

Study on Surplus Management of Listed Companies under the New Delisting Regulation

-- Example of *ST Yisheng

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Abstract

The unsound exit system of listed companies will affect the formation of good market reputation, make financial resources unevenly distributed, and inhibit the internal optimization reform of enterprises to a certain extent. Western countries such as the United States and other mature markets have a long history and a sound delisting system, compared to the slow development of China's capital market, there are small costs of illegal violations of listed companies, unsound exit system, unreasonable delisting indicators, lengthy delisting process and other problems, and lead to "shell companies" can not be cleared in a timely manner. To this end, China is actively deepening its reforms, and the Shanghai and Shenzhen exchanges introduced new delisting rules in December 2020 to optimize the diversified mandatory delisting indicator system. The new delisting rules make it difficult for listed companies on the verge of delisting to hang on to their horses and improve the elimination rate of the market. However, there are still limitations in the relevant studies, one is the lack of detailed elaboration and analysis of the updated delisting rules of the Shanghai and Shenzhen stock exchanges in December 2020, as well as the newly introduced delisting rules of the Beijing Stock Exchange; the second is the lack of case studies and empirical research, and the theoretical analysis is not convincing enough. Based on the current research, this project analyzes the internal governance changes and surplus management behaviors of *ST Yisheng listed companies before and after the delisting system reform through case studies, makes recommendations for relevant regulatory authorities, alerts relevant institutions to strengthen the identification of surplus management behaviors, and reminds small and medium-sized investors to take precautions against risks. We hope to guide ST companies to regulate their surplus management behavior and focus on improving their true operating ability.

Keywords

Delisting System; Surplus Management; ST Companies.

1. Introduction

Research significance: the number of listed companies in China is climbing every year, but the number of companies delisted in the same year is much less, the delisting rate is low, and the phenomenon of surplus management is more common. Some listed companies that no longer have the ability to continue to operate should be eliminated in a timely manner, and a good mechanism for the elimination of the fittest is conducive to the sustainable and healthy development of the capital market. This makes it important to study the effects of the delisting system reform.

Current status of domestic and foreign research and development: Foreign scholars' research on delisting system in mature markets is more complete, mostly analyzing from internal

reasons such as company size, governance structure and earnings level of listed companies. Domestically, Yu-Bo (2022) uses a survival model to examine the effect of the delisting system reform and finds that under the previous delisting system with a single indicator, the effectiveness of mandatory delisting is not obvious, and the more stringent new delisting rules make ST companies need to adjust their production and operation activities more actively to solve the problem at source, thus the secondary cap rate of listed companies will be significantly reduced under the guidance of the new delisting rules. Several scholars believe that the positive and negative effects of surplus management are more or less important depending on internal factors such as company size and profitability. Tan, Qing, and Zhang, Jie (2022) used a double difference method to analyze the test that the delisting system can have a positive effect in inhibiting corporate financial fraud, and the better the profitability and profitability of the company, the greater this positive effect. Li Dingju.(2022) (2022) Similar views are also held: the surplus management of most domestic manufacturing listed companies is an active management behavior, and the larger the scale of the enterprise, the more it can suppress surplus management; other scholars believe that the supervision of the CPA audit process should be strengthened through the public and national laws and regulations, and the concentration of the CPA at work should be increased through such means as supervision of them, and the phenomenon of misjudgment, omission and underwriting should be reduced The quality of financial information of listed companies should be improved by increasing the concentration of CPA's work and reducing the incidence of errors, omissions and cover-ups through the supervision of CPA's. Wang Meng (2022) considers the measure of including audit opinion indicators after the delisting system reform as a direct manifestation of strengthening the requirements for audit quality.

Foreign scholars have mixed views on the consequences of surplus management for listed companies. Graham (2005) shows that surplus management tools can only achieve short-term benefits and have negative effects on future performance and their value in the long run. In contrast, Gunny's (2010) analysis found that true surplus management techniques would have a positive effect on the future growth and operations of the company. On the domestic front, Guo Fei (2022) calls the new rules the "strictest ever" delisting rules, which narrow the scope of surplus management for listed companies and are a milestone in the process of promoting the orderly and healthy development of China's capital market, but ST companies may be more inclined to use accrued surplus management techniques in the future, and their violations will be more difficult to detect. Yan-Yan Gao and Jian-Bo Huang (2023) argue that when financing constraints and performance pressure, which are the motives for real surplus management, are alleviated, corporate management will accordingly reduce real surplus management activities, so the authorities should go to help companies with going concern to tide over their difficulties and reduce the motives for surplus management. Jing-Yi Lai (2022) argues that true surplus management controls the normal production and operation activities of enterprises, and it is difficult to control it in all aspects by the means of accounting standard changes alone, so it needs to be combined with other means to cooperate, so the new diversified delisting indicators after the delisting system reform will enhance the elimination rate of listed companies. Based on this, the main significance of this paper is to evaluate the implementation effect of China's delisting system reform through case studies, to provide an empirical basis for the study of surplus management of listed companies under the new delisting regulations, and to advocate that *ST companies standardize their surplus management behavior and focus on improving their own financial fraud before and after the promulgation of the new delisting regulations by specifically analyzing the financial fraud of *ST Yisheng listed companies. The study also aims to advocate that *ST companies should regulate their surplus management behavior and focus on improving their own going concern ability.

2. Full Text

The once extremely glorious home wood listed company Yihua Life officially exited the A-share market on March 22, 2021. Yihua Life also became the first \$1 delisting stock after the delisting system reform in December 2020, such a great ups and downs. On April 24, 2020, the Securities and Futures Commission (SFC) formally launched an investigation into Yihua Life for alleged irregularities in disclosure and financial fraud. After probing, it was found that the amount of financial fraud involved in Yihua Life was higher than 40 billion. Once standing at the top of the pyramid in the home wood industry, with a market value of up to 34 billion yuan, Yihua Life has now been delisted for financial fraud. In five short years, Yihua Life sank deeper and deeper into the "cash flow swamp" and eventually became obsessed with a path of no return.

Established in 1987, Yihua Wood was mainly engaged in the production and processing of solid wood furniture. In 1991, Yihua Wood started to produce products under license from Hong Kong to Taiwan, and later cooperated with Taiwan in the production and sales of wood flooring, from which the name "Yihua" was born. In 1996, the trademark "Yihua" was successfully registered, and the period of OEM was over and the next stage was entered. In 2004, Yihua Wood was listed on the main board of the Shanghai Stock Exchange, with its business objectives directed to the domestic market, trying to do well in both the roles of distributor and home experience hall. In 2016, Yihua Wood changed its name to Yihua Life, which is already an upstream and downstream complete industry chain type enterprise. 2016 to 2019 were exposed to suspicion of financial fraud as the accounts did not match the actual situation. On January 29, 2021, the closing price of Yihua Life's shares was below RMB1, and on February 22, 2021, the closing price of Yihua Life's shares was still below RMB1. During this period, Yihua Life satisfied the termination of listing condition that "the daily closing price of the shares has been below RMB1 for 20 consecutive trading days". Trading of Yihua Life's shares was suspended from the opening of the market on February 23. On March 22, 2021, Yihua Life, once the "No. 1 stock in China's wood industry", was fined a total of 18.7 million and banned from the market for life!

The financial falsification of Yihua Life has been suspected for a long time. First, from 2015 to 2019, Yihua Life's book monetary funds increased from 3.426 billion to 4.046 billion, and there existed sufficient funds, while the company's liabilities were slowly climbing during this period, and the annual finance charges paid increased to 186 million, 256 million, 415 million, 447 million and 405 million, respectively. Yihua Life has a lot of idle funds, but is willing to bear the high interest rate to loan financing, before that Kangde Xin and Kangmei Pharmaceutical also have similar unreasonable operation. Second, according to the calculation, the average value of interest-bearing liabilities/total assets is 30% and the average value of monetary capital/total assets is 15%, which is very high compared with the industry, and this is contrary to the cost-benefit principle, especially in 2018, when the company has sufficient free funds, but has carried out debt financing, and the financing cost and finance cost are high. Although the company later made a statement that the reason for keeping so much cash was to have sufficient working capital for the company's development, the waste and idleness of the funds have already made the public suspicious, and there must be problems with the financial aspects of Yihua Life. The year-on-year growth rates of the company's revenue from 2016 to 2019 were 24.14%, 40.73%, -7.73% and -29.15%, while the year-on-year growth rates of accounts receivable for the same period were 33.93%, 10.32%, 28.35% and 11.41%; that is to say, the company's sales revenue and the company's accounts receivable do not change at the same frequency, no matter how the former In other words, the company's sales revenue and the company's receivables do not change at the same frequency, no matter how the former ebbs and flows, the latter maintains rapid growth, which is theoretically difficult to do. In just three years, the company's accounts receivable turnover days grew from 92.44 to 171.33. The

payback cycle was extended again under the epidemic, but the speed of payback grew rapidly, and the company's huge cash flow was clearly not a cash transaction. Taking the above factors together, we can see that there are clearly a number of things that defy logic in the financial data of Yihua Life.

After analyzing Yihua Life, there are three major falsification techniques (1) Yihua Life reduced or increased the balances of certain accounting accounts by falsifying bank documents, not keeping accounts, or making false entries, thereby reconciling revenues and profits and concealing the true amounts (2) Fictitious operating revenues and profits, the relevant financial personnel of Yihua Life increased operating revenues and thus profits by inflating them, largely deviating from their true profitability. For four consecutive years beginning in 2015, YHLS's financial inflated operating income reached up to more than 50 times the true revenue. (3) From 2016 to 2019, the person in charge of Yihua Group and related financial personnel used 10 bank accounts belonging to Yihua Life to transfer amounts to a total of 3 bank accounts of Shantou Honghui Wood Products Co. and Shantou Liangguang Building Materials Trading Co. for a total amount of \$15,710,968,918.60, returning funds of \$16,420,811, 763.60 Yuan. Ltd. and Shantou Honghui Wood Products Co., Ltd. are effectively controlled by Yihua Group, the controlling shareholder of Yihua Life, and the monetary transactions between Yihua Life and these two companies are connected transactions, but these transactions of huge amounts are not recorded in the accounts, and there are significant problems with the annual reports from 2016 to 2019; (4) the relevant executives and financial personnel of Yihua Life and the registered There were improper transactions between the relationship of the accountants, and the relevant CPAs were bribed and issued audit opinions for them that did not correspond to the actual situation, and for three consecutive years, starting from 2016 to 2018, it was Zhengzhong Pearl River that issued standard unqualified audit opinions for the financial statements of Yihua Life, and the remuneration paid by Yihua Life was significantly higher than the average market level. It is important to know that the audit report of Guangdong Rongtai and Kangmei Pharmaceuticals in the year of financial fraud was issued by the accounting firm Zhengzhong Zhujiang. The conspiracy between accounting firms and listed companies for personal gain has greatly increased the concealment of surplus management practices, making the work of the relevant regulatory authorities even more difficult.

Based on the above analysis, the following recommendations are made.

2.1. Company Level

If ST wants to grow steadily and well, it is necessary to build on one business and drive other businesses mainly with it. When a company is about to be delisted, it should be sensitive to the external market, anticipate the development trend of the industry, optimize the production and operation structure, and establish an efficient working mechanism to select and appoint employees of good moral character and ability to the core positions of the company.

The listed companies want to use accounting surplus management moderately and reasonably, they need to create a good internal environment for supervision to work, for large companies, they need to start from the top to choose capable and honest people, and this layer of selection down to weaken the bad culture of corruption.

Customize long-term development goals for the company, improve the promotion and reward mechanism within the company, combine personal interests with the company's interests, individual and company progress together, improve the collective identity of employees, and reduce the short-sighted behavior of blindly pursuing personal interests to the detriment of collective interests. At the same time performance appraisal should be enriched, diversified and personalized to include all kinds of operational and financial indicators to encourage management to give full play to their talents and govern the company with a problem-solving attitude so as to achieve the company's long-term goals, thereby reducing the short-term

behavior of the company's management to pursue personal appraisal indicators at the expense of the company's interests and reducing the management's speculative surplus management behavior. In addition, we give full play to the role of independent supervisors and the Supervisory Committee in monitoring before, during and after the event, increase the frequency of verifying the accounts to ensure that the accounts are in line with the facts and that there is no falsification, independently and objectively evaluate the performance of the management's functions, make timely announcements of the inspection results and increase the internal transparency of the company. The company's financial staff should take the initiative to learn the latest financial knowledge and ensure that their business level and professional skills are qualified, while focusing on improving their inner cultivation and professional ethics, taking responsibility for their own language and behavior, and not failing the public's trust.

2.2. The Government Level

Some of the rules in accounting standards are vaguely defined and may be interpreted differently by different people. Many listed companies take advantage of this uncertainty for their own personal gain, such as the common reconciliation of profits, thus preventing delisting. After the implementation of the new delisting rules, the more common surplus management practices are difficult to apply, but there are also more insidious ways of surplus management. In recent years, our experts will refer to the more mature and practice-tested systems in the West when revising accounting standards, and constantly face the world and strive to be in line with international standards. For example, the standardization of connected transactions, standardization of the provision and reversal of asset impairment, standardization of deferred income tax, and clear definition of ambiguous word concepts in the standard. However, the relevant laws and regulations and accounting standards still need to be improved, and only continuous improvement can make the capital market more standardized, so that ST companies have no way out. The previous delisting system has a weak impact on listed companies, many ST companies jump repeatedly between "cap" and "cap", and do not really exit the capital market, the net profit indicator is secretly adjusted by many listed companies to avoid delisting. These common underlying tools will be less likely to be utilized after the implementation of the new delisting rules. The relevant authorities should further improve the delisting system to reduce the room for manipulation of ST companies. Regulators should reduce the tolerance of ST companies, accelerate the liquidation of members who do not have the ability to continue business, and promote the elimination of winners and losers in the capital market. The regulator should also increase the scope of investigation and evidence of related transactions, mergers and acquisitions, asset sales, etc. conducted by ST companies during "sensitive periods", and once irregularities are found, do not condone them, increase the cost of the relevant personnel, and urge them to comply with the law. At the same time, the exchange should, depending on the situation, open a green channel for companies with sustainable business potential to help them get through the difficult times and prevent them from getting the idea of falsifying. For companies on the verge of delisting and without the ability to continue as a going concern, the cost of making mistakes should be increased so as to reduce capital market chaos. The relevant personnel of regulatory agencies should continue to learn and improve their professional judgment, professional discernment, and increase their professional sensitivity. In addition, the regulatory authorities should also refine the classification of supervision, for different business capacity, different sizes, different industries of business companies specializing in supervision, to improve the accuracy of law enforcement.

2.3. Social Dimension

(i) strengthen the protection of small and medium-sized investors

"The small and medium-sized investors have limited channels to get information about listed companies, and they can only judge the company's sustainable development ability with their

limited personal ability and the small amount of information they get. Due to the limited and uneven access to information, it is difficult for investors to understand the actual financial situation of listed companies, so they are very easy to be misled to make wrong investment decisions. In particular, ST companies often lose money for years, and it is difficult to achieve profitability in the short term through conventional means. Management usually conceals the true operating situation of the company and "whitewashes" the results through surplus management, which may be a bottomless abyss behind the successful escape. This makes it even more difficult for investors to judge the authenticity. Investors should increase their sensitivity to abnormal behavior of listed companies, enhance their risk awareness and increase their judgment by continuously learning about surplus management. Small and medium-sized investors, a vulnerable group, should receive the attention of the government, which can provide assistance and seek benefits for them through policies or other effective means.

(ii) Enhancement of CPA audit capability

The audit report issued by the CPA has a great guiding effect on the general small and medium-sized investors, so the CPA needs to maintain objectivity and independence. However, there are some people in the CPA's team with poor professional ability and poor ability to resist temptation, and they are prone to violate the relevant management regulations during the actual audit process and fail to effectively identify or deliberately fail to identify the company's surplus management behavior.

CPAs should have a sense of crisis, focus on improving their professional standards and personal qualities, improve their professional judgment, professional sensitivity, resist temptation, and be responsible for their work and for society. In addition, CPAs should maintain a state of continuous learning, carefully study the relevant policies and regulations, strengthen the mastery of places where the concept is vague, think differently about which areas are prone to falsification and fiction, and appropriately expand the scope of investigation when obtaining audit evidence. For companies on the verge of delisting CPAs should be particularly alert to its recent unusual behavior and strengthen audit quality while ensuring audit efficiency so that listed companies can be exploited seamlessly. At the same time, the state should also strengthen the supervision of the personal integrity and professional ethics of CPAs, and urge them to conduct objective and fair audit supervision on the fraudulent acts of listed companies, so as to maintain the normal order of the securities market and create a healthy and stable environment for China's capital market.

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