

Zijing Storage Financial Fraud Case Analysis - Audit Risk Prevention for Listed Companies

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Abstract: Zijing Storage, as a company listed on the Science and Technology Innovation Board, originally enjoyed a high reputation in the industry for its research and development, design, and development of core technologies for Blu-ray data storage systems, as well as the production, sales, and services of optical storage media, equipment, and solutions based on this technology. However, the company's recent financial fraud case has attracted widespread attention. This case analysis aims to deeply analyze the process, causes, and impact of Zijing Storage's financial risk fraud, and put forward corresponding suggestions.

Keywords: Zijing Storage; Financial Fraud; Audit Risk.

1. Introduction to Zijing Storage

1.1. Basic information of the company

Date of establishment: April 15, 2010 Main business: R&D, manufacturing, and sales of storage equipment, other industrial production equipment, and related auxiliary materials; providing services such as solar photovoltaic power generation, computer software and hardware products and system integration, tangible movable property leasing, and import and export of goods and technology. Stock code and abbreviation: Listed on the Science and Technology Innovation Board of the Shanghai Stock Exchange, stock code "688086", stock abbreviation "Zijing Storage"^[1].

1.2. Development history and current situation

Listing information: On February 26, 2020, Zijing Storage was listed on the Science and Technology Innovation Board of the Shanghai Stock Exchange, becoming the second company in Meizhou to land on the Science and Technology Innovation Board, and the first A-share listed company in Meizhou High-tech Zone (Guangmei Industrial Park). Delisting information: Due to major violations, Zijing Storage issued an announcement on April 21, 2023 stating that it will be subject to major illegal forced delisting. On May 31 of the same year, *ST Zijing announced that it had received a decision to terminate the listing of its shares. The company's shares entered the delisting period, and the expected last trading date is June 30, 2023. The company's shares were delisted and delisted by the Shanghai Stock Exchange on July 7, 2023^[2].

1.3. Technology and Products

Core technology: Zijing Storage has independent intellectual property rights for blue-ray storage media, which has the advantages of long-term storage time, safety and reliability, and data cannot be tampered after writing. Product application: The products have covered terminal fields such as green data centers, government affairs, Internet, medical care, archives, and energy. The company has launched products for the industry in multiple fields such as finance, medical care, archives, public security, and data disaster recovery centers^[3].

1.4. Company achievements and honors

Zijing Storage is an optical storage company. Facing the application needs of optical-magneto-electric hybrid storage in the context of hot and cold data tiered storage in the big data era, as well as the needs of government, military and other fields for autonomous control and improved data storage security, it carries out research and development, design, development, production, sales and services of optical storage media, optical storage equipment, and data intelligent tiered storage and information technology solutions based on optical storage technology^[4]. Selected as a demonstration enterprise in the "one-stop" application plan of the memory storage of the Ministry of Industry and Information Technology's industrial foundation strengthening project, and identified as a demonstration enterprise for optical storage materials. The blue-ray data storage system has passed the evaluation of the scientific and technological achievements of the Ministry of Industry and Information Technology, and its overall technology has reached the domestic advanced level^[4].

1.5. Company achievements and honors

Due to fraudulent issuance and illegal information disclosure, Zijing Storage and its actual controller, relevant directors, general managers, etc. were all severely punished^[6]. The chairman was banned from the market for life, and many other directors, supervisors and senior managers were also banned from the market for 5 or 10 years. At the same time, Zijing Storage and its actual controller paid 1.086 billion yuan in advance to 16,986 investors^[4].

2. Case Introduction

On April 18, 2023, the CSRC published the Administrative Penalty Decision No. (2023) 30 (Zijing Storage and Relevant Responsible Persons) on its official website. The parties (the company, board members (including independent directors), supervisors, senior executives (including the secretary), South District Sales Director, Purchasing Manager, and subsidiary vice president) were found to have committed the following illegal acts: Fraudulent issuance:

The Prospectus falsely increased operating income and profits (On April 3, 2019, Zijing Storage disclosed the draft of the Prospectus. After receiving the approval of the CSRC

for the public issuance of shares in early 2020, it disclosed the official draft of the Prospectus on February 21, 2020). It was determined that the parties had signed a false sales contract. The company falsely increased revenue and profits by forging logistics documents and acceptance documents, arranging fund collection, and recognizing revenue in advance. In 2017, 2018, and 2019, the falsely increased revenue reached more than 43 million yuan, more than 110 million yuan, and more than 66 million yuan, respectively, accounting for 13.9%, 27.75%, and 42.97% of the annual revenue, respectively. The falsely increased profits in the three years were more than 21 million yuan, more than 39 million yuan, and more than 25 million yuan, respectively, accounting for 35.82%, 32.59%, and 137.33% of the annual profit, respectively. The total falsely increased revenue was more than 220 million yuan, and the total falsely increased profits were more than 85 million yuan.

The Prospectus did not disclose external guarantees in accordance with regulations. It was determined that the balance of external guarantees of Zijing Storage at the end of 2016, the end of 2017 and the end of the first half of 2019, which were not disclosed in accordance with regulations, were RMB10 million, RMB10 million and RMB75,001,200 respectively. As of the date of signing of the prospectus, the balance of external guarantees that were not disclosed in accordance with regulations totaled RMB135,001,200.

The CSRC determined that the above-mentioned behavior of Zijing Storage violated the third and fourth items of the first paragraph of Article 13 and the first paragraph of Article 20 of the Securities Law of 2005, Article 11 of the Measures for the Administration of Registration of Initial Public Offering of Stocks on the Science and Technology Innovation Board (Trial), and Article 4, Article 80 and Article 95 of the Guidelines for the Content and Format of Information Disclosure by Companies Issuing Securities to the Public No. 41 - Prospectus of Companies on the Science and Technology Innovation Board, and constituted the first paragraph of Article 189 of the Securities Law of 2005. It is determined that the actual controllers Zheng Mu and Luo Tiewei are the directly responsible supervisors, and Zhong Guoyu (General Manager), Li Yanxia (CFO), Huang Meishan (Supervisor), Jiao Shizhi (Deputy General Manager), Wei Qiang (Deputy General Manager), Yang Siwei (Supervisor), Wang Wei (Secretary), Lin Haizhong (South District Sales Director), and Ding Jie (Purchasing Department) are other directly responsible persons. It is determined that Zheng Mu and Luo Tiewei, as the actual controllers of Zijing Storage, organized and instructed to engage in the above-mentioned fraudulent issuance, which constitutes the illegal behavior described in Article 189, Paragraph 2 of the Securities Law of 2005.

At the same time, Zijing Storage also has problems such as illegal information disclosure and false records in periodic reports. Zijing Storage's "2019 Annual Report" omitted the disclosure of 145.0012 million yuan of external guarantees, accounting for 16.15% of the net assets of the current period (consistent with the illegal behavior of the prospectus). In 2020, it failed to disclose external guarantees of RMB 175 million in a timely manner, accounting for 19.49% of the audited net assets in the latest period, and failed to disclose them in the 2020 Annual Report in accordance with regulations; in 2021, it failed to disclose external guarantees of RMB 417.9 million in a timely manner, accounting for 22.46% of the audited net assets in the latest period, of which RMB 167.2 million was also not disclosed in the 2021 Annual

Report in accordance with regulations. The CSRC determined that the above-mentioned behavior of Zijing Storage violated the provisions of Article 78, paragraph 2 of the Securities Law and constituted the illegal behavior described in Article 197, paragraph 2 of the Securities Law. Zijing Storage's failure to disclose external guarantees and major omissions in periodic reports in a timely manner violated Article 78, paragraph 1, Article 79, and Article 80, paragraph 2, item 3 of the Securities Law, Article 9, Article 30, paragraph 2, items 17 and 21, Article 31, paragraph 1, and Article 71, paragraph 1, item 2 of the Measures for the Administration of Information Disclosure of Listed Companies, Article 11, Article 22, paragraph 2, items 19, Article 24, paragraph 1, and Article 62, paragraph 1, item 3 of the Measures for the Administration of Information Disclosure of Listed Companies, Article 41 of the "Guidelines on the Content and Format of Information Disclosure by Companies Issuing Securities No. 2 - Content and Format of Annual Reports", Article 55 of the "Guidelines on the Content and Format of Information Disclosure by Companies Issuing Securities to the Public No. 2 - Content and Format of Annual Reports", and Article 7.1.16 of the "Shanghai Stock Exchange Science and Technology Innovation Board Listing Rules" constitute the illegal acts as described in the first and second paragraphs of Article 197 of the Securities Law.

The actual controllers, Zheng Mu and Luo Tiewei, are identified as directly responsible supervisors, and Zhong Guoyu (General Manager), Li Yanxia (CFO), Huang Meishan (Supervisor), Jiao Shizhi (Deputy General Manager), Wei Qiang (Deputy General Manager), Yang Siwei (Supervisor), Wang Wei (Secretary), Lin Haizhong (Southern Sales Director), and Ding Jie (Purchasing Manager) are other directly responsible persons. Zheng Mu and Luo Tiewei, as the actual controllers of Zijing Storage, organized and instructed the above-mentioned illegal and irregular information disclosure, which constituted the illegal acts described in the first and second paragraphs of Article 197 of the Securities Law. Based on the above two items, the Securities Commission imposed the following penalties: 1. Zijing Storage was ordered to make corrections, given a warning, and fined 36.6852 million yuan; the actual controller Zheng Mu was given a warning and fined 21.6426 million yuan; the actual controller Luo Tiewei was given a warning and fined 18.0355 million yuan; the general manager Zhong Guoyu and the financial director Li Yanxia were given a warning and fined 2.2 million yuan respectively; the supervisor Huang Meishan and the deputy general manager Jiao Shizhi were given a warning and fined 1.6 million yuan respectively; the deputy general manager Wei Qiang, the supervisor Yang Siwei, the secretary Wang Wei, the southern sales director Lin Haizhong, and the purchasing manager Ding Jie were given a warning and fined 1.05 million yuan respectively; the subsidiary's executive deputy general manager Liu Ningning was given a warning and fined 1 million yuan; the independent director Wang Tielin was given a warning and fined 500,000 yuan. In addition, the company was ordered to delist and entered the delisting consolidation period on June 8, 2023. As of June 30, 2023, the company's stock had been traded for 15 trading days in the delisting consolidation period, and the delisting consolidation period has ended. The company's stock was delisted and delisted by the Shanghai Stock Exchange on July 7, 2023. Regarding the identification and handling of illegal acts of intermediaries, the China Securities Regulatory Commission stated that in the

Zijing Storage case, relevant investigations were initiated against intermediaries such as CITIC Construction Investment Securities Co., Ltd., Rongcheng Accounting Firm, Grant Thornton Accounting Firm, and Guangdong Hengyi Law Firm. In the future, the next step will be handled in accordance with the law based on their diligence and responsibility in related professional behaviors, combined with their proactive advance compensation and the commitment of the parties to the application for securities and futures administrative law enforcement.

It is estimated that there will be a conclusion soon. I will supplement this article at that time. On May 27, 2023, CITIC Construction Investment announced that the company, together with Zhitong Accounting Firm (Special General Partnership), Rongcheng Accounting Firm (Special General Partnership), and Guangdong Hengyi Law Firm, officially established a special fund for advance compensation for the Zijing Storage incident (hereinafter referred to as the special fund), totaling 1 billion yuan, to be used to advance compensation for investors' investment losses caused by Zijing Storage's fraudulent issuance and illegal information disclosure. The above penalties are all based on the Securities Law. In fact, these violations also involve violations of the Accounting Law, the Company Law, and the Criminal Law.

3. Summary of important matters in the case

On November 18, 2022, Zijing Storage received the "Administrative Penalty and Market Ban Advance Notice" from the China Securities Regulatory Commission, which disclosed the content of performance fraud: Zijing Storage's "Prospectus" is suspected of inflating operating income and profits by fictitious sales contracts, forging logistics documents and acceptance documents, arranging fund repayments, and recognizing income in advance. The specific situation is as follows:

In 2017, Zijing Storage was suspected of conducting false business with Shenzhen Yuwei Vision Technology Co., Ltd., Shenzhen Fuhonghua Industrial Co., Ltd., Nanjing Diejia Information Technology Co., Ltd., Guangzhou Yunshuo Technology Development Co., Ltd., Hubei Shenhu Times Cloud Technology Co., Ltd. and other units, and inflated operating income and profits.

In 2018, Zijing Storage was suspected of conducting false business with Guangdong Huixin Communication Technology Co., Ltd., Shenzhen Yuwei, Shenzhen Fuhonghua, Nanjing Diejia, Jiangsu Feliston Information Technology Co., Ltd., Huaian Ruichi Information Technology Co., Ltd., Guangdong Youshi United Holding Group Co., Ltd., Hubei Shenhu, Beijing Youshi Internet Intelligent Technology Co., Ltd. and other units, and pre-recognized the income of Wuhua County Huacheng Town Central Hospital, and inflated operating income and profits.

In the first half of 2019, Zijing Storage was suspected of conducting false business with Guangdong Huixin, Suzhou Stratosphere Information Technology Co., Ltd., Zhaoqing Youshi United Wisdom Technology Co., Ltd. and other units, and pre-recognized the income of Wuhua County People's Hospital, and inflated operating income and profits.

《2019 In the 2020 Annual Report, Zijing Storage is suspected of inflating operating income and profits by conducting false business with Guangdong Huixin, Guangzhou Chuangxian Science and Education Co., Ltd.,

Suzhou Stratosphere, Huaian Ruichi, Zhuzhou CRRC Special Equipment Technology Co., Ltd.,

Zhaoqing Youshi and other units, as well as pre-recognizing the income of Shanxi Zijing Tianzhong Technology Co., Ltd. and Beijing Zhonghong Wisdom Technology Co., Ltd. In the 2020 Annual Report, Zijing Storage is suspected of inflating operating income and profits by conducting false business with Shenzhen Yuwei, Suzhou Stratosphere, Jiangsu Feliston, Huaian Ruichi, Guangdong Youshi, Zhaoqing Youshi, Chengdu Industrial Cloud Manufacturing (Sichuan) Innovation Center Co., Ltd., Hefei Ruida Robot Co., Ltd., Hefei Harbin Institute of Technology Lubo Robot Technology Co., Ltd., Hefei Harbin Institute of Technology Rongtai Power Technology Co., Ltd., Shenzhen Beidou Education Information Co., Ltd., Guangdong Weilan Data Information Co., Ltd., Guangdong Awei Information Technology Co., Ltd., and pre-recognizing the income of Guangdong Awei, Shanxi Zijing Tianzhong, Beijing Zhonghong, Inner Mongolia Zhonghong Zijing Technology Co., Ltd., and Hunan Shulian Zichen Information Technology Co., Ltd.

4. Case analysis

From the current accounting process, it is very difficult to falsify income. Especially for manufacturing enterprises, it involves four major business cycles (if the company has ERP, it is even more troublesome to falsify in the system). For example, in the purchase and payment cycle, if it is falsified, the BOM must be decomposed according to the sales order to generate the material demand plan. The missing parts in the inventory need to be purchased from suppliers. It involves the sales department, the purchasing department, the supplier, the warehouse and the financial department. The purchase forges the purchase order, the supplier receives the order, but does not actually ship the goods, issues a false invoice, and forges the delivery note. The warehouse department relies on the receipt to enter the warehouse, and the financial department is responsible for recording (PTP) accounts payable and inventory. It is also necessary to arrange payment (which may not be paid and has been on account for a long time) and collection (which may be returned outside the body). The production and inventory cycle requires the production department to forge production records (work orders, material collection, etc.), quality inspection records, and check the warehouse, delivery notes, and customers need to cooperate in forging the receipt (if it is a project system, acceptance documents are also required). The financial department also needs to calculate product costs and inventory receipt and storage records. Sales and collection cycle, the sales department colludes with customers to forge sales contracts, customers place sales orders, the sales department organizes shipments, asks the finance department to issue invoices, and then collects money from customers (it may be posted as accounts receivable, and after receiving the money, find a way to return it to the customer outside the body), and the finance department is responsible for confirming income, costs and accounts receivable according to these fake documents. Funds cycle, this is the most difficult, if there is no collection and payment record, it may be necessary to forge bank documents and bank statements. If there is a collection and payment record, how to return it to the customer and how to return the money from the supplier is also a problem. In addition, if it is a long-term account receivable, it will be necessary to collude with suppliers or customers during the annual audit to let them

stamp the confirmation letter. From this point of view, it is difficult to falsify income, costs and funds. From the handling of this case, it is speculated that the three departments of procurement, sales and finance conspired to forge documents and false records, and the production and manufacturing departments may not be involved.

Revenue recognition in advance may mean that all revenue is recognized after receiving advance payment, or the delivery record after the new year is brought forward to the new year, so that customers can sign for it before the new year. If it is project revenue, when the stage acceptance certificate has not been received, the documents are forged and the revenue is recognized in advance to embellish the performance.

Therefore, the auditors of the accounting firm involved in the financial fraud of Zijing Storage must have known about the entire fraud and may have participated in it, because the evidence of the fraud was forged, and it was easy to find clues with a little review. For example, by checking the integrity and authenticity of the documents in each cycle, and then confirming bank deposits, accounts receivable and accounts payable, and conducting physical inventory and applying analytical procedures, many problems can be found. Securities counselors have been conducting listing supervision and have more or less known about the performance fraud in the three years before listing, and are even suspected of participating.

In general, there are at least three levels of major risks in the Zijing storage fraud process, which are analyzed as follows:

First, there is a significant risk of misstatement in the financial statements. Zijing Storage has serious violations in the disclosure of financial statements and has seriously falsified many financial data, especially in terms of revenue and profit, which amounted to 25% of the actual total revenue in the past three years.

Secondly, in terms of the recognition level, Zijing Storage has the problem of unconfirmed returns of large-scale sales transactions. On the one hand, this behavior will lead to problems in inventory recognition, and on the other hand, it will lead to a false increase in main business income.

From an external perspective, Zijing Storage's means of inflating its revenue were not sophisticated and were full of loopholes, but they were not properly dealt with during the audit process of the accounting firm, indicating that Zijing Storage itself had an improper cooperative relationship with

the accounting firm. For listed companies, the audit report of the accounting firm is undoubtedly an important force for corporate supervision. This behavior will undoubtedly greatly undermine investor confidence.

5. Conclusion

In the case of Zijing Storage's financial fraud, it can be considered that there are serious flaws in multiple processes such as internal corporate supervision, accounting firm audits, and government supervision. In order to prevent and reduce the occurrence of similar financial frauds, companies, accounting firms, and governments need to work together to strengthen internal control, improve audit quality, improve the regulatory system, and strengthen regulatory enforcement. At the same time, it is also necessary to strengthen education and protection for investors and improve investors' risk awareness and self-protection capabilities.

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