

Analysis of Financial Fraud Cases of Le.com

Siyuan Liu^{1,a,*}

¹Global Education, Guangzhou, China

a. 2822754966@qq.com

*corresponding author

Abstract: Le.com (formerly LeTV), as the first online video company listed in A shares in China, which plays a role as a weather vane for the online video industry, was reported to have committed financial fraud for up to ten years from 2007 to 2016, mainly by fabricating business with related companies and third-party companies to construct a false capital cycle. On May 2, 2021, the China Securities Regulatory Commission (CSRC) issued a penalty decision. By introducing the background of Le.com and its main fraud methods, based on the three major reasons of case analysis and fraud triangle theory, this paper focuses on the problems of its ownership concentration and imperfect audit system, and analyzes the specific motivation analysis of Le.com financial fraud.

Keywords: Le.com, financial fraud, fraud triangle theory, case analysis method

1. Introduction

In recent years, the China Securities Regulatory Commission (CSRC) has been making continuous efforts to prevent the capital market from operating illegally and making financial frauds. On January 21, 2022, the newly released document of the CSRC, Some Provisions on the Trial of Civil Compensation Cases for Infringement of False Statements in the Securities Market, made many changes based on previous shortcomings. However, the process to prevent financial fraud is really an obstacle and long. There are still many companies and their managers in the capital market who do not hesitate to take risks for their immediate interests. Le.com (formerly LeTV) is one of them. In order to prevent this kind of thing from happening again, and to detect and stop it in time, it is very important to use motivation analysis to find out the characteristics of such fraudulent events.

Le.com was founded in 2004 and was listed in A shares on August 12, 2010, becoming the first listed online video company in China. On April 2, 2021, the CSRC imposed a fine of RMB240.6 million on Le.com and a fine of RMB900,000 on Jia Yueting, founder of Le.com, for 10 consecutive years of financial fraud from 2007 to 2016; A fine of up to RMB240.3 million was imposed on Jia Yueting for the fraudulent issuance of Le.com's non-public offering in 2016; And a lifetime ban on Jia Yueting's participation in security markets.

Based on the case analysis and fraud triangle theory, this paper analyzes the motivation of Le.com's financial fraud from the perspectives of opportunity, pressure and rationalization. This paper analyzes the main loopholes of Le.com.com and the reasons why it is not perfect enough to make the fraud smoothly.

This paper is divided into the following parts. The second part introduces the research methods of this paper. The third part introduces the case. The fourth part analyzes the case motivation through fraud triangle theory; The last part summarizes the full text.

2. Research Methods

2.1. Case Analysis

Case analysis method, also called case study method, was developed by Harvard University in 1880 and later used by Harvard Business School to train senior managers and management elites. It has gradually developed into today's "case analysis method". The case analysis method mainly studies and analyzes the actual problems separately. It is one of the most practical research methods in business analysis [1,2].

2.2. Fraud Triangle Theory

The fraud triangle theory was proposed by Jane F. Mutchler, the founder of the Association of Certified Fraud Examiners (ACFE) and the current president of American Accounting Association (AAA). The president believes that the three elements of pressure, opportunity and rationalization constitute the occurrence of corporate fraud. Fraud triangle theory is commonly used in motivation analysis [3,4].

3. Case Subject Analysis

3.1. A Brief Description of the Case

Le.com (formerly LeTV), was founded in 2004. It was listed in A shares on August 12, 2010. It became the first listed online video company in China, enjoying the qualification of a national high-tech enterprise. Since then, it has gradually developed a number of related projects such as LeTV Sports and LeTV Film, and handed over the financial indicators for the first time in the industry. However, Le.com, a company ranked 17th in the same industry, with such an eye-catching network of financial indicators, is extremely suspicious.

In 2018, Le.com released its 2017 annual report, which showed that Le.com's revenue in FY2017 was RMB7,025 million, representing a year-on-year decrease of 68%. Net profit loss was RMB13,878 million, representing a year-on-year decrease of 2601.63%. Shu Lun Pan issued an "unqualified opinion" audit report on this annual report. BDO China stated that it was unable to obtain sufficient and appropriate audit evidence as a basis for expressing an audit opinion on the financial statements, which attracted the attention of the CSRC. On April 29, 2019, Le.com officially announced that the enterprise had received the notice of investigation from CSRC. On April 2, 2021, the CSRC completed its two-year investigation into the case and officially issued a penalty notice against Le.com. According to the report, Le.com had committed financial fraud for 10 years from 2007 to 2016, and there were false records in the documents relating to the application for initial public offering and listing of shares submitted and disclosed by Le.com and the annual reports for 2010 to 2016.

3.2. The Fraud Event

Prior to the listing, Le.com inflated its results by fictitious business through companies actually controlled by Jia Yueting and by creating a false capital cycle through bank accounts controlled by Jia Yueting, totaling RMB24,449,600. It also inflated its results by RMB199 million from 2007 to 2015 by cooperating with four other third-party companies to fabricate business in a similar way. In

addition, in the process of dealing with customers, Le.com falsely increased its profits by nearly 176 million yuan by pretending to be customers and collecting money. Among them, Le.com made up a profit of 98.0633 million yuan by pretending to be China Unicom. Finally in April 2010, through these inflated results, the listing conditions were satisfied and the listing was successful.

After the listing, Le.com, in addition to continuing to use the previous methods, also invented the advertising business to recognize revenue. In the absence of capital collection, accounts receivable were written off for a long time, inflated the business revenue and profit. At the same time, it reached the book balance by offsetting the accounts receivable with intangible assets and falsifying the corresponding amount of cost and profit.

3.3. Consequences of Fraud

On April 2, 2021, according to the administrative penalty decision issued by the CSRC against Le.com, the financial fraud and other bad behaviors of Le.com for ten consecutive years from 2007 to 2016 were affected. A total fine of RMB240,600,000 was imposed on Le.com, a total fine of RMB241,200,000 was imposed on Jia Yueting, the actual controller of Le.com, and a total fine of RMB600,000 was imposed on Yang Lijie, chief financial officer of Le.com.

On August 20, 2021, Jia Yueting filed an application for administrative reconsideration against the Administrative Punishment Decision and the Market Exclusion Decision made in the Administrative Punishment Decision [5-8] and the Market Exclusion Decision with the Securities and Futures Commission. The Securities and Futures Commission wrote in the Reconsideration Decision: In addition to failing to perform due diligence obligations as the chairman of Le.com, the applicant also acted as the actual controller to direct relevant personnel to make financial fraud and withdraw loans from Le.com, which led to the illegal and fraudulent disclosure of information by listed companies. The punishment of the acts directed by the actual controller has both factual and legal basis. Based on the above facts and circumstances, this case has decided to impose an administrative penalty and a market ban on the applicant. The law is correctly applied and the penalty range is appropriate.

Since then, the CSRC has temporarily suspended the punishment of Le.com and its main controller in the fake personal leave. However, as the actual controller of Le.com, Jia Yueting has not returned to the United States for a short-term business trip as early as July 4, 2017 after the debt crisis.

4. Case Analysis Based on Fraud Triangle Theory

4.1. Opportunity Factor

4.1.1. Internal Factors

The internal distribution of shares of Le.com is extremely concentrated. Before the judicial freeze of shares in Jia Yueting, he once held up to 92.07% of the shares of Le.com. He is also the CEO of Le.com. Le.com can be said to be his one-man. At the same time, as a listed company, Le.com has as many as 90 affiliated companies. Among these 90 companies, 14 are wholly-owned subsidiaries of Le.com, and nearly 70 other industries are directly or indirectly controlled by Jia Yueting. In this case, Jia Yueting can easily control these related companies to forge the capital circulation chain and cooperate in financial fraud.

4.1.2. External Factors

The audit system of the audit company contacted by Le.com is not perfect. The auditor of Le.com's annual report two years after it was listed on the Growth Enterprise Market in early 2007 was

REANDA, which produced an unqualified audit report. After the successful listing, Le.com changed its audit organization. For the next five years, the annual report of Le.com was audited by HPTJCPA. From 2015 to 2016, Le.com changed its auditor to ShineWing.

Although the above two institutions have highlighted matters in their audit reports, they issued standard unqualified audit reports. It was not until 2017, when Le.com revealed its financial problems, that the auditor's attitude changed. For the year of 2017, Le.com changed its audit institution to CBO China.

In 2018, Le.com released its annual report for 2017. The huge loss caused a shock in the industry. CBO China issued an audit report "unable to express an opinion" on this annual report. CBO China stated that it was unable to obtain sufficient appropriate audit evidence to form the basis of its audit opinion on the financial statements. This represents a very serious problem for the enterprise, and the relevant companies will be given special attention by the regulators.

4.2. Pressure Factor

For a capitalist, the biggest problem is how to obtain benefits. Making use of the stock market to cash in after the stock price is high is a quick way to get money. The prerequisite for obtaining cash in this way is listing, which is also a source of pressure for Jia Yueting in the early days of the establishment of Le.com. In order to meet the listing requirements as soon as possible, Jia Yueting began to commit financial fraud shortly after the company was founded.

Less than one year after the successful listing, Le.com's financial position began to deteriorate. From 2013 to 2015, Le.com's revenue from various businesses continued to rise, while its operating profit began to decline. In 2015, negative earnings even began to appear, which is one of the reasons for the continuous financial fraud after Le.com's listing.

4.3. Rationalization

Since 2014, Le.com has been working hard to create a complete ecological model. Jia Yueting believes that Le.com's choice of cross-border and vertical industrial integration can better meet the users' experience. Only by breaking down the barriers of professional division of labor can users experience better service. The management of the Company has been preparing Le.com for cross-border innovation, which naturally requires a large amount of funds to support. From 2009 to 2013, Jia Yueting himself insisted on his dedication to Super TV, but more than 90% of employees objected because Le.com was in a net loss state at that time. It was not until May 2013 that Jia Yueting's Super TV Plan was realized. In Jia Yueting's view, these financial frauds are a means to raise capital and innovate for the company. Perhaps it is his "contribution" to this that has enabled Super TV to be produced so quickly.

5. Research Conclusion

Based on fraud triangle theory and case analysis, through the specific analysis of Le.com from three aspects of pressure, opportunity and rationalization, it can be found that Le.com's financial fraud is mainly the responsibility of Jia Yueting. However, this is not an excuse for Le.com's other facilitators to get away with it. The financial fraud has a bad impact on the market, and any person who voluntarily participates in fraud is not innocent.

The financial fraud of listed companies is equivalent to providing false information to the entire market and the vast number of investors, damaging the market operation mechanism, challenging the authority of the CSRC and financial laws and regulations, and damaging the interests of investors, with extremely serious consequences. In order to avoid this kind of situation, all listed companies should truthfully disclose their transactions with related companies. Audit companies should conduct

more detailed inspection on the matters that cannot be confirmed as their authenticity, and carry out their main responsibilities of audit supervision. It is because only when each listed company discloses its true and fair financial statements to the public can it maintain the sound development and circulation of the securities market.

References

- [1] Bower, Joseph, and Stuart Gilson. "The social cost of fraud and bankruptcy." *harvard business review* 81.12 (2003): 20-20.
- [2] Ochs, Susan M. "The leadership blind spots at Wells Fargo." *Harvard Business Review* 6 (2016).
- [3] Manurung, Daniel TH, and Niki Hadian. "Detection fraud of financial statement with fraud triangle." *Proceedings of 23rd International Business Research Conference. Vol. 36. No. 8. 2013.*
- [4] Homer, Emily M. "Testing the fraud triangle: a systematic review." *Journal of Financial Crime* (2020).
- [5] China Securities Regulatory Commission {2021} 16.
- [6] "Decision on Administrative Punishment of China Securities Regulatory Commission (Le.com, Jia Yueting and Other 15 Responsible Subjects)".
- [7] China securities regulatory Commission no {2021} 7.
- [8] "Decision of China Securities Regulatory Commission on Prohibition of Entry into the Market (5 Responsible Entities including Jia Yueting and Yang Lijie)" www.csrc.gov.cn.