

Determinants and Consequences of Illegal Information Disclosure: Evidence from Guangzhou Langqi

Xinshuo Wang

Department of Business and Management, Oxford Brookes University, Oxford, England

wang.xinshuo@student.zy.cdut.edu.cn

Abstract. The accounting information disclosed by listed companies is the intermediary between companies and investors, so the premise of accounting information disclosure of listed companies is open and true. However, there are many listed companies for their own interests, so as to disclose information fraud, which leads to the disclosure of illegal information. Now, listed companies disclosure of illegal information emerge in endlessly, repeatedly banned. Taking the violation information disclosure of Guangzhou Langqi as an example, this paper analyzes the motivation of violation information disclosure of listed companies and its impact on the company itself. Finally, it discusses how to govern the disclosure of illegal information of listed companies from the internal and external dimensions.

Keywords: Guangzhou Langqi; Illegal information disclosure; Event Study.

1. Introduction

Compared with some developed countries, China's securities market is still in the stage of development and laws in China's securities market that need to be improved. In recent years, illegal information disclosure of listed companies in China occur frequently. This paper takes Guangzhou Langqi as an example, event study is conducted to explore the motivation of violations of information disclosure of companies. Then through the comparative analysis method to analyze the impact of financial fraud on the company and the market and discuss how to govern the disclosure of illegal information of listed companies and prevent listed companies disclosure of illegal information.

From the perspective of accounting, this paper takes Guangzhou Langqi as an example to analyze the impact of illegal information disclosure of listed companies on the enterprise from the perspective of listed companies.

This paper aims to study the motivation, impact and consequences of enterprises' disclosure of illegal information. First of all, through the study of the case to understand the motivation of the enterprise to disclose illegal information and what information the enterprise did illegal disclosure. This can help to judge whether an enterprise has disclosed illegal information through these aspects in the subsequent audit of listed companies. Secondly, through the study of the impact and consequences of the disclosure of illegal information of enterprises, to study the governance of listed companies' disclosure of illegal information, so as to avoid the disclosure of illegal information of enterprises.

The paper is organized as follows. The section 2 of this paper is a literature review. By reviewing previous scholars' studies on the impact of illegal information disclosure of companies on companies and the market and the measures for controlling illegal information disclosure of listed companies, this paper broadens the research ideas and lays a foundation for the research of this paper. The section 3 and 4 show the research methods and theories adopted in this paper. And then, the section 5 discusses the existing problems of accounting information disclosure of Chinese listed companies and the motivation of illegal information disclosure. The section 6 takes the violation information disclosure of Guangzhou Langqi as an example and uses the event study method to study the impact of violation information disclosure of listed companies on the company's stock price. The section 7 discusses how to govern the illegal information disclosure of listed companies.

2. Literature Review

2.1 The impact of illegal disclosure of accounting information of listed companies on the company and the market

Firstly, illegal information disclosure seriously undermines the principle of fairness, impartiality, this seriously infringes the interests of investors [1, 2]. For instance, when enterprises do not disclose some negative information about the company. This will lead to investors unable to fully understand the real situation of the company, so as to misjudge the investment risk. In addition, for companies, when the illegal disclosure of information is exposed, the cumulative excess return of listed companies will decline for a long time [3]. Moreover, the company will incur some additional costs, such as fines, taxes, litigation costs and so on [4].

2.2 Measures for controlling illegal information disclosure of listed companies

On the one hand, the civil compensation mechanism of certified public accountants can be improved. Accountants should ensure the quality of financial statements disclosed by listed companies, so as to solve the problem of asymmetric information between companies and external stakeholders of companies, then can maintain the order of the securities market [5].

On the other hand, listed companies should improve the company system and set up a board of supervisors in the company. It is used to supervise and inspect whether the company's managers have violated the articles of association and laws in their work.

In the scholars for the Shenzhen Stock exchange small and medium-sized board of private enterprises survey shows, most companies do not set up a board of supervisors in the company [6], and many companies believe that it is only a temporary institution, which is dispensable in the company.

2.3 Literature summary

Illegal information disclosure by a listed company is a violation of regulations and laws for the benefit of the company. In the previous research of scholars, it is not difficult to find that the illegal information disclosure focuses on companies have financial problems, they are needs to falsely increase the company's profits, therefor these listed companies make the wrong financial information disclosure. Many listed companies that disclose illegal information do not do well in internal control, which is irresponsible for listed companies and internal and external stakeholders. Many listed companies that make illegal information disclosure are due to these companies didn't do a good job in internal control, this is irresponsible for the listed company and its internal and external stakeholders. Therefore, previous scholars have also done a lot of research on the prevention and governance of illegal disclosure of accounting information, such as improving the civil compensation mechanism of certified public accountants and establishing the board of supervisors in the company, and standardizing information disclosure both inside and outside the company.

3. Research Methode

3.1 Event Study

This research method is used to study whether the stock price of a company will fluctuate and whether it will produce abnormal returns when a certain event occurs in the market. This allowed academics to study whether the company's share price movements were related to the event.

In this paper, the market model is used to analyze the changes of Guangzhou Langqi stock price before and after investors know the disclosure of illegal information of Guangzhou Langqi, so as to understand whether the disclosure of illegal information of companies will have a influence on the stock price of listed companies.

3.2 Case study

Case study is the study of a phenomenon or topic. Case study will fully understand and analyze a certain phenomenon or topic by collecting a large amount of relevant information, so as to comprehensively understand and analyze relevant issues. In this paper, the case study of Guangzhou Langqi illegal information disclosure is used to analyze the impact of listed companies' illegal information disclosure on the company.

3.3 Literature reading method

Literature reading method is reading a lot of previous literature, to understand the research degree of predecessors on something, and capture the most useful information in a short time. For this paper, literature reading method is used to understand the degree of research on disclosure of illegal information by predecessors, as well as their suggestions and methods for governance of information disclosure.

4. Relevance theory

4.1 Information asymmetry theory

Information asymmetry theory holds that the seller may have more information than the buyer, and the seller is in a dominant position to turn the message into a profit tool, thus distorting the price of the goods sold. Listed companies will deliver false information to the market in order to attract more investment, and investors will make wrong judgments after receiving wrong information, which damages the interests of investors to a great extent. On the other hand, the adverse selection caused by information asymmetry will make the poor companies drive out the good ones. In the long run, the market economy will become worse and worse, which is not good for the long-term development of the market. In general, the theory of information asymmetry reflects the importance of information to market economy.

4.2 Fraud triangulation

W. Steve Albrecht proposed this theory. He believed that corporate fraud is composed of pressure, opportunity and rationalization, which is impossible without any of the above elements.

For example, when the enterprise is facing financial pressure, the leadership may take the way of false profit to disclose information at the right time in order to get more investment.

5. Problems of accounting information disclosure and motivation of illegal information disclosure of listed companies in China

5.1 Problems of accounting information disclosure of listed companies in China

The problems of Listed Companies in accounting information disclosure have been a long-standing problem, which appear in the following aspects. The firstly, companies' insufficient information disclosure. Due to the fierce market competition, the company will have the choice to disclose the company's information [7]. For example, listed companies will choose some information that is beneficial to the company to disclose, instead of disclosing some negative information about the company. This will cause investors to be unable to fully understand the real situation of the company. The second is the false disclosure of financial information. Listed companies falsely increase their profits by means of fraud and fabrication out of thin air [8]. The last problem is that there are misleading statements in the information disclosure of many listed companies. For example, the company conducts financial fraud by concealing related parties and related transactions.

5.2 Motivation of illegal information disclosure of listed companies in China

There are many reasons for listed companies to disclose illegal information. For example, business there are financing motivations [9]. Because according to China's securities law, the company must make profits for three consecutive years when issuing shares for the first time. Therefore, when a company has listing demand, but its profitability does not meet the requirements, it will falsely report the company's profit growth, resulting in illegal disclosure of information.

Secondly, the equity structure of the company. If the ownership of a company is too concentrated, it is easy for the leadership to organization financial fraud. In addition, during the period of equity pledge by major shareholders, companies are more likely to disclose illegal information [10]. Because major shareholders want to avoid the risk of losing control by reducing the transparency of corporate information.

Third, shareholder meetings become a mere formality. The shareholders' meeting has the most power in the company, and can decide major matters of the company, which is the most effective link in the enterprise manage structure. However, according to the Shenzhen Stock Exchange's Survey and research report "The Situation of Individual Investors in China's Stock Market", as many as 83% of investors said that they did not attend the shareholders' meeting.

6. Research on information violation disclosure --- Take Guangzhou Langqi for example

6.1 Events introduced

In January 2021, CSRC decided to file an investigation against Guangzhou Langqi on suspicion of illegal information disclosure.

On November 12, 2021, according to the investigation results of China Securities Regulatory Commission (CSRC), In 2018 and 2019, Guangzhou Langqi falsely increased its operating revenue, operating cost and profit by fictitious commodity trading business, circular trading glycol warehouse receipt and other ways.

Among them, in 2018 and 2019, the inflated operating revenue was 6.234 billion yuan and 6.651 billion yuan respectively, and the inflated profit was 210 million yuan and 201 million yuan respectively, accounting for 518.07% and 256.57% of the total profit of the current period. In addition to cheating on income, from 2018 to 2019, the company adjusted part of falsely increased prepayments to falsely increased inventory, with the amounts of 956 million yuan and 1.082 billion yuan, both 75.84% and 78.58% of the disclosed inventory amount in the current period.

6.2 Sample selection and study design

This paper adopts the event study method to determine the market reaction to the company's illegal information disclosure by studying the stock price before and after Guangzhou Langqi's illegal information disclosure.

The market model was used to observe the changing trend of Guangzhou Langqi's CAR in the event window period to determine whether the disclosure of violation information of Guangzhou Langqi would have an impact on the company's stock price.

6.3 Model select

This paper uses the Market Model to estimate the expected rate of return for analysis, and the Model is as follows:

$$AR_{i,t} = R_{i,t} - (\alpha_i + \beta_i R_{m,t})$$

Terms	Explanation
$AR_{i,t}$	in period t, the abnormal rate of return of company i
$R_{i,t}$	in period t, the actual rate of return of company i The formula for $R_{i,t}$ is: Stocks in Guangzhou Langqi amount of increase and amount of decrease in each day — The daily amount of increase and amount of decrease of stocks in the market
$(\alpha_i + \beta_i R_{m,t})$	the expected rate of return of company i
	α_i is the excess return rate of company i
	β_i is the marketability risk of company i
	$R_{m,t}$ is the yield of the market in period t The formula for $R_{m,t}$ is: <u>(The market closing price of market on day t in share market – The market closing price of market on day (t-1) in share market)</u> The closing price of market on (t-1) day in the share market

Fig. 1 An explanation about market model and how to calculate each of these terms

This paper also calculated CAR to reflect the company's stock price volatility is different from the performance without this event, which is used to explain whether this event has an impact on the company's stock price.

Event window selection and sample selection:

According to the disclosure time of violation information announced by Guangzhou Langqi, this paper selects event data (t=0) on the day of disclosure of illegal information as the event date by Guangzhou Langqi, 4 days before and after the occurrence of the event as Event Window, -201days to 10 days before the occurrence of the event as Estimation Window.

Event date (t)	Announcement of the company's violation of disclosure of the day t=0
Event window	[t-4, t+4]
Estimation window	[-201, -10] days before the event

Fig. 2 Data selection

6.4 Data Analysis

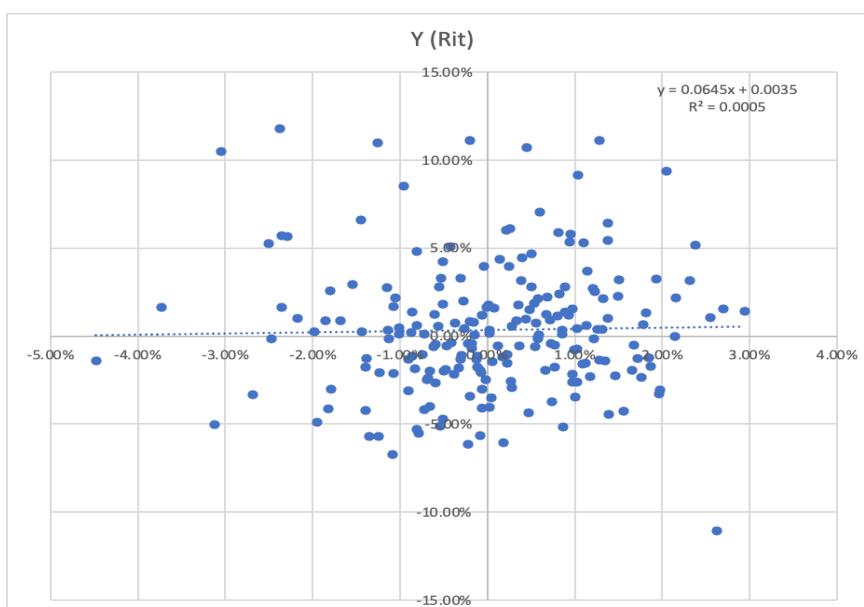


Fig. 3 Expected return rate of Guangzhou Langqi

By using Excel to calculate the data in the estimation period of Guangzhou Langqi, it can be concluded that the yield curve of Guangzhou Langqi is $Y = 0.0645x + 0.0035$. Among them, the excess return rate is 0.0035, the marketability risk is 0.0645.

Then, this paper select the event window form November 5, 2021 to November 18, 2021. And the data of these nine days are used to calculate the AR and CAR in the event period. The data are as follows:

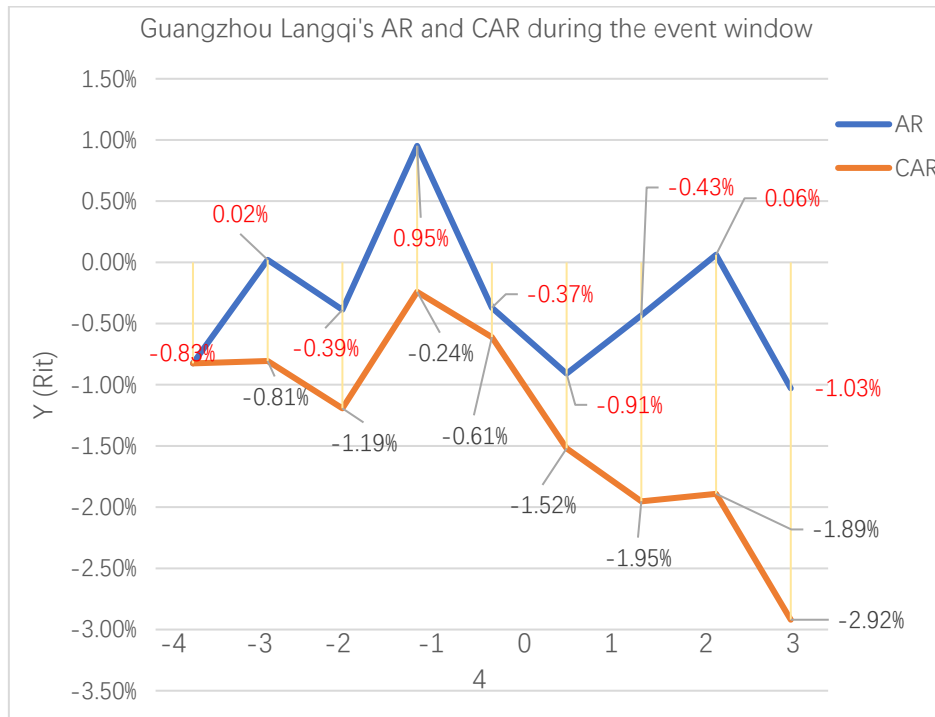


Fig. 4 AR and CAR in Guangzhou Langqi event window

6.5 Conclusion the data

As can be seen from Figure 2, from the day before the incident to the day of the incident, CAR value of Guangzhou Langqi became negative. In the four days after the incident, CAR value fluctuated but was generally negative, and accumulated to -2.92% on the fourth day after the incident. However, before this event, although The AR of Guangzhou Langqi showed a positive number, the ABSENCE of CAR showed a negative number. It is possible that some investors got to know the news in advance through some special channels. If so, there may be the problem of insider trading, but this problem is not verifiable. In general, when the illegal information of Guangzhou Langqi was disclosed, the CAR value of the company showed a significant decline, indicating that the disclosure of illegal information of listed companies had a significant impact on the company's share price.

7. Control measures for disclosure of illegal information of listed companies

For the company's internal, corporate executives need to establish a sense of risk and take the initiative to strengthen internal control. It is necessary to strengthen the financial risk training of managers, improve the comprehensive quality of managers, and establish a good professional ethics. High risk projects within the company should be checked frequently to eliminate possible risks. Secondly, optimize internal audit. Strengthen the independence of the internal audit department; Strengthen the management of the company's attention to internal audit, improve the internal audit system, standardize the audit process.

For external enterprises, one is to standardize the behavior of intermediary institutions and give full play to the independent audit role of intermediary institutions. For example, improve the CPA

civil compensation mechanism. In this way, CPA can be responsible for the quality of financial statements, so as to maintain the order of the securities market.

Second, expert teams can be formed to improve accounting information disclosure standards. Many companies will take advantage of the loopholes in disclosure standards when disclosing information, so the existing accounting information disclosure standards can not well regulate the accounting information disclosure of companies.

Therefore, on the basis of the existing standards, the government takes the lead and experts and scholars from all walks of life work together to formulate detailed rules for the financial statements of listed companies in this industry. Refine information disclosure standards around each key information disclosure.

8. Conclusion

This paper first discusses the motivation of listed companies to illegal information disclosure. For example, the financial condition of the listed company, the shareholding structure of the company and the shareholders' meeting was a mere formality.

Then, this paper adopts the event analysis method, case study method and literature reading method to analyze the impact of listed companies' illegal information disclosure on the company. The main methods are event analysis and case study. Taking Guangzhou Langqi as an example, the market model is used to confirm that the disclosure of illegal information of listed companies has an impact on the company. After the illegal information disclosure of Guangzhou Langqi, the company's stock price has a clear downward trend.

This paper also discusses how to govern the illegal information disclosure of companies. The governance of companies' illegal information disclosure can be carried out from the internal and external parts. Inside the company, on the one hand, corporate executives need to establish a sense of risk and take the initiative to strengthen internal control. On the other hand, optimize the internal audit of listed companies. For the outside of the company, the first is to standardize the behavior of intermediary institutions, give full play to the independent audit role of intermediary institutions. Secondly, expert teams can be formed to improve accounting information disclosure standards.

References

- [1] Zhang Chengrui, Jian Jing. Research on the Influence factors of illegal information Disclosure of Listed companies in China [J]. Auditing research, 2008(01): 75-81+74.
- [2] Yi Ye. Research on supervision of accounting information disclosure of listed Companies -- Taking Zhangzidao as an example [J]. Chinese Certified Public Accountant, 2018 (06): 79-82. DOI:10.16292/j.cnki.issn1009-6345.2018.06.014.
- [3] Weili Ge, Sarah McVay. The Disclosure of Material Weaknesses in Internal Control after the Sarbanes-Oxley Act. Accounting Horizons, (2005) 19 (3): 137–158.
- [4] Cheng Xiaoyan, Aaron D. Crabtree, David B. Smith. Disclosure of allegedly illegal corporate activities and information risk. Advances in Accounting, Volume 25, Issue 2, 2009, Pages 136-146, ISSN 0882 6110.
- [5] Sun Zunguo. Analysis of civil compensation Mechanism in CPA audit System [J]. Audit in China, 2003 (11): 35-37.
- [6] Guo Li. Chinese-style Board of Supervisors: Where to settle and where to go? Rethinking from the perspective of international comparison [J]. Journal of Comparative Law, 2016(2): 74-87.
- [7] Wu Jingzhao. Problem of accounting information disclosure of listed companies in our country and countermeasure study [J]. Market modernization, 2021 (18): 159-161. The DOI: 10.14013/j.cnki.scxhdh.2021.18.058.
- [8] Fu Jieru. Accounting information disclosure of listed companies and suggestions on improving the quality of disclosure [J]. Modern Enterprise, 2022(01): 170-171.

- [9] Han Yali. Research on motivation and Governance of Listed Companies' Information Disclosure Violations [D]. Henan Polytechnic University, 2012.
- [10] Zhang Chenyu, Wu Jianfeng. Does Share Pledging by Controlling Shareholders Aggravate Illegal Actions of Information Disclosure? *Foreign Economics & Management* Vol. 42, Issue 05, pp. 29 - 41 (2020).