

On the Reasons and Countermeasures of the Distortion of Accounting Information of Listed Companies in China

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Abstract

In the era of big data, the quality of accounting information is very important, and it is very urgent to solve the problem of distortion of accounting information of listed companies. This paper analyzes the current situation of accounting information distortion in listed companies, and discusses the reasons for information distortion in an all-round way with the help of real cases, which are the imperfect internal control system of enterprises, the need to improve the professional quality of accounting practitioners, the lack of diligent and conscientious accountants in accounting firms, and the existing accounting legal system is not perfect. In view of these four reasons, the paper finally proposes solutions to establish an effective internal control mechanism, strengthen the integrity education of accountants, improve the external audit system and improve the relevant legal system.

Keywords

Listed Company; Accounting Information Distortion; Solution.

1. Introduction

Accounting information refers to the information that an accounting unit discloses the unit's financial status and operating results to investors, creditors or other information users through financial statements, financial reports or notes [1]. Distortion of accounting information refers to the loss of reliability, one of the primary quality requirements of accounting information, which is not conducive to the economic decision-making of relevant information users. In recent years, with the advancement of technology and the development of the times, the competition among listed companies has become increasingly fierce, and it is more and more important to ensure the authenticity of accounting information. For listed companies, their dominant position in the securities market complicates the problem of accounting information distortion. From a micro level, accounting information records various economic activities of an enterprise. Once the accounting information is distorted, stakeholders cannot make reasonable decisions when using the information, which will inevitably affect the development of the company and be detrimental to the management of the micro economy. From a macro level, the distortion of accounting information leads to the inability of relevant government departments to correctly assess and regulate the macro economy, which affects the order of the market economy. Therefore, taking effective measures to prevent the distortion of accounting information is of great significance to maintaining the stable operation of the economic order.

2. Literature Review

In the field of accounting, accounting information distortion is a troubling problem. Therefore, Chinese scholars have carried out many researches on this problem, and devoted themselves

to analyzing the causes of information distortion in order to find effective solutions. Zhang Zhaoxia (2018) selected A-share non-financial listed companies in Shanghai and Shenzhen stock exchanges as samples, introduced internal control, and found that effective internal control can reduce the increase in debt financing costs caused by distortion of accounting information [2]. Xu Jun (2018) focused on accounting files of listed companies, discuss the manifestations and causes of accounting file information distortion, and put forward research countermeasures [3]. Wang Xiaohan and Wang Yuhong (2021) analyzed the listed companies that have had accounting information distortion problems in recent years, and found that the methods used by them are becoming more and more concealed, and put forward suggestions for improving the supervision mechanism [4]. Zhang Zhiheng and Deng Qilan (2019) believe that financial indicators and non-financial indicators should be combined, and based on support vector machines, the method of data mining should be used to optimize the method of identifying the authenticity of accounting information [5]. Xing Enquan et al (2019) proposed that the methods used to prevent accounting information distortion in the past are no longer fully applicable to the current situation, and the use of blockchain technology can speed up the resolution of information distortion problems [6]. Wang Jianxin and Cao Zhiming (2021) deeply analyzed the LeTV financial fraud incident and believed that the focus of accounting supervision should be shifted from post-event supervision to pre-event and in-process supervision [7]. It can be seen that many scholars agree that the problem of accounting information distortion should be paid attention to, and put forward their own opinions on the solution to this problem. However, the focus is different, resulting in the lack of comprehensive research in the past, and even ignoring some key details. This article intends to conduct a comprehensive discussion on the problem of accounting information distortion in listed companies, in-depth analysis of the reasons for this phenomenon, and improve the summary of the solution.

3. The Current Situation of Distortion of Accounting Information of Listed Companies

Statistics show that in 2020, the China Securities Regulatory Commission issued a total of 110 administrative penalty notices, of which 31 involved information disclosure violations or excessive shareholding that was not reported or disclosed. In the first half of 2021, the CSRC issued a total of 32 administrative penalty notices, 14 of which involved violations of laws and regulations in information disclosure, failure to perform due diligence in auditing, and failure to disclose excessive shareholding in accordance with the law, accounting for almost half of all administrative penalty notices. According to related news reports, in 2021, the China Securities Regulatory Commission has fined 730 million yuan for cracking down on financial fraud. From the above information, it is not difficult to see that the distortion of accounting information of listed companies is increasing every year, and the means of fraud are also being updated. Among them, Kaidi Eco-Environment Technology Co., Ltd. (hereinafter referred to as Kaidi Eco) is a typical example. The company was registered and established in Wuhan East Lake New Technology Development Zone on February 26, 1993, and was listed on the Shenzhen Stock Exchange in September 1999.

3.1. Inaccurate Accounting Information

False accounting information is generally caused by non-standard accounting information processing and technical errors made by accountants. Irregular handling of accounting information is often caused by objective reasons for untrue accounting information, rather than intentional actions by accountants. For example, the original vouchers obtained by the enterprise did not meet the standard requirements; the account settings of the enterprise were not reasonable enough, and the accountants could not truthfully record the contents of the account books. Accounting itself is uncertain, and accountants need to make a lot of estimates

in the process of accounting. Different accounting policies are adopted, and the obtained accounting information is also different. Coupled with the impact of changes in the external economic environment, it is very likely that the final accounting information will be untrue.

The non-standard accounting information processing is reflected in many aspects, the first is accounting vouchers. As the starting point of accounting work, once the accounting voucher information is distorted, there will be errors in the preparation of account books and reports. In order to improve performance, company executives may instruct accountants to fill in false documents; for personal gain, accountants may also choose to fabricate expenses. The second is the accounting book, which is mainly used as an intermediate link to process and organize the original accounting documents to prepare financial reports. Since the distortion of information in the accounting books is difficult to judge, the decision-making of auditors and managers is likely to be affected. Lastly, financial reporting, investors and shareholders often make decisions based on balance sheets and income statements. However, when a listed company faces losses, in order to conceal this situation and prevent the loss of investor confidence, the company's executives may choose to inflate profits and falsify financial reports. Inaccurate accounting information caused by traditional accounting is mostly related to technical mistakes made by accountants, such as repetitions, omissions, and reverse lending directions during accounting processing. If the professional quality of accountants can be improved, the probability of technical distortion causing false accounting information will become very small. However, with the development of computerized accounting, the problem of technical distortion has almost disappeared.

3.2. Distortion of Economic Transactions

Accounting information falsification, that is, illegal distortion, refers to the fact that the parties involved in accounting activities, for the benefit of accounting subjects or related subjects, disregard the requirements of other stakeholders for the authenticity of accounting information, falsify relevant accounting data, and disrupt the order of economic development. Distortion of economic transactions is a specific manifestation of accounting information fraud, which refers to the fact that listed companies falsely record the economic business generated by the company, and profit from them by manipulating accounting information. Some companies use inflated operating income and understated financial expenses, resulting in inflated book profits and achieving the purpose of completing performance ahead of schedule. In order to attract venture capital investment and shareholding, some companies inflated their operating performance by making false business contracts and false accounting, or raised the company's valuation during the merger negotiation to obtain a higher merger consideration.

From 2015 to 2017, some power plants under construction of Kaidi Eco have been suspended. According to the accounting standards and the accounting policies of Kaidi Eco, the borrowing costs incurred during the interruption period should be recognized as expenses and included in the current profit and loss. However, Kaidi Ecology did not suspend the accounting treatment of the capitalization of borrowing costs, resulting in the inflated construction-in-progress, deflated financial expenses, and inflated total profits in the financial reports from 2015 to 2017. It is not difficult to see that the purpose is to whitewash the financial statements, thereby disturbing the judgment of stakeholders, and mistakenly thinking that Kaidi Eco is still in good operating conditions, and ultimately wins the interests of shareholders and obtains huge profits.

3.3. Information Disclosure Violations of Laws and Regulations

Accounting policies are not constant. With the release of newly revised accounting standards, companies should also update accounting policies in a timely manner. However, some listed companies may ignore this change or choose to withhold accounting information that should be disclosed, disregarding other stakeholders, and focusing on their own self-interest.

According to the administrative penalty decision issued by the China Securities Regulatory Commission, Kaidi Eco's financial fraud means, in addition to improper capitalization of borrowing costs, also failed to disclose major debt defaults as required, failed to disclose related transactions as required, and failed to disclose actual controller information. Kaidi Ecology took the risk of breaking the law and chose to conceal some accounting information for the sake of further profit. It can be seen from the survey results that the actual controller of Kaidi Eco is Chen Yilong, who not only owns a high proportion of shares, but can also decide the appointment of board members. In the 2017 annual report of Kaidi Ecology, it was recorded that the company had no actual controller, concealed the actual situation of the company, and constituted a violation of laws and regulations in information disclosure, in order not to expose the fact that the company was actually in power by Chen Yilong alone. It can be seen that there is a big loophole in Kaidi Eco's internal control system, and it is also expected that the CSRC will eventually find out the problem of distortion of accounting information.

4. The Reasons for the Distortion of Accounting Information of Listed Companies

4.1. The Internal Control System of the Enterprise is not Perfect

Internal control describes the processes designed, implemented and maintained by those charged with governance, management and others to provide them with reasonable assurance that the entity will achieve its objectives. Simply put, internal control is any action taken by management to increase the likelihood of achieving the organization's objectives. The objectives of internal control can be summarized into the following three points: business objectives, reporting objectives, and compliance objectives. Some listed companies ignore the reporting objectives and compliance objectives, and put the promotion of the effective operation of the enterprise in the first place, resulting in the imperfect internal control system of the enterprise and the distortion of accounting information.

The company's equity allocation structure is unreasonable. Taking Kaidi Ecology as an example, Chen Yilong can actually control Sunshine Kaidi through Fengying Yangtze River, and he is the actual controller of Sunshine Kaidi. From the perspective of shareholding, Chen Yilong holds a 66.81% stake in Fengying Changjiang and is the largest shareholder of Fengying Changjiang. In addition, the appointment of more than half of the members of the board of directors of Sunshine Kaidi is decided by Chen Yilong [8].

There are defects in the internal governance mechanism of the enterprise. On the one hand, in order to achieve the goals of corporate governance and establish an internal control system, enterprises need to set up special institutions, such as the establishment of an audit committee. Because these behaviors require enterprises to pay human and material resources, many companies use internal control systems as decorations in order to save costs. On the other hand, Kaidi Eco's equity is highly concentrated, and Chen Yilong is "one share", which affects the independence of independent directors, the board of supervisors and intermediaries, and the internal control system cannot run smoothly.

4.2. The Professional Quality of Accounting Practitioners Needs to be Improved

In the daily work of accountants, the accounting data, such as original vouchers, should be accounted for first, and financial reports should be prepared after obtaining the accounting books. This is the final accounting information, and the accounting information should be handed over to the relevant information users for decision-making. In this process, the role of accountants is not only to correctly process information, but more importantly, the authenticity and reliability of accounting information quality must be guaranteed. Because of this, if the professional quality of accountants is not high enough, they may make low-level mistakes,

resulting in distortion of accounting information for a certain business. On the one hand, the professional skills of some accountants are low, and sometimes they cannot fully understand the accounting standards of enterprises and the relevant policies of the company. They make mistakes when sorting out accounting vouchers or financial reports, resulting in the distortion of objective accounting information. On the other hand, driven by interests or under the coercion of managers, some accountants with low professional quality conduct financial fraud, which leads to the problem of distortion of accounting information.

4.3. The Accounting Firm Failed to Perform its Duties Diligently

Kaidi Ecology has gone from being a star stock in the past to delisting now, which is also related to the audit institution Zhongshen Zhonghuan Accounting Firm (hereinafter referred to as Zhongshen Zhonghuan). In the 2016 annual report of Kaidi Ecology, there were cases of falsely increasing construction in progress, falsely reducing financial expenses, and falsely increasing total profits by a total of 273 million yuan. Zhongshen Zhonghuan, as the audit institution of Kaidi Ecology's 2016 annual report, issued a standard unqualified audit report, which constituted a false record. In addition, the Hubei Securities Regulatory Bureau stated that Zhongshen Zhonghuan did not fully assess the risks of Kaidi Ecology, nor did it implement adequate risk response procedures; faced with the improper handling of construction in progress and the capitalization of borrowing costs in Kaidi Ecological Financial Report, it did not raise due professional doubts. The implementation of audit procedures was obviously problematic, and the audit process was not diligent and responsible. This is also a common problem for many accounting firms today. In the face of fierce competition in the industry, in order to reduce audit costs, firms do not delve into doubts in corporate annual reports, resulting in distortion of accounting information.

4.4. The Existing Accounting Legal System is not Perfect

In order to standardize accounting work, China has promulgated many relevant laws and regulations, such as "Accounting Law of the People's Republic of China" and "Company Law of the People's Republic of China". However, with the rapid economic development, the existing laws are inevitably lagging behind, and the external market restraint mechanism is not powerful enough for many listed companies. At the same time, increasing the penalties of laws and regulations can play a better deterrent effect. Due to violations of laws and regulations on information disclosure, the government and the China Securities Regulatory Commission mainly adopt administrative penalties, with relatively small fines. Taking Kaidi Ecology as an example, Chen Yilong, the actual controller and the person who is directly responsible, was fined 900,000 yuan. Even if this is a large amount in cases of violations of laws and regulations in information disclosure, it is not enough to frighten managers when compared with the benefits of financial fraud. Therefore, the low cost of crime also caused the occurrence of distortion of accounting information.

5. Countermeasures for the Distortion of Accounting Information of Listed Companies

5.1. Establish an Effective Internal Control Mechanism

In China's listed companies, the board of directors and senior managers are often highly overlapped, and Kaidi Ecology is not an exception. As a result, the board of directors loses the function of supervision and management, and cannot really play a role in supervising financial accounting information. In order to solve this problem, we should first optimize the company's shareholding structure and balance the shareholding of each shareholder. In addition, the board of directors of the company can introduce non-executive directors, and use the independence of non-executive directors to play a supervisory role. In order to ensure this

independence, non-executive directors are not allowed to have business and economic transactions with the company, and cannot participate in the company's equity incentive plan; the term of office of non-executive directors should be limited to a certain period, and if they continue to be employed after the term ends, they need to go through a formal process for approval; the company should have processes in place to ensure that non-executive directors have unhindered independent opinions and independent reporting lines. Finally, the company can establish an audit committee to supervise the company's financial statements, review and judge major financial reports; for the company's internal financial control system and internal audit function, it can also review its effectiveness through monitoring; when the board of directors makes a decision on the external auditor, the audit committee shall express its own opinions from a professional perspective, and supervise the external auditor from the perspective of independence, objectivity and effectiveness [9].

5.2. Strengthen the Integrity Education of Accountants

On July 30, 2021, the General Office of the State Council issued the "Opinions on Further Regulating the Order of Financial Auditing and Promoting the Healthy Development of the Certified Public Accountant Industry" (hereinafter referred to as the "Opinions"). The "Opinions" pointed out that the construction of integrity should be regarded as the lifeline of the development of the industry, the financial audit order should be rectified according to the law, and the daily management of the industry should be strengthened. On the one hand, when educating students, colleges and universities should not only impart professional knowledge, but also cultivate students' professional ethics. On the other hand, enterprises should strengthen on-the-job training for accountants to improve the quality of accounting work; relevant departments regularly carry out integrity education activities, so that the awareness of integrity can be rooted in the hearts of accounting practitioners, investors and supervisors.

5.3. Improve the External Audit System

In the selection of accounting firms, the government and regulatory authorities should take measures to supervise and prevent companies from choosing firms that have interests related to them. The CSRC may stipulate that listed companies should implement a rotation system for auditing business. A qualified auditor should always maintain due professional skepticism. Once the auditor is familiar with the audited unit, it may lead to the loss of this professionalism. Being in charge of the same accounting firm for a long time, the audit process of the auditor may make the audited unit get used to it, and in a sense, create conditions for the distortion of accounting information. At the same time, after changing the accounting firm, the new firm may also find out the problem of distortion of accounting information in the past enterprise.

5.4. Improve the Relevant Legal System

Compared with developed countries, China's accounting standards development process is relatively backward. Therefore, the first thing to solve the problem of distortion of accounting information is to speed up the construction of accounting standards and legal systems, and to strengthen and improve the construction of laws and regulations. When formulating accounting standards, the uncertainty of accounting itself should be reduced as much as possible, and the listed companies should not be given opportunities for financial fraud, and the operation process of each step should be specified in detail to prevent loopholes. In addition, the CSRC should also give full play to the deterrent effect of the law. In this way, even if the listed company can obtain huge profits after choosing to disclose information illegally, the listed company will consider that once the illegal behavior is discovered, it will pay a huge price for it, and thus give up the means of financial fraud to inflate profits, etc.

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