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Research on Collaborative Governance of Financial Fraud in Listed Companies

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Abstract:The management of financial fraud in publicly traded companies is a critical issue affecting market stability and investor confidence. Recent regulatory actions underscore the urgency of addressing these challenges. Financial fraud not only distorts the economic order of markets, but also causes significant losses to investors through misleading financial statements and misallocation of resources. Effective cooperative governance is critical to curbing these harmful practices and safeguarding economic integrity. This study examines the root causes of financial fraud and proposes practical strategies for improving corporate governance and risk management in listed companies.

Keywords: Collaborative Governance; Financial Fraud; Listed Companies; Corporate Governance; Risk Management

1. INTRODUCTION

On October 9, 2020, the State Council of China issued the "Recommendations on Further Improving the Quality of Listed Enterprises", which emphasizes the need to optimize the internal structure and development environment of listed companies and enhance their sustainable development capabilities, so as to significantly improve the overall quality. This policy aims to encourage listed enterprises to better fulfill their social responsibilities, strengthen corporate governance structures, improve operation and management levels, and promote the healthy development of the market. In April 2022, the China Securities Regulatory Commission released the "20 Typical Illegal Cases in the Securities Supervision and Inspection in 2021", in which 6 listed companies were punished for suspected financial fraud. These cases demonstrate the regulators' determination to crack down on market violations and protect the investors' interests, strengthen the supervision and management of capital market order, and further improve the compliance awareness and risk control capabilities of listed companies.

Hence, the studies host the following meanings.

1. Financial fraud not only disrupts the normal order of the capital market, but also raises a number of urgent problems for government regulators and relevant managers.

2. Financial fraud not only has a negative impact on the healthy development of market economic order, but also causes serious economic losses to investors. For personal interests, fraudsters take advantage of information asymmetry to deliberately alter financial statements and even falsify data. These false financial data mislead the decision-making of other stakeholders, causing serious economic losses.

3. Financial fraud destroys the fair competitive order of the market, not only damages the rational allocation of resources, but also directly affects the interests of the company itself. This behavior has a negative impact on all parties.

4. Financial fraud poses the serious threat to the steady development of the national economy. Once it occurs, it will cause irreparable and significant losses. In order to reduce or even eliminate these losses and maintain a good economic order, it is necessary to fundamentally prevent the occurrence of financial fraud.

5. At present, the most effective way is to thoroughly analyze the causes of financial fraud and, on the basis of this analysis, formulate practical and feasible prevention and control measures to ensure the fairness and also transparency of the market.

Therefore, in the next sections, the detailed discussions will be provided

2. THE PROPOSED METHODOLOGY

2.1 The Definition of Financial Fraud

"China Certified Public Accountant Auditing Standard No. 1141 - Responsibilities Related to Fraud in Financial Statement Audits" defines financial fraud as the deliberate actions of management, governance, employees, or third parties associated with the audited entity, aimed at gaining improper or illegal advantages through deceitful methods. In 1999, Bologna G. Jack and Lindquist Robert J. introduced the renowned "Iceberg Theory" to vividly illustrate the factors influencing financial fraud. They divided the impact of financial fraud into two parts: the visible iceberg structure on the surface represents the objective aspect of organizational internal management, while the concealed part beneath the surface involves more subjective and individualized fraudulent behaviors. These behaviors are particularly perilous as they are difficult to detect, encompassing attitudes, values, incentives, and other facets. In 1995, W. Steven Albrecht proposed the well-known "Fraud Triangle Theory", asserting that three fundamental elements are necessary for corporate fraud: pressure, opportunity, and justification. Pressure serves as the motivation for committing fraud within the enterprise, encompassing financial pressures, addiction pressures, work-related pressures, and others, with financial and addiction pressures being particularly significant. Opportunities denote the circumstances enabling fraudulent acts within companies, including deficient internal controls, challenges in assessing work quality, inadequate punitive measures, and more. The existence and frequency of fraud opportunities are further influenced by regulatory frameworks, industry attributes, and various influential factors

2.2 The Causes of Financial Fraud in Listed Companies

Financial fraud within a company is often highly concealed and can exist for a long time without the outside world being

aware of it. Even if an audit is conducted and a standard audit report is issued with an unqualified opinion, this does not mean that there is no possibility of financial fraud within the company. On the contrary, such an opinion provides cover for potential misconduct because management or internal personnel can use this seemingly normal audit result to cover up the true situation. In order to pursue personal or corporate interests, management may take various measures to conceal financial fraud in order to prevent it from being discovered by external regulators or the auditors. This behavior not only increases the risk of corporate funds management, but may also violate legal and ethical standards. According to the demand theory in the GONE theory, management usually has the need to control the company's capital and obtain more funds, and also needs to maintain the company's continuous operation and development. Therefore, as the profit motive increases, the possibility of financial fraud in the company will also increase accordingly. This situation poses a potential threat to the company's business and reputation, and it is necessary to effectively prevent and combat the occurrence of financial fraud by strengthening internal supervision and transparency.

2.3 The Countermeasures for the Management of Financial Fraud in Listed Companies

Reasonable increase in the size of the board of supervisors and optimization of its member structure are aimed at ensuring its stability and maximizing its effectiveness in corporate governance. As a key governance institution, the scientific composition of the board of supervisors directly affects the company's operating conditions and governance effectiveness. By expanding the size of the board of supervisors, more supervisors with diverse professional backgrounds and experience can be introduced to increase the diversity and depth of governance. At the same time, by standardizing the composition of the board of supervisors and ensuring their independence and representativeness, it will help avoid excessive concentration of power and conflicts of interest, and further enhance the supervision and decision-making capabilities of the board of supervisors. The board of supervisors plays a key role in corporate governance. Its effective operation can not only reduce the company's regulatory costs, but also help improve the company's performance. By formulating a reasonable organizational structure and member structure, the board of supervisors can better perform its supervisory duties, promptly discover and correct possible mistakes or misconduct of management, and effectively prevent and reduce the risk of financial fraud. Financial fraud is often hidden in the complex system of a company's long-term operation, and it is difficult to be detected externally through superficial financial reports. In particular, when management chooses to conceal the actual financial situation due to profit-driven, the company's capital flow and financial risks may expand rapidly. In this case, the independence and professionalism of the board of supervisors are particularly important. They can independently evaluate and supervise the company's financial disclosures, ensure the authenticity and accuracy of the reports, and effectively protect the rights and interests of investors.

In addition, when combined with the demand factors in the GONE theory, management usually has a motivation to control capital and obtain more funds. This motivation may lead management to take inappropriate measures to increase profits, which may result in financial fraud. In order to maintain the long-term development and sustainable operation of the company, the board of directors should strengthen the constraints and supervision of management to ensure that the company's business activities are legal and transparent, thereby reducing the risk of financial fraud. In addition to adjusting the role and structure of the board of supervisors, attention should also be paid to the impact of the shareholding ratio of the largest shareholder on financial fraud. Studies have shown that the larger the shareholding ratio of the largest shareholder, the more serious the phenomenon of power concentration within the company, and the more the interests of small shareholders and investors may be harmed. Therefore, moderately reducing the shareholding ratio of the largest shareholder will help balance the corporate governance structure, enhance the voice of small shareholders, and thus reduce the risk of management abuse of power and financial fraud. While strengthening the internal governance structure of the company, ways to improve the quality of accounting information should also be explored. Improving the internal control system and ensuring timely and accurate disclosure of financial information can effectively prevent and detect financial fraud. In addition, strengthening the regulatory mechanism and making full use of the Internet and big data technology can improve regulatory efficiency, timely detect potential signs of financial fraud, and protect the interests of investors and the stability of market order.

3. CONCLUSIONS

The study underscores the importance of the collaborative governance in mitigating financial fraud in publicly traded companies. By examining root causes and adopting rigorous preventive measures, including strengthening board oversight and enhancing transparency in financial reporting, companies can strengthen their defenses against fraudulent activities. In addition, regulatory improvements and technological advances in monitoring mechanisms play a key role in early detection and prevention. Going forward, sustained efforts are essential to maintain the market fairness, protect investors' interests and ensure the sustainable development of the listed companies enhance the evolving economic landscape.

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