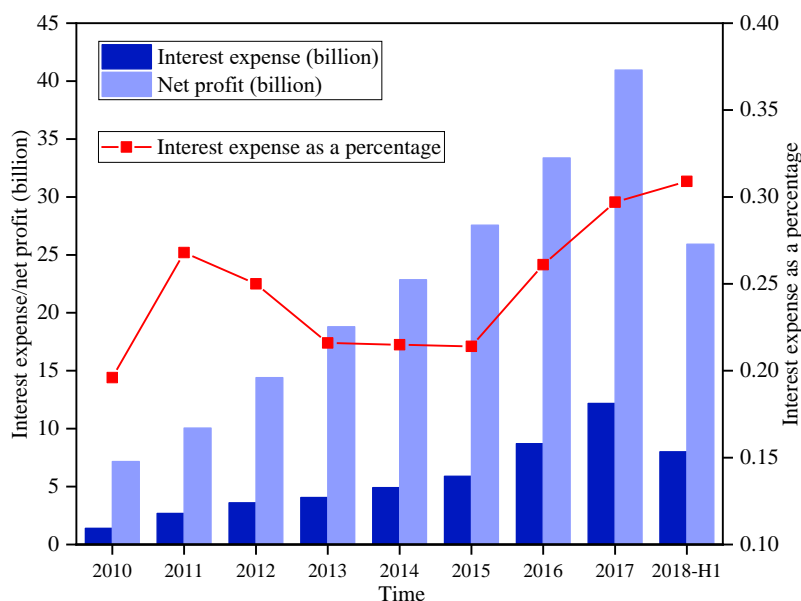


Figure 4 Interest expenses of Kangmei Pharmaceuticals and their percentage share

In general, the company has been engaging in significant short-term or long-term debt financing activities in recent years, but apart from short-term debt expenditures, Kangmei Pharmaceuticals still has sufficient monetary funds to draw on corporate bank deposits if there is a funding need, and there is no need to engage in further external debt financing. As a result, there is a suspicion of bank transaction orders and inflated deposits.

2.2.2 Net cash flow from operations well below net profit

From 2010 until the first half of 2018, Kangmei Pharmaceutical could actually achieve a cumulative net profit of approximately RMB20 billion, yet considering that it only had a net cash flow from operating activities of approximately RMB9.5 billion, it can be calculated that the net present ratio was only approximately 47%. In particular, in the first half of 2018, its net present ratio was actually only about 17%. The net present ratio of Kangmei Pharmaceutical is much less than 1 and presents a huge negative operating cash flow, both indicating that its revenue figures and net profit figures are not very realistic and reliable, and are most likely artificially inflated. (Table 1)

An analysis of the phenomenon in terms of the industry as a whole shows that operating cash flow in the Chinese medicine industry is generally poor, even for the majority of the pharmaceutical industry as a whole. Even though all major pharmaceutical companies have net cash ratios of less than one, Kangmei Pharmaceutical's net cash ratio is still well below the average at 39%, fuelling public skepticism. (Table 2)

Table 1 Net Present Ratio (NPR) of Kangmei Pharmaceuticals

Time (Year)	2010	2011	2012	2013	2014	2015	2016	2017	2018H1	合计
Net profit (RMB billion)	7.2	10.0	14.4	18.8	22.9	27.6	33.4	41.0	25.9	201.2
Net cash flow from operations (RMB billion)	6.7	5.8	10.1	16.7	11.3	5.1	16.0	18.4	4.5	94.6
Net Present Ratio (%)	93.1	58	70.1	88.8	49.3	18.5	47.9	44.9	17.4	47.0

Table 2 Comerica's industry peer group net present ratio

Company	Three-year net profit (RMB billion)	Three-year operating cash flow (RMB billion)	Net Present Ratio (%)
Lizhu Group	58.36	35.23	60
Kangmei Pharmaceuticals	101.98	39.55	39
Hengrui Pharmaceutical	79.77	74.17	93
Yunnan Baiyao	88.36	63.20	72
Fosun Pharma	83.90	63.11	75
Health Dollar	29.97	47.80	159
Renfrew Pharmaceuticals	35.55	8.76	25
Baiyun Mountain	48.70	62.20	128
Dong Ah Gum	55.22	33.60	61
Jilin Oodong	61.24	9.78	16
New Harmony	33.09	34.34	104

2.2.3 Inventory perspective

Since 2016, Kangmei Pharmaceutical's inventory turnover ratio has decreased year-on-year to 0.39 times from the previous 1.35 times, reflecting Kangmei Pharmaceutical's continued deteriorating liquidity and its decreasing rate of inventory realisation, which means that the pressure on the business to manage its inventory is intensifying.

In 2019, Kangmei Pharmaceuticals has increased its inventory by approximately \$19.5 billion. A look at Kangmei Pharmaceutical's unadjusted financial statements for 2017 reveals that a provision of approximately 2% has been made for a fall in value of inventories, which suggests that there will be no increase in the price of inventories in 2017, and therefore most of the increase in inventory revisions comes from an increase in the quantity of inventories.

Therefore, if the goods are not selling well, the inventory will increase and its turnover will decrease, which in turn will result in lower sales revenue and profit. To alleviate this stagnant sales situation, the company will sell at a reduced price in order to sell at a lower margin. As a result, inventory and gross margin exhibit a negative correlation. However, the increase in inventory and declining inventory turnover from 2013 to 2017 was accompanied by a simultaneous increase in gross profit margin and sales revenue, which is a significant logical contradiction.

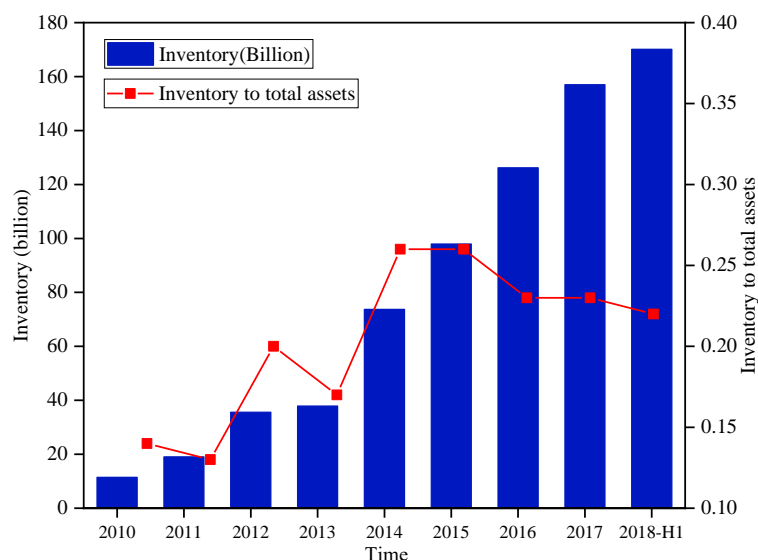


Figure 5 Inventory and share of Kangmei Pharmaceuticals

2.2.4 The contradiction between operational targets and acquisitions

The working capital turnover ratio of Kangmei Pharmaceutical is generally on a decreasing trend, which to some extent indicates the decreasing actual operating capacity of Kangmei Pharmaceutical. However, Kangmei Pharmaceutical has never stopped opening up related businesses and investing in other projects. In 2018, Kangmei Pharmaceutical not only continued to acquire stakes in related businesses and establish wholly-owned and joint venture subsidiaries, but also invested capital in numerous mobile healthcare projects. While such investments have allowed Kangmei Pharmaceuticals to capture market share, its operating income and profits have shown inconsistencies with its operational management, which begs the question.

2.3 Fraudulent practices at Kangmei

Table 3 Data falsification by Kangmei Pharmaceuticals

Major accounting accounts	2015 data (RMB billion)	Inflated 2016-2018 (RMB billion)	Inflated percentage (%)
Operating income	189	275	146
Total profit	32	39	122
Monetary funds	158	800	506
Other assets	56	36.05	64

2.3.1 Inflated assets

Monetary funds: Kangmei Pharmaceuticals achieved inflated funds by altering and falsifying large order deposit slips, while at the same time falsifying repayment slips to act as a match for operating income. From 2016-2018 alone, Kangmei Pharmaceuticals inflated its monetary funds by approximately RMB 89 billion.

Fixed assets: Some of the engineering projects included in the statements by Kangmei Pharmaceutical did not actually meet the conditions for accounting recognition and measurement, but such recognition allowed it to achieve an inflated amount of fixed assets, for example, Kangmei Pharmaceutical included six engineering projects in 2018 that did not meet the conditions for accounting recognition and measurement, resulting in an inflated amount of approximately RMB400 million of construction in progress, a high of approximately RMB1.2 billion of fixed assets and 2 billion of investment properties.

2.3.2 Inflated income

Firstly, the falsified revenues were generally distributed among the top-ranked large customers, which were used to avoid the risks associated with verifying new customers during the audit. The accounting vouchers were altered directly by Kangmei Pharmaceuticals rather than through the company's Jetco business system, and the vouchers lacked corresponding evidence of entry and exit and sign-off records, and were simply fabricated sales contracts in an attempt to muddle through.

Secondly, the increase in sales revenue was disguised by the use of falsified bank statements to write off the inflated accounts receivable, and by the processing of bank enquiry letters to disguise the fabricated bank deposits. Kangmei Pharmaceuticals achieved the inflated operating revenue through false entries, forgery of business vouchers and alteration of VAT invoices.

Finally, Kangmei Pharmaceuticals gradually began to include as a part of the business in 2018 the herb trader with whom the Chairman's wife had dealings. To further demonstrate that the employees within the trader were also Kangmei Pharmaceutical's own workers, Kangmei Pharmaceutical extensively falsified cash journals and records of workers' social security contributions to convince third parties of its representations. In this way, Kangmei Pharmaceutical could also naturally incorporate the income and expenses of the herbal traders into its own financial statements.

2.3.3 Related Party Accounts

From 2016 to 2018, Kangmei Pharmaceuticals directly skipped the authorisation process and related decision-making and approval process to provide its controlling shareholder and its related

parties with non-operating funds of approximately RMB 11.6 billion, which were used to purchase shares, repay principal and interest on behalf of related parties, advance funds for release of pledges or pay for acquisition premiums.

The company's trading practices were to transfer large amounts of funds to related parties and to purchase a large number of its own shares in time for a downward trend; to use false profit increases to modify its own financial results to attract more investors; and to sell off its original shares at the right time to achieve large gains.

3. Analysis of the drivers of financial fraud at Kangmei Pharmaceutical

3.1 Individual risk factors

3.1.1 Low ethical quality

Ethical failings of the management: In 2001, before Kangmei Pharmaceuticals was listed, Chairman Ma began to befriend Li Liang, who was then the Director of the Issuance Review Division of the Issuance Supervision Department of the SFC and Deputy Director of the GEM Issuance Supervision Department; in the seven years from 2004 to 2011, Chairman Ma paid bribes to Secretary Chen of the Municipal Party Committee of Jieyang City; from 2010 to 2011, Mayor Jiang, who was then Deputy Secretary of the Municipal Party Committee and Mayor of Langzhong City, was paid another HK\$200,000 by Chairman Ma. From 2000 to 2014, Ma Xingtian also directly bribed Secretary Wan, former member of the Standing Committee of the Guangdong Provincial Party Committee and Secretary of the Guangzhou Municipal Party Committee, and received repeated assistance from Secretary Wan in relation to the development, regulation and growth of the enterprise; in May 2018, a division-level cadre from the Guangdong Food and Drug Administration's Drug Safety Production Supervision Division fell, and Kangmei Pharmaceutical was One of the contributors to its "huge amount of unexplained property".

Lack of professional ethics of auditors: According to the SFC's Administrative Penalty Decision, the auditors of Kangmei Pharmaceuticals, Zhengzhong Zhujiang and Kangmei Pharmaceuticals, did not comply with the requirements of the Code of Professional Ethics and violated the interests of the general public.

① Zhengzhong Pearl River voluntarily facilitated the staff of Kangmei Pharmaceutical to enable them to intercept the letter of inquiry in the course of the letter of assurance, which greatly aggravated the fraudulent practices of Kangmei Pharmaceutical.

② Zhengzhong Zhujiang claimed that it had performed relevant audit procedures to be able to judge the correctness of the Kingdee system and therefore waived the audit procedures on the Jieke system. However, Kangmei Pharmaceutical had to use the Jieke system to process sales orders before it could transition its trading operations to the financial Kingdee system. Therefore CZK did not exercise due diligence in the audit process.

③ In the risk response aspect of internal control testing, Zhengzhong Zhujiang presented several more problems as follows: internal control testing without a primer simply could not demonstrate the process of internal control; internal control testing was not complete and did not cover the whole chain to perform.

3.1.2 Presence of a fraudulent motive

Firstly, in the face of continued slowing economic growth, a number of listed companies in the pharmaceutical industry have had to face a range of reactions to declining revenues, such as falling share prices, shrinking market capitalisation and suspended financing. As a leading company in the industry, a shortage of customer resources, buyers with increasing bargaining power and increasing market competition have all contributed to the declining operating performance and profitability of Kangmei Pharmaceuticals. The potential for financial fraud by corporate managers has also increased dramatically in order to reduce the pressure on performance.

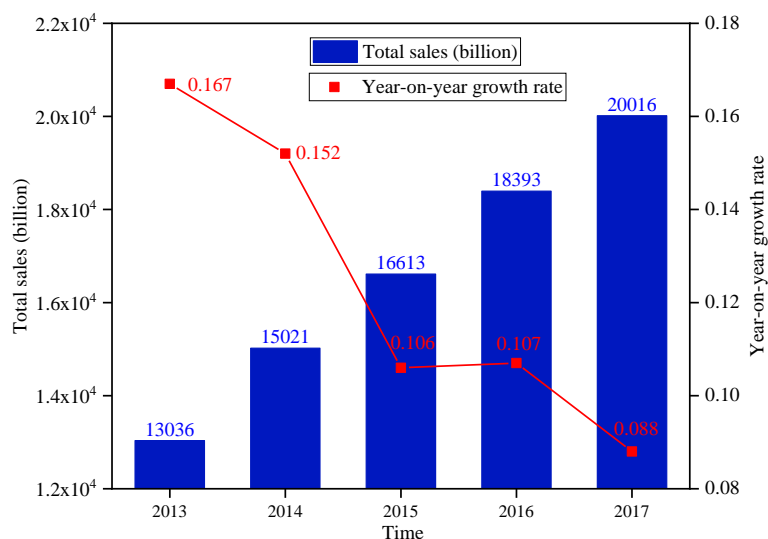


Figure 6 Sales trends in the industry for circulating pharmaceuticals, 2013-2017

Secondly, since 2010, the level of pledges on Kangmei's shares has risen sharply. In particular, by 2016, the year in which financial fraud was committed by Kangmei Pharmaceutical, the pledge ratio was surprisingly high at approximately 92%. Throughout the course of the pledges, there were a number of transactions that were processed in the first half of 2015 when the share price was at a high level, i.e. the shares were first unpressed and then pledged, and the rising share price provided the money that could be financed after processing, allowing more money to be financed. However, the share price then fell directly to RMB11 in early 2016 from the original RMB25. In such a bad market, if pledges continue to be made at a 50% discount to obtain financing, Comerica Industries would need to replenish its margin, otherwise the brokerage firm would risk a mandatory closeout sale of its pledged shares, which would lead to a series of chain reactions in the share price.

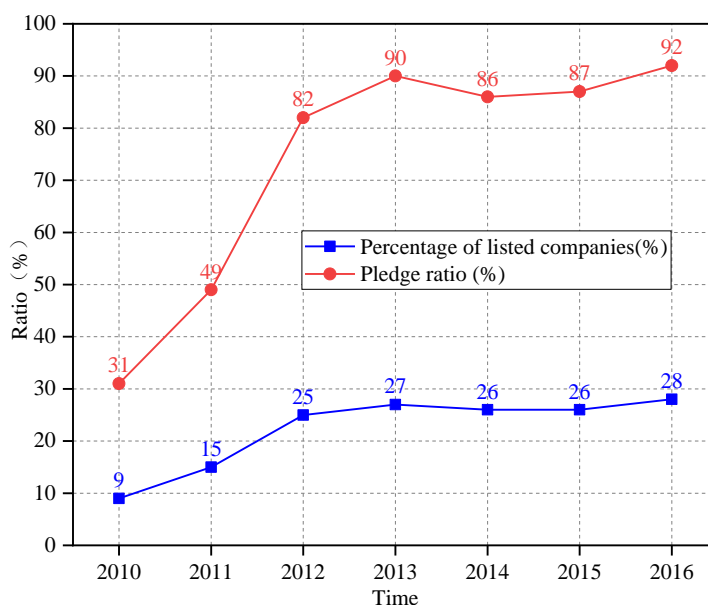


Figure 7 Percentage of shareholding pledged by major shareholder Kangmei Industrial

3.2 General risk factor drivers

3.2.1 High chance of corporate fraud

Internal Opportunities: The main weaknesses are in the shareholding structure and management structure of the company. It is the overly centralised shareholding structure, the control of the board

of directors by some of the major shareholders, the virtual independent directors and the lack of an independent supervisory board, among other factors, resulting in a dysfunctional internal structure that tends to breed financial fraud.

(1) In the shareholders' meeting, the Ma family, as the largest shareholder of Kangmei Pharmaceuticals, has a high percentage of shareholding and absolute power; in the board of directors, with Ma Xingtian as chairman and his wife Xu Dongjin as vice-chairman, the Ma Xingtian family has absolute control. In the more than a dozen board meetings held by Kangmei Pharmaceutical in 2018, several independent directors have surprisingly never issued any negative opinions.

(2) In terms of company management, Ma Xingtian is the general manager, while his wife Xu Dongjin holds the position of deputy general manager, with many important positions also held by members of the Ma Xingtian family. Not only that, but the company's Supervisory Board as well as the Audit Committee are only forced to exist as a mere formality, unable to effectively restrict any of Kangmei Pharmaceutical's actions.

External opportunities: Firstly, as one of the leading auditors in Guangdong, the firm has been working with Kangmei Pharmaceutical since 19 years ago, before Kangmei Pharmaceutical was listed. The relationship is extremely close. This excessively close client relationship could easily lead to concealment of each other. Secondly, following the public outcry over financial fraud at Kangmei Pharmaceuticals, CCHK was also investigated by the SFC, which found that CCHK had neglected and harboured many of the financial audits carried out by Kangmei Pharmaceuticals.

3.2.2 Low likelihood of fraud detection

Low probability of internal exposure: Not only does Kangmei Pharmaceutical have a centralised shareholding structure, but a small number of major shareholders control the board of directors, while its virtual independent directors and supervisory board simply cannot act as a real check on managers, so when the probability of internal disclosure is relatively low, the incidence of financial fraud increases.

Low probability of external exposure: As the auditor of Kangmei Pharmaceuticals, Zhengzhong Pearl River has suffered from a serious lack of professional ethics and has failed to take responsibility for its 19 years of excessively close client relationships, allowing Kangmei Pharmaceuticals to engage in financial fraud, and has been negligent in its auditing of Kangmei Pharmaceuticals, submitting standard unqualified audit reports for many years, with a very low probability of external exposure, keeping Kangmei Pharmaceuticals within a hotbed that is prone to financial fraud.

3.2.3 Low penalties for fraud detection

The penalties for non-compliance are small: Since the exposure of the financial fraud, the share price of Kangmei Pharmaceutical has been falling, and the market value has also fallen from as much as 139 billion yuan to 13.6 billion yuan, during which many major shareholders have already made huge profits by manipulating the share price, while small and medium shareholders have suffered, with almost all of the investment losses of 84.3 billion yuan being borne by small and medium shareholders. This kind of behaviour by Kangmei Pharmaceutical not only infringes on the interests of small and medium shareholders, but also seriously disrupts the order of the capital market, yet it has only received a fine of 600,000 yuan from the Securities and Futures Commission.

Limited deterrent effect of the delisting system: The financial fraud of Kangmei Pharmaceuticals, which not only inflated its revenue by RMB 30 billion and profits by RMB 4 billion, but also caused damage to the interests of countless shareholders, has only become an ST and has not been delisted. This overly "benevolent" delisting mechanism has little enforcement power, which is not at all conducive to the healthy development of China's securities market, and is also against the market law of the elimination of the fittest, making financial fraudulent enterprises even more unscrupulous.

Lack of laws and regulations: China is still in the primary stage of socialist development, and the development of the capital market is not yet perfect. Although China's Securities Law, Company Law and other laws and regulations can punish companies for financial fraud to a certain extent, they are still not detailed enough to achieve real regulation and punishment for fraud in the financial field.

4. Measures to prevent financial fraud at Comerica

4.1 Measures for road quality factor

(1) **Maintain the independence of the internal audit body:** first, the company should set up an independent internal audit body that is not subordinate to any department to reduce the involvement of the interests of other departments; second, establish an audit accountability system to discipline auditors to do their job; third, strengthen the leadership's awareness of risk and integrity quality; fourth, internal auditors and business activities, financial work and other operations that affect audit independence (2) **Maintain the effectiveness of independent directors**

(2) **Maintain the effectiveness of independent directors:** firstly, appoint independent directors by small and medium shareholders so that they can take into account the interests of small and medium shareholders rather than just those of major shareholders; secondly, establish sound guidelines for the regulation of remuneration payments to independent directors.

(3) **Improving the shareholding structure to avoid "one power to rule them all":** Improving the shareholding structure to achieve "decentralisation" of shareholding as far as possible, in order to maintain the status of the shareholders' meeting, ensure the authenticity of financial data and ensure the coordinated development of the company.

4.2 Measures for fraud motivation factor

(1) Listed companies should implement comprehensive budget management: firstly, enterprises must strengthen the awareness of all employees' participation, so that employees can establish the importance of corporate projects and understand the project steps and overall objectives; then, the incentive effect of budget management should be actively exercised, so as to motivate employees and at the same time enhance employees' participation to achieve the long-term and short-term business objectives of enterprises; finally, the implementation of budget management responsibility (2) Listed companies should be strict with themselves, and should be responsible for the management of the budget.

(2) Listed companies should be strict with themselves and disclose information to the public in a timely manner: firstly, if the information disclosed by the company is correct and sound, it can further attract capital investment; secondly, if the information disclosed by the company is complete, then investors will have a basis to follow when making decisions and realise the optimal allocation of resources.

4.3 Measures for fraud opportunity factor

(1) Listed companies should optimise their corporate governance structure: firstly, listed companies should build a system of checks and balances among shareholders; secondly, clarify the openness and transparency of information among various departments, not only to bring into play the role of independent directors, but also to allow internal audit to continuously play a supervisory role; finally, prevent the phenomenon of cross-functioning or shifting of responsibilities to realise that powers and responsibilities are in place and have a basis to follow.

(2) **Implement an audit rotation system:** the government imposes a requirement on listed companies that they must change their accounting firms within a certain number of years; the government arranges for the regulator to act as an intermediary to help listed companies with the affairs of changing their accounting firms on a regular basis.

4.4 Measures for fraud exposure possibility factor

(1) The regulator should strengthen the monitoring and analysis of abnormal information: the regulator can use real-time and automatic monitoring of publicly disclosed information of listed companies to find out the abnormal part of it and conduct in-depth analysis to understand the actual situation of its operation, and set certain threshold of monitoring and warning to pinpoint the first signs of fraud in order to reduce the impact brought by fraudulent events.

(2) Increased government supervision of intermediaries: Firstly, the government should require accounting firms to strengthen the construction of professionalism and corporate culture; secondly, the government should strengthen the regulation of the accounting firm industry and strictly punish the phenomenon of low-price competition in the industry.

4.5 Measures for the post-fraud cost factor

(1) The state should improve the delisting system: firstly, constantly optimise the new rules for delisting, and strictly deal with those listed companies that have committed financial fraud or have been losing money for years; secondly, continuously promote the state's protective work for small and medium-sized investors in the delisting process; finally, combine the investor protection fund to undertake the task of protecting small and medium-sized investors.

(2) The State should raise the penalties for violations of the law and increase the penalties for counterfeiting: firstly, raise the penalties for listed companies after disclosing information in violation of the law; secondly, increase the penalties for financial fraud of listed companies.

(3) The State should improve the class action system: continuously strengthen the promotion of the securities class action system, give in-depth consideration to the operability of litigation, give full play to the deterrent effect of the class action system on listed companies, and use the class action system to fill the shortcomings of traditional litigation methods.

5. Conclusion

This paper takes Kangmei Pharmaceuticals as the object of study and explores in depth the financial fraud of listed companies in China. Firstly, the research content related to financial fraud at home and abroad is analysed; secondly, a comprehensive overview of the development history of Kangmei Pharmaceuticals, the history of fraud incidents and the signs of fraud is given, and the fraud risk factor theory is selected for in-depth analysis in the case of Kangmei Pharmaceuticals, and measures to prevent corporate financial fraud are proposed at the level of general risk factors and personal risk factors.

The analysis leads to the following conclusions: at the personal risk factor level, the fraudulent behaviour of Kangmei Pharmaceuticals is not only related to Chairman Ma's own lack of moral quality, but also to its shareholding structure in which power is concentrated in a few individuals; at the general risk factor level, the fraudulent behaviour of Kangmei Pharmaceuticals is inextricably linked to the accounting firm that undertakes its business, and the excessively close relationship makes it less likely that fraud at Kangmei Pharmaceuticals will be detected, while the existing regulatory regime also facilitates financial fraud at Kangmei Pharmaceuticals.

Therefore, in the context of an in-depth analysis of the case of Kangmei Pharmaceuticals, some reasonable measures are proposed on how to prevent financial fraud in listed companies. Starting from various aspects, such as enterprises, supervisory bodies and intermediaries, in order to effectively avoid incidents of financial fraud and maintain the stability and healthy development of China's securities market.

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