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Analysis of the Financial Fraud Case of Hengli Industrial Development Group Co.,Ltd.

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Abstract

Under the circumstances where the regulation on delisting in the capital market is becoming stricter, financial fraud not only disrupts the market order, but also highlights the serious harm caused by the deviation of accounting ethics and business ethics. Hengli Enterprise, as a listed company in the automotive air conditioning industry, from 2020 to the first half of 2023, in order to avoid the risk of delisting and ensure the private compensation of senior management,through its wholly-owned subsidiary, constructed a closed loop of ethylene glycol trade without commercial substance, and adopted means such as falsely increasing revenue and profits, fabricating accounts receivable turnover rate,and forging fund flow to carry out systematic financial fraud. The cumulative false increase in operating income was 595 million yuan. Eventually, due to the exposure of fraud, it was delisted and suspended by the Shenzhen Stock Exchange. The relevant responsible persons and the auditing institution were all severely punished. This article takes this case as the research object, combines the core points of the new business ethics and accounting ethics courses, uses the fraud triangle theory to analyze the pressure,opportunity and excuse motivations of fraud,systematically sorts out the commercial ethics deviations of directors, supervisors and management in the fraud, and explores the deep reasons for audit failure from four dimensions: accounting firms, certified public accountants, the audited entity and the external environment. The research aims to reveal the implementation logic and harm of financial fraud, provide practical references for listed companies to strengthen corporate governance, adhere to the bottom line of accounting ethics, and improve the audit supervision system, and help the capital market develop healthily and orderly.

Keywords: Financial Fraud; Business Ethics; Audit Failure; Accounting Professional Ethics

1. Introduction

In recent years, financial fraud in listed companies has become a prominent problem affecting the healthy development of China's capital market. Against the background of increasingly strict delisting regulations, some listed companies have resorted to systematic financial manipulation in order to avoid delisting risks, maintain stock prices, and secure senior management compensation. Such behavior not only seriously distorts the authenticity and accuracy of financial information, infringes on the legitimate rights and interests of investors, but also undermines the integrity foundation of the market and weakens the effectiveness of regulatory mechanisms.

As an important part of corporate governance, business ethics and accounting professional ethics play a fundamental role in restraining management behavior, standardizing financial disclosure, and preventing financial fraud. However, in practice, deviations from business ethics and the absence of accounting professional ethics often become the internal driving force behind financial fraud. Under the combined effect of delisting pressure, institutional loopholes, and ethical anomie, financial fraud may evolve from individual misconduct into organized and systematic fraud, ultimately leading to severe consequences such as regulatory penalties, company delisting, and even social credibility crisis.

Taking Hengli Industrial Development Group Co., Ltd. as the research object, this paper systematically sorts out the specific methods and implementation paths of its financial fraud from 2020 to the first half of 2023, uses the fraud triangle theory to analyze the pressure, opportunity and rationalization motives behind the fraud, and deeply explores the ethical deviations of directors, supervisors and senior management in the fraud process. On this basis, the paper further analyzes the root causes of audit failure from four dimensions: accounting firms, certified public accountants, audited entities and the external regulatory environment. The purpose of this study is to reveal the internal logic and serious harms of listed companies' financial fraud under the current regulatory background, provide targeted suggestions for listed companies to improve corporate governance, strengthen business ethics construction, and standardize financial information disclosure, and also provide practical reference for regulatory authorities to optimize the audit supervision system and curb financial fraud, so as to promote the stable, healthy and orderly development of China's capital market.

2. Introduction to Financial Fraud Cases and Analysis of Fraud Methods

2.1. Introduction to Financial Fraud Cases

Hengli Industrial Development Group Co.,Ltd. is an automotive air conditioning industry enterprise that went public in 1996. From 2020 to the first half of 2023, the company implemented systematic financial fraud to avoid the risk of delisting, becoming a typical case of "delisting without exemption" in the capital market (Rezaee, 2005). The fraud was centered around its wholly-owned subsidiary, Hunan Hengsheng Tongpu International Trade Co.,Ltd., coordinating related parties upstream and downstream to fabricate fictitious ethylene glycol trading business without commercial substance. The specific methods included signing false purchase and sale contracts without clearly defined logistics and warehousing terms, achieving "documents passed but goods not delivered" ; constructing a false capital flow through third-party bridge funds to forge the appearance of repayment; fabricating complete sets of materials such as purchase orders, sales invoices, and logistics and warehousing vouchers to cover up the essence of the fraud (Dechow & Sweeney, 1996).

From 2020 to the first half of 2023, the company inflated its operating revenue by a total of 595 million yuan, with each period's inflation rate ranging from 47.77% to 74.24% . During the same period, it inflated its operating costs by 577 million yuan, and accumulated a fictitious profit of 17.8479 million yuan. After deducting the inflated portion, the company's actual revenue from 2020 to 2022 was all below 100 million yuan and its net profit was negative, triggering the delisting indicators continuously. After the fraud was exposed, the regulatory authorities imposed penalties, ordering the company to correct, warning it, and fining it 8 million yuan. A total of 19 relevant responsible persons were fined 31.40 million yuan, and the then chairman Ma Weijin and 5 others were subject to 3-5 years of securities market banishment measures; the company was additionally fined 11.50 million yuan for refusing to cooperate with the audit and failing to disclose the 2024 annual report on time. On July 16, 2025, Hengli Industrial was delisted by the Shenzhen Stock Exchange. The lawsuit filed by the company against the auditing institution to shift responsibility was not supported. In this fraud case, 3 directors, 5 independent directors, and 4 supervisors, who were aware of the abnormal trade business, still signed to certify the false financial reports as true, demonstrating serious dereliction of duty (Beasley, 1996).

2.2. Analysis of Fraudulent Tactics

2.2.1. The fictitious Trade Loop and Business Involving Ethylene Glycol Without any Commercial Significance

The ethylene glycol trade led by the then chairman was essentially a transaction that merely involved signing contracts without actual delivery of goods. The company signed false purchase and sale contracts with upstream and downstream affiliated or non-affiliated enterprises, forged purchase entry forms, sales exit forms, logistics documents, invoices, etc., as a complete set of transaction vouchers. However, no actual goods delivery or transfer occurred, and the trading process remained only on paper. The specific operation was carried out through the wholly-owned subsidiary Hengsheng Tongtong as the platform, coordinating upstream and downstream suppliers and customers, and establishing a"purchase-sale"false cycle (Dechow & Sweeney, 1996).

(1) Transaction design transformation: The signed trade contracts only stipulated quantity and price, but did not specify key commercial terms such as logistics storage, quality inspection, etc. The goods were directly transported from the supplier to the customer, the company had no entry records and did not bear the risk of inventory, which was a typical"signing but not delivering goods"empty circulation trade.

(2) Complete voucher forgery: Forged purchase orders,sales invoices, logistics documents, storage agreements, and acceptance reports, etc., as a complete set of transaction vouchers, to ensure "formal compliance" of financial records and avoid verification.

(3) False capital circulation: Through related parties or third-party bridge funds, a capital loop from "Hengli Enterprise→Supplier→Customer→Hengli Enterprise" was achieved, forging the appearance of capital flow and the authenticity of the transaction (Rezaee, 2005).

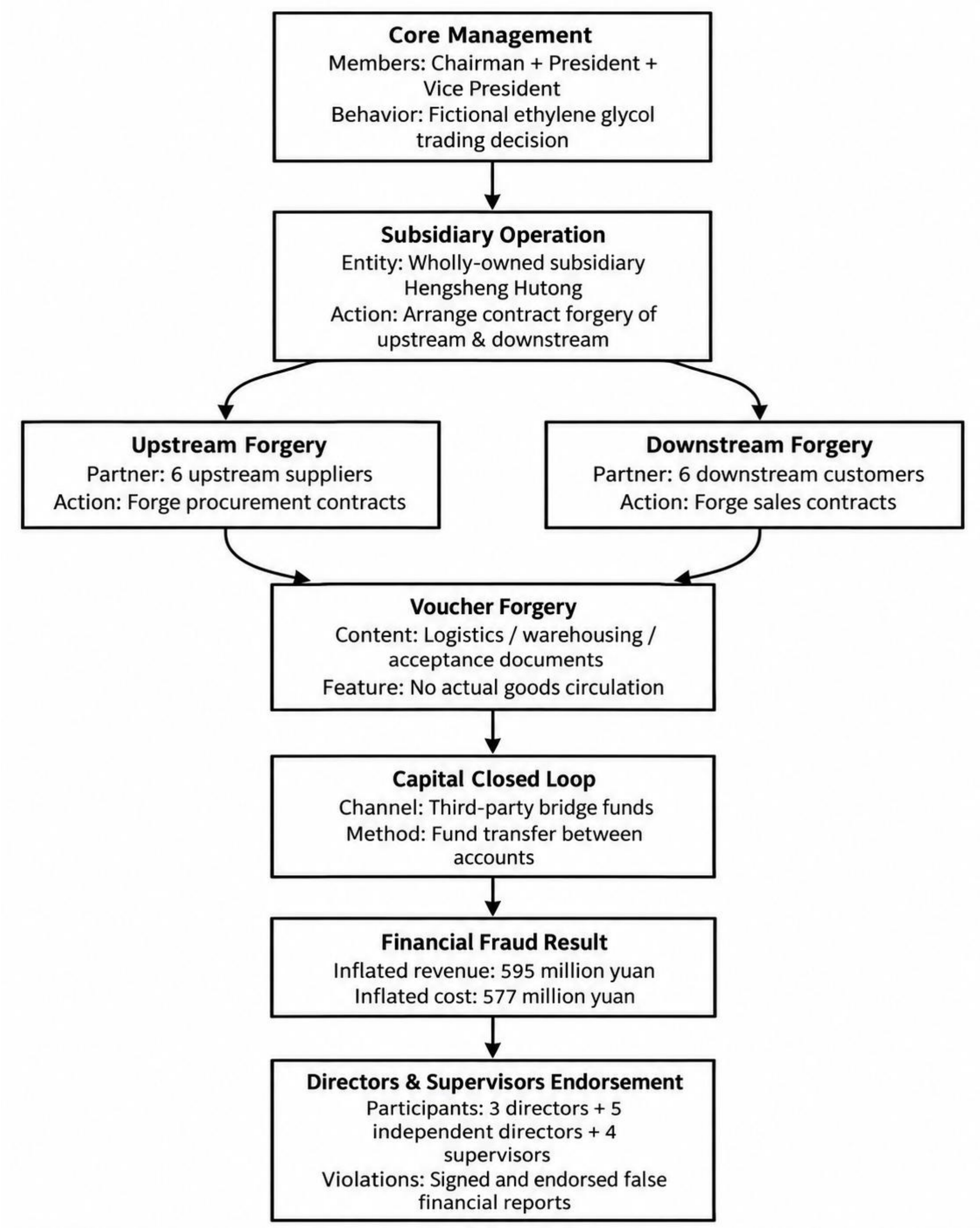

Figure 1. Hengli Industrial Trading Closed Loop

This method, by simultaneously inflating revenue and costs, essentially constitutes a blatant violation of the principle of honest operation in business ethics (Kaplan & White,1988).

Hengli Enterprise conducted a false ethylene glycol trade through its wholly-owned subsidiary, Hunan Hengsheng Interchange International Trade Co.,Ltd. This involved 12 enterprises engaged in coordinated false reporting (6 upstream suppliers and 6 downstream customers) , and a total of 117 counterfeit trade contracts were forged from 2020 to 2023 first half, with a combined contract amount of 623 million yuan (including value-added tax).

Table 1. Breakdown of Key Indicators of Fictitious Trade by Hengli Industria

During the period	Number of forged contracts(copies)	Contract amount(ten thousand yuan,including VAT)	Corresponding to inflated revenue(ten thousand yuan,excluding tax)	Number of upstream and downstream enterprises involved(units)
2020	42	23856.32	22705.71	10
2021	35	19021.65	18096.81	8
2022	26	14258.47	13565.58	6
First half of 2023	14	5163.56	5119.12	4

As shown in Table 1, the number of forged contracts shows a positive correlation with the inflated revenue scale. In 2020, when fraud was most severe, there were over 40 forged contracts in a single year, involving 10 upstream and downstream enterprises. Later, as the regulatory attention increased, the scale of fraud gradually shrank, but it still did not stop (Dechow & Sweeney, 1996).

2.2.2. Overstating Operating Income, Operating Costs, and Operating Profit

From a financial processing perspective, the company recorded fictitious sales revenue as part of the main business revenue, while inflating accounts receivable or monetary funds. Corresponding purchase costs were recorded as inventory or main business costs. In this way, it simultaneously expanded the scale of revenue and costs, creating a false prosperity of revenue growth (Rezaee, 2005).

From 2020 to the first half of 2023, Hengli Enterprise cumulatively inflated its operating revenue by 595 million yuan, inflated its operating costs by 577 million yuan, and accumulated a profit of 17.8479 million yuan.

Table 2. Details of Core Data on Financial Fraud of Hengli Industrial from 2020 to the first half of 2023

During the fraud period	Inflated operating income(ten thousand yuan)	Proportion of disclosed revenue for the current period	Inflated operating costs(in ten thousand yuan)	Proportion of disclosed costs for the current period	Inflated operating profit(in ten thousand yuan)
2020	22700	74.24%	22017.39	77.53%	688.32
2021	18096.81	52.27%	17512.21	53.90%	584.6
2022	13565.58	55.08%	13231.68	55.45%	333.9
First half of 2023	5119.12	47.77%	4941.15	50.43%	177.97

From Table 2, it can be seen that fraud exhibits a notable characteristic of decreasing scale but a high proportion: In 2020, the proportion of falsely inflated revenue exceeded 70%, reaching the peak of fraud;although the scale dropped to 51.1912 million yuan in the first half of 2023, the proportion of this amount in the disclosed revenue for the current period was still close to 50%. If the falsely inflated part is excluded, the company's actual revenue from 2020 to 2022 was only 78 million yuan, 165 million yuan, and 111 million yuan respectively, and the actual revenue in the first half of 2023 was only 56.2 million yuan, all of which have reached the delisting red line (Dechow & Sweeney, 1996).

2.2.3. Fictitious Accounts Receivable Turnover Rate

They artificially inflated the turnover rate to create the illusion of strong collection capabilities. They fabricated trade transactions without any substantive credit risk, resulting in a small amount of accounts receivable on the books and high revenue. This led to a fictitious turnover rate that was much higher than the actual value and significantly higher than the industry average, thereby masking the problem of weak main business collection. The company adjusted the bookable accounts receivable based on the proportion of fictitious revenue, preventing the fictitious turnover rate from being abnormally excessive and enhancing the credibility of the financial statements (Rezaee, 2005). From 2020 to 2022, the fictitious turnover rate rose and then declined, which was in line with the gradual reduction of the fictitious scale. In the first half of 2023, the fictitious turnover rate dropped to 4.49 times, still higher than the actual value of 2.35 times. This reflects that under the pressure of supervision, the intensity of fraud has decreased but has not stopped. After excluding the fictitious elements, the actual turnover rates in 2020 were 2.98 times, in 2022 4.79 times, and in the first half of 2023 2.35 times. The actual operating collection ability remained consistently weaker than the industry average, forming a sharp contrast with the fictitious indicators.

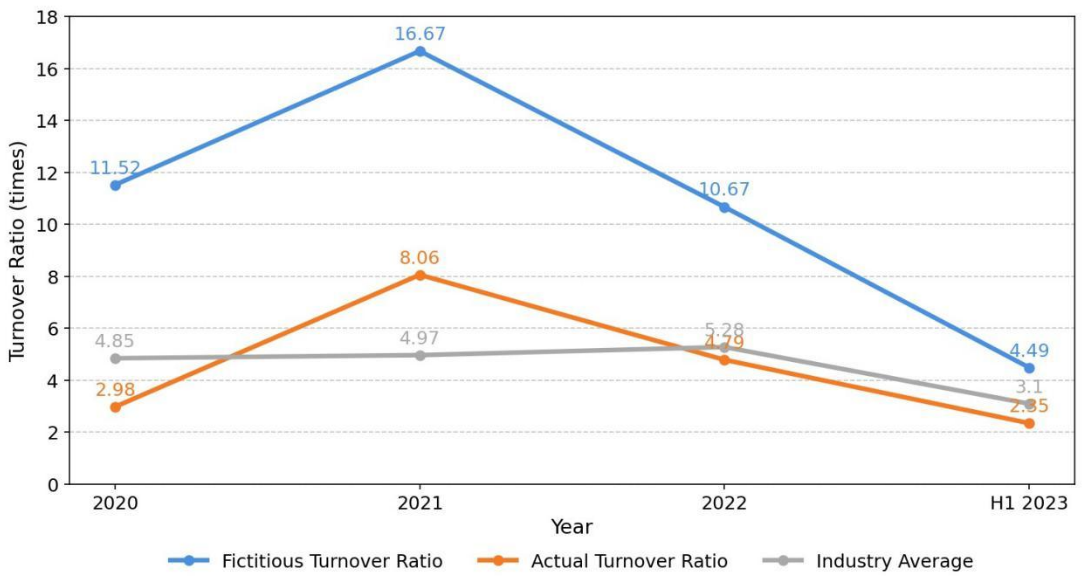

Figure 2. Trend Comparison of Accounts Receivable Turnover Ratios of Hengli Industrial

As shown in Figure 2, the fictitious turnover rate significantly deviates from the industry and the company's actual levels,and the high turnover rate without a reasonable explanation is an important signal of fraud (Messier, 2000). The significant difference between the fictitious turnover rate and

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the actual turnover rate indicates that there is artificial manipulation of revenue or receivables. The excessive difference between the fictitious and actual turnover rates suggests that there is intentional manipulation of the scale. The increase in fictitious scale is strongly correlated with the fluctuation of turnover rate. When the fraud is shrinking, the turnover rate also decreases simultaneously, which is in line with the fraud characteristic where indicators follow the fraud (Dechow & Sweeney, 1996).

2.2.4. Fraudulent manipulation of financial transaction records

From 2020 to the first half of 2023, Hengli Industrial mainly relied on its subsidiary Hengsheng Interchange. Through capital circulation without actual investment, document fraud, and the cooperation of third parties, they fabricated false capital flow records, forming a false capital loop to support the fictitious ethylene glycol trade, and matching the inflated revenue and receivables (Rezaee,2005). Hengli Industrial conducted capital transfers through three affiliated bridge companies,signed false purchase/sale contracts, and partially transferred funds through personal accounts to evade regulatory penetration.

Table 3. Core data of Hengli Industrial's fraudulent bridge funds from 2020 to the first half of 2023

During this period	Bridge funds transfer amount(ten thousand yuan)	Average cycle of capital turnover(days)	Number of fund transfers(transactions)	Proportion of non-actual receipts and payments
2020	22560.85	6.5	84	100%
2021	17890.32	7	70	100%
2022	13420.18	7.5	52	100%
First half of 2023	5028.65	8.1	28	100%

As shown in Table 3, from 2020 to the first half of 2023, a total of 589 million yuan was planned for fund transfer. The average cycle for fund turnover was only 7.2 days. The amount of bridge funds transferred decreased from 225.6085 million yuan in 2020 to 50.2865 million yuan in the first half of 2023, with a cumulative reduction of over 77%. The number of fund transfers also decreased from 84 transactions to 28 transactions, reflecting that under the pressure of regulatory inspections, the company gradually reduced the scale of fictitious capital idle circulation and attempted to lower the risk of fraud exposure. The proportion of actual receipts and payments in each period was 100%, confirming that all bridge funds only circulated between accounts and there was no actual fund receipt and payment corresponding to the real goods delivery, which was completely a false capital loop constructed for fictitious trade business and was a typical act of false capital flow fraud (Dechow & Sweeney,1996).

3. Analysis of the Causes of Financial Fraud

3.1. Pressure Factors: Dual Practical Motivations Driven by Regulatory Survival Guarantees and Private Compensation.

3.1.1. Meeting the Demand for Maintaining Afloat Status in Line With the Requirements of Delisting Supervision

Pressure is the core root cause that triggers financial fraud (Rezaee, 2005). The fraud pressure of Hengli Enterprise directly corresponds to the two practical motivations described in the textbook, namely "meeting specific regulatory requirements"and"maximizing personal compensation based on financial performance" . It is also the direct trigger that led it to cross the bottom line of accounting professional ethics (Kaplan & White, 1988).

The Shenzhen Stock Exchange has clearly stipulated that if a listed company's "revenue is less than 100 million yuan for two consecutive years and its net profit is negative" , it will be subject to mandatory delisting. Hengli Enterprise's actual revenue in 2020 was only 78 million yuan. Its actual revenues in 2021 and 2022 were 165 million yuan and 111 million yuan respectively, and its net profit was negative for three consecutive years. This has substantially triggered the delisting red line. To avoid delisting, the company inflated its revenue by 227 million yuan in 2020, raising it to 306 million yuan for disclosure; from 2021 to the first half of 2023, it continued to inflate its revenue, with the inflation ratio ranging from 47.77%to 74.24%in each period. Through financial fraud to create a false appearance of "revenue exceeding 100 million yuan" , the essence is to take risks to meet the practical needs of the"shell preservation threshold"set by the regulators (Dechow & Sweeney, 1996).

3.1.2. The Desire for Maximizing Personal Rewards

The compensation of the core executives of the company is directly linked to the revenue scale. This assessment mechanism has closely tied the private remuneration of the management team to the financial performance. To maintain high performance-based compensation and job stability, the management team actively led financial fraud (Jones, 1991). The then chairman Ma Weijin and the president Lu Youbang, among others, were fined 4.5 million yuan and 3.5 million yuan respectively for the fraud. This serves as a side evidence of their true intention of distorting financial data to obtain personal compensation,and also reflects the deviant behavior of prioritizing personal interests over accounting professional ethics (Cohen & Sharp, 1996).

3.2. Opportunity Factor: Institutional LoopholesResulting from the Railure of Corporate Governance and Internal Control

Opportunities are the necessary conditions for the implementation of fraudulent acts (Rezaee, 2005). The systematic flaws in the governance structure and internal control system of Hengli Enterprise provided an operational space for their practical motives of "staying afloat"and"seeking personal gain" , and also exposed the complete failure of the internal ethical supervision mechanism within the enterprise.

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3.2.1. The Collective Absence of Supervisory Responsibilities of the Governance Layer

The three directors, five independent directors and four supervisors of the company were all aware of the abnormal characteristics of the ethylene glycol trade,such as "no storage, no logistics, false orders but no delivery" . However, they failed to fulfill their supervisory and verification duties and instead signed off on the false financial reports as being true and accurate. This resulted in a collusion of fraud where the management was in control and the governance layer tacitly approved it (Beasley, 1996). Among them, the independent directors did not conduct independent investigations into the abnormal trade business as required, completely losing their independence. This violated their duty of loyalty to the listed company and its minority shareholders, causing the ethical supervision line of company governance to completely collapse.

3.2.2. Systemic Loopholes in the Internal Control Process

Hengli Industrial uses its wholly-owned subsidiary, Hunan Hengsheng Interchange International Trade Co.,Ltd., as the core entity for the fraud.This subsidiary is completely outside the control of the group's internal control system. The key executives of this subsidiary were fully responsible for signing false trade contracts, handling fund flows, and forging documents. At the same time, the finance department fabricated a complete set of transaction materials, including purchase orders, sales invoices, and logistics and warehousing agreements. They used the total method for accounting in the ethylene glycol trade to falsely increase revenue. Moreover, the internal control system did not conduct any effective review of the authenticity of financial documents or the compliance of accounting procedures, significantly reducing the probability of exposing the fraud (Dechow & Sweeney, 1996).

3.3. Excuse Element: Complete Failure of Accounting Professional Ethics and Business Ethics

The excuse is the psychological support for the perpetrators to rationalize their actions (Jones, 1991). The moral cognition distortion of the management and financial staff of Hengli Industrial Co.,Ltd. has clothed their practical motives of "stabilizing the company's position"and" seeking personal gain "with a"reasonable" appearance. This is also a typical manifestation of the "abnormal accounting professional ethics" covered by the course.

3.3.1. The Management's Incorrect Rationalization of the Fraudulent Behavior

The management misinterpreted the fraudulent behavior in the fictitious trade as "to prevent the company from going bankrupt and protect the interests of shareholders" , deliberately ignoring the serious harm that financial fraud causes to the order of the capital market and the rights and interests of small and medium-sized investors. After the fraud was exposed, the company not only failed to face up to its own responsibility, but instead sued the auditing institution in an attempt to shift the blame. This fully demonstrates the management's incorrect moral perception of the fraudulent behavior and also violates the core requirements of business ethics such as "honesty and trustworthiness, and responsibility assumption"(Hoffman & Patton, 1997).

3.3.2. The Professional Moral BBottom Line of Financial Personnel has been Violated

The company's financial staff participated in forging transaction vouchers and compiling false financial statements, violating the core requirement of the "Accounting Basic Work Specifications" that "accurately account and ensure the authenticity and completeness of accounting information" . They abandoned the professional bottom line of accountants, "objectivity, fairness, honesty and trustworthiness" , and became the direct executors of fraudulent behavior. This kind of behavior not only violated the basic norms of accounting ethics, but also led to the final distortion of the enterprise's financial information (Cohen & Sharp, 1996).

4. Analysis of Business Ethics Issues

4.1. Business Ethics Issues of Directors in Cases of Fraud Behavior

As the decision-making body of the company,directors have fiduciary obligations towards shareholders, including the duties of loyalty and diligence, which are the core requirements of "fiduciary responsibility" in business ethics (Jones, 1991). The directors of Hengli Industrial fully violated these obligations in the case of financial fraud, and engaged in the following unethical behaviors:

4.1.1. Violating the Duty of Loyalty and Harming the Interests of the Company and its Shareholders.

The duty of loyalty requires directors to act in the best interests of the company and not to seek improper benefits for themselves or their affiliated parties. Some directors of Hengli Enterprise, in order to maintain the company's "shell" status and boost the stock price for personal gain, led or tacitly approved the manipulation of financial statements through methods such as falsely increasing operating income, fabricating related-party transactions, and underreporting financial expenses. For example, when facing the risk of delisting due to consecutive losses, the board of directors collectively decided to use false purchase and sales contracts with affiliated parties to disguise non-operating income as operating income, thereby falsely increasing profits by over 10 million yuan. This action essentially prioritizes the short-term interests of " shell" preservation over the long-term development of the company and the fundamental interests of shareholders, violating the ethical commitment to shareholders in the "stakeholder theory" and also contravening the legal requirements of the directors'duty of loyalty stipulated in the " Company Law " (Beasley, 1996).

4.1.2. Violation of the Duty of Diligence, Failure to Fulfill the Responsibilities of Decision-Making and Supervision

The duty of diligence requires directors to make decisions based on professional judgment and thorough investigation, and to carefully verify the authenticity and accuracy of the company's financial reports. The directors of Hengli Industrial Company exhibited obvious "negligence" during the fraud process: Firstly, they did not raise any doubts about the abnormal financial data submitted by the financial department, such as a significant discrepancy between operating income and operating cash flow, or a significant deviation in the pricing of related transactions from the market's fair price,and failed to fulfill the ethical responsibility of "reasonable suspicion" ; Secondly, some independent directors did not independently express their opinions,and even "agreed unanimously" in the board resolution to the false financial report, becoming "token directors" . This violates the requirements of "responsibility ethics" in business ethics. Independent directors should act as representatives of minority shareholders to supervise the company's operations, but due to their failure to perform their duties, they became "accomplices" in the fraud, seriously damaging the ethical value of the independent director system (Kaplan & White, 1988).

4.1.3. Ethical Violations in Information Disclosure, Deceiving the Capital Market

The effective operation of the capital market relies on the true,timely and complete disclosure of information. This is the basic ethical responsibility of directors towards the capital market. The management team of Hengli Industrial knew that the financial statements contained false records, but deliberately concealed the fraud facts in regular reports and temporary announcements. They even misled investors by releasing "positive news about performance growth" . For example, at the annual report disclosure stage, the directors did not verify the authenticity of the financial data before signing and confirming, resulting in the dissemination of false financial information to the market, causing abnormal fluctuations in stock prices, and causing losses to small and medium-sized shareholders due to their erroneous investment decisions based on false information. This behavior violates the "principle of honesty and credit" in information ethics and undermines the information symmetry mechanism of the capital market (Cohen & Sharp, 1996).

4.2. Ethical Issues of Supervisors in Fraudulent Behaviors

As a part of the company's supervisory team, the core responsibility of the supervisors is to oversee the performance of duties by the directors and senior management, as well as to monitor the company's finances. Their ethical responsibilities stem from the ethics of supervision and accountability, as well as the ethics of public trust (Hoffman & Patton, 1997). The supervisors of Hengli Industrial Company completely lost their supervisory functions during the fraud incident, and the following ethical issues emerged.

4.2.1. The Supervisory Duties were Absent, and it Became Merely a Formal form of Supervision

According to the Company Law and the company's articles of association, the supervisory board is required to review the company's financial reports and propose corrective opinions on the violations of regulations by directors and senior management. However, during the period of financial fraud at Hengli Industrial Supervisory Board, they did not carry out any substantive supervision procedures: neither did they conduct random checks on the accounting records of the financial department, nor did they verify the authenticity of the related transactions. Even in the annual supervisory board report, they issued a false conclusion that "the company's financial reports are true, accurate and complete" . This "formalistic" supervision violates the principle of responsibility ethics. The supervisors received salaries but failed to fulfill their supervision obligations.Essentially, it is a betrayal of the responsibility entrusted by the shareholders and also violates the basic requirement of "keeping promises" in business ethics (Beasley, 1996).

4.2.2. Failed to Fulfill the Obligation of Supervision and Accountability, and Tacitly Permitted Fraudulent Behavior

When signs of financial fraud are detected among the directors or management, the supervisors have the obligation to report to the shareholders'meeting and demand correction. This is the core

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manifestation of the supervisory ethics. Some supervisors of Hengli Enterprise, after learning that the company inflated profits through fictitious transactions, chose to conceal the information due to concerns about "affecting the stability of the company" or being pressured by the management. They even assisted in destroying the evidence of fraud. This action not only violated the legal duties of the supervisors, but also crossed the bottom line of business ethics-placing the local interests of the company above the rules of the capital market and the public interests-allowing the fraud to continue, resulting in the continuous expansion of the scale of the company's financial fraud, and ultimately leading to severe penalties from the China Securities Regulatory Commission (Jones, 1991).

4.2.3. Infringing Upon the Rights of Minority Shareholders to Information Access and Supervision

The supervisory board is an important channel for minority shareholders to participate in the supervision of the company. The performance of its duties directly affects the protection of the rights and interests of minority shareholders. The supervisory board of Hengli Industrial failed to disclose any abnormal situations during the supervision process to the shareholders, nor did it respond to the shareholders' doubts about the financial data. This deprived minority shareholders of their right to know and their right to supervise.Such behavior violates the responsibility towards minority shareholders stipulated in the stakeholder ethics and neglects the ethical requirements of the"fairness principle"in the capital market.It further exacerbates the imbalance of interests between the controlling shareholder and minority shareholders (Kaplan & White, 1988).

4.3. Ethical Issues of Management in Fraudulent Behaviors

The management, as the executive layer of the company, bears the responsibility of operating on behalf of the board of directors and shareholders. Their ethical behavior directly affects the authenticity of the company's financial data and the compliance of business decisions. The management of Hengli Industrial (such as the financial director,general manager,etc.) are the direct implementers of financial fraud, and they exhibit the following ethical deviations:

4.3.1. Lack of Professional Integrity, Leading to the Manipulation of Financial Data

Honesty is the core ethical standard for professional managers. However, the management team of Hengli Enterprise, in order to meet the "shell protection" demands of the board of directors, directly planned and carried out financial fraud: Under the instructions of the management team, the financial department inflated income and profits by forging purchase and sale contracts, issuing false value-added tax invoices, adjusting accounting items,etc. The management team also used non-operational funds occupation with related parties to fabricate operating cash flow, thereby covering up the traces of financial fraud. This behavior violated the "honesty principle" in professional ethics and also violated the legal requirements in the Accounting Law for accounting personnel to "ensure the authenticity and completeness of accounting materials" . It was a complete betrayal of one's own professional ethics (Cohen & Sharp, 1996).

4.3.2. Violating Compliance Ethics, Disregarding Laws and Regulations as well as Internal Control Requirements

The management of the Hengli Industrial Company must conduct business activities within the framework of laws and regulations and the company's internal control system, which is a fundamental requirement of "compliance ethics" in business ethics. The management of Hengli Industrial deliberately evaded the company's internal control procedures to commit fraud: for instance, they bypassed the approval procedures for procurement and sales to sign false contracts, failed to make collective decisions on large-scale related-party transactions in accordance with the internal control requirements, and even tampered with financial system data to evade internal audits. This action not only undermined the effectiveness of the company's internal governance but also regarded laws and regulations as mere formalities, demonstrating the management's disregard for "legal ethics" , ultimately leading to the company being fined a huge amount by the China Securities Regulatory Commission for information disclosure violations and financial fraud (Hoffman & Patton, 1997).

4.3.3. Ignoring the Responsibility Towards Stakeholders and Thereby Harming the Interests of Multiple Parties

According to the stakeholder theory, the management team must take into account the interests of various stakeholders, including shareholders, creditors, employees, and suppliers. The fraudulent behavior of the management team at Hengli Industrial Co.,Ltd. led to a significant distortion of the company's financial situation: creditors made incorrect credit decisions based on false financial data, facing the risk of losing their debts; suppliers suffered losses due to the company's broken capital chain; employees face layoffs and pay cuts because of the company's delisting risk. The management team only focused on the short-term interests of the board of directors, ignoring their ethical responsibilities towards other stakeholders, and violated the core requirement of "interest balance" in business ethics (Jones, 1991).

5. Analysis of the Reasons for Audit Failure

5.1. Accounting Firm

5.1.1. Business Contracting Stage: Risk Assessment is Merely a Formality

The firm violated the principle of prudent operation in business ethics and failed to adequately assess the governance risks and fraud potential of Hengli Enterprise. Before accepting the business, it did not conduct in-depth due diligence on the performance of the directors, supervisors, and senior management, as well as the abnormal fluctuations in past financial data, and overlooked the high-risk signal of collusion for fraud by the core management (Messier, 2000).

5.1.2. Business Execution Stage: Insufficient Audit Procedures

Regarding the fictitious ethylene glycol trade of Hengli Industrial, the firm failed to conduct a thorough verification procedure. They neither verified the authenticity of the trading counterpart, nor visited the storage locations to confirm the flow of goods, nor analyzed the closed-loop nature of the fund transactions; for the abnormal phenomenon of the collective signature confirmation of false financial reports by the directors, supervisors and senior management, no additional auditing procedures were taken to verify the authenticity of their duties, and the auditing work merely remained at the superficial stage of data verification, completely deviating from the professional requirements of diligence and responsibility (Loebbecke & Willingham, 1989).

5.1.3. Audit Quality Control Aspect: The Review Mechanism is Ineffective

The quality control system of the firm failed to perform its supervisory role. Neither the internal review by the project team nor the independent review by the quality control department identified the flaws in the auditing procedures. The quality control personnel did not conduct strict verification of the audit evidence in areas with high risks of fraud such as abnormal growth in revenue and related party transactions, nor did they assess the rationality of the professional judgment of the certified public accountants. As a result, false audit opinions were issued (Trompeter, 1994).

5.2. At the Level of Certified Public Accountants

5.2.1. Lack of a Professional Skeptical Attitude and Ignoring the Warning Signs of Fraud

The certified public accountant violated the core professional ethics principle of maintaining professional skepticism. They ignored the abnormal signals such as the significant increase in ethylene glycol trading revenue of Hengli Enterprise without corresponding cash flow support, the single trading model and the lack of commercial rationality. In the face of the management's vague explanations of the trading details, they failed to maintain a questioning mindset and instead believed the management's statements, thus losing the first line of defense in detecting fraud (Messier, 2000).

5.2.2. Failure to Fulfill the Obligation of Diligence and Responsibility, Resulting in Insufficient Acquisition of Audit Evidence

The certified public accountant failed to conduct sufficient and appropriate audit procedures, and the obtained audit evidence lacked relevance and reliability. For instance, only written materials such as trade contracts and documents were obtained, but their authenticity was not verified; the process of sending confirmations did not maintain control, and there might be situations where the audited entity interfered with the confirmation results. This "formalistic" auditing behavior violates the professional standards for obtaining sufficient and appropriate audit evidence to support the audit opinion (Loebbecke & Willingham, 1989).

5.3. At the Level of the Audited Entity

5.3.1. The Core Management Team Colluded in Committing Fraud, and the Fraudulent Methods were Highly Covert

The core executives such as the chairman and the president were in charge of the fabricated trade, forging a complete set of transaction vouchers, forming a fraudulent pattern of collusion between upper and lower levels. The fraudulent methods were systematic and concealed. This collective fraud scheme by the management team broke through the verification scope of conventional auditing procedures,increasing the difficulty for certified public accountants to identify fraud (Rezaee, 2005).

5.3.2. The Directors, Supervisors and Senior Management Collectively Failed in Their Duties, and the Internal Supervision Mechanism Completely Broke Down

Three directors, five independent directors and four supervisors failed to fulfill their supervisory duties. They turned a blind eye to the false trade and financial reports and even signed off on them. As a result, the three lines of defense in internal governance (decision-making,supervision,and execution) collapsed completely. The internal unit lacked an effective anti-fraud mechanism, which was unable to provide reliable internal support for the auditing work.Instead, it provided a compliant cover for fraudulent activities (Beasley, 1996).

5.3.3. Deliberately Concealing the Facts of Fraud and Interfering with the Auditing Process

During the auditing process, the management deliberately concealed crucial information, made false statements in response to the inquiries of the certified public accountants, and even forged evidence to mislead the auditing judgment. After the fraud was exposed, they attempted to shift the blame onto the auditing institution, further highlighting their lack of an honest business philosophy and seriously disrupting the normal progress of the auditing work (Dechow & Sweeney, 1996).

5.4. At the Level of External Environment

5.4.1. Insufficient Regulatory Penalties and Low Cost of Violating Regulations

In some regions, the penalties imposed on the fraudulent acts committed by auditing institutions and the audited entities are relatively lenient, failing to exert sufficient deterrence. Compared to the gains from fraud, the cost of violating the law is relatively low, leading some accounting firms and enterprises to take risks and violate business ethics and professional standards (Rezaee, 2005).

5.4.2. The Industry Self-Regulation Mechanism is not Well-Established, and the Education on Professional Ethics Lags Behind

The regulatory role of the self-regulatory organization of the certified public accountants has not been fully exerted. The education on professional ethics for members and the punishment for violations are insufficient.Some certified public accountants lack continuous professional ethics training and have a weak sense of professional conduct, making it difficult for them to adhere to the professional bottom line in complex auditing environments (Cohen & Sharp, 1996).

6. Conclusion

This paper systematically analyzes the financial fraud case of Hengli Industrial Development Group Co., Ltd., revealing that under the dual pressure of delisting risk and personal compensation incentives, the company constructed fictitious ethylene glycol transactions without commercial substance through its wholly-owned subsidiary, inflated operating revenue and profits on a large scale, fabricated accounts receivable turnover rate and fund flow, and carried out systematic financial fraud. From 2020 to the first half of 2023, the cumulative inflated operating revenue reached 595 million yuan, which eventually led to the company's delisting and severe penalties for relevant responsible persons and the auditing institution.

Based on the fraud triangle theory, the study finds that the direct pressure of avoiding delisting and maximizing personal compensation was the core motivation for the fraud; the collective absence of supervisory responsibilities by directors, supervisors and senior management and the serious loopholes in internal control provided institutional opportunities for the fraud; while the complete failure of business ethics and accounting professional ethics became the psychological excuse for the management to rationalize the fraudulent behavior. In the fraud process, directors violated the duties of loyalty and diligence, supervisors failed to perform supervisory functions, and management abandoned professional integrity, all of which reflected serious deviations from business ethics and accounting professional ethics.

Furthermore, the audit failure in this case was the result of multiple factors. Accounting firms had formal risk assessment and insufficient audit procedures; certified public accountants lacked professional skepticism and failed to obtain sufficient and reliable audit evidence; the audited entity had management collusion, concealed fraud facts and interfered with the audit process; and the external environment had insufficient regulatory deterrence and lagging professional ethics education. The combination of these factors led to the failure of audit supervision and the smooth implementation of financial fraud.

The case of Hengli Industrial fully demonstrates that financial fraud in listed companies is a complex problem involving corporate governance, ethical construction, audit supervision and regulatory systems. To effectively curb financial fraud, listed companies should improve their corporate governance structure, strengthen the construction of business ethics and accounting professional ethics, and strictly implement internal control systems; accounting firms and certified public accountants should adhere to professional ethics, maintain professional skepticism, and improve audit quality control systems; regulatory authorities should increase penalties for financial fraud, optimize the regulatory system, and create a good market environment with integrity and compliance. Only through the joint efforts of all parties can we effectively prevent and curb financial fraud, protect the legitimate rights and interests of investors, and promote the healthy and sustainable development of China’s capital market.

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