

## Original Paper

# Research on Financial Fraud of Selen Technology

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### Abstract

*China's Construction of High-quality Capital Market Holds Zero Tolerance to Financial Fraud of Listed Companies. Selen Technology was listed on the Shenzhen Stock Exchange in 2010. In 2020, it was disclosed by the CSRC that it had engaged in financial fraud for three consecutive years from 2016 to 2018, with inflated profits of up to RMB180 million. In this paper, Selen Technology is selected as a case company, and the motivation, means and causes of financial fraud are analyzed based on fraud triangle theory, and the corresponding governance measures are given.*

### Keyword

*Selen Technology Financial Fraud Fictitious Trade Business*

## 1. Introduction

With the development of capital market, there has always been a problem of financial fraud of listed companies, no matter in foreign countries or in China, financial fraud is still a problem. Although China's market supervision is constantly improving and the level of corporate governance is constantly improving, there are still loopholes, and some listed companies take advantage of these deficiencies to commit financial fraud. Financial fraud not only makes investors suffer huge losses, but also affects investors' confidence in the capital market to a certain extent. For this reason, our country has also actively promoted the process of securities market law, and has also promulgated the new "Securities Law" in 2020 to protect the creation of a good securities market environment. Based on this background, this paper selects Shenzhen Selen Technology as a case company to study financial fraud.

## 2. Company Profile

Selen Technology Co., Ltd. was established in December 2002. In 2007, the Company was changed into a company limited by shares and was listed on the Shenzhen Stock Exchange in 2010. It is a national high-tech enterprise. The main production and operation activities of Selen Technology are research and development, production and sales of advanced polymer composites and precision

processing of new materials. The core technology of the Company is high-end precision coating technology.

On June 26, 2019, Selen Technology received the Notice of Filing an Investigation from the CSRC on suspicion of illegal information disclosure, and the CSRC decided to file an investigation on the company. After investigation, it was found that Selen Technology committed financial fraud for three consecutive years from 2016 to 2018. The illegal facts are as follows: Selen Technology inflated its operating income by a total of RMB737,173,300, inflated its purchase cost by RMB538,901,000 and inflated its profit by RMB180,641,400 in 2016-2018. And did not disclose related party transactions or external guarantees as required. According to the relevant provisions of the Securities Law, listed companies should disclose information in accordance with the relevant provisions and ensure that the information disclosed is true and reliable, and should not be false records, misleading statements or material omissions. Selen Technology's behavior is contrary to the provisions of the Securities Law. The CSRC considers Selen Technology's behavior constitutes fraud and violates relevant laws and regulations. According to the illegal behavior of those responsible for Selen Technology, the severity of the illegal behavior and the degree of harm to the securities market, Selen Technology and related personnel are given warnings and fined. Table 1 lists the penalties imposed by the CSRC on Selen Technology and some personnel involved in fraud. A total fine of 1.77 million yuan was imposed.

**Table 1. Administrative Penalties of the Responsible Subjects Related to Fraud**

person liable	Position/role	Fine amount (ten thousand yuan)
Selen Technology	Subject of responsibility	60
Hou yi	CEO	30
Fu Bo	Vice chairman and president	15
Gao xiang	Vice President and Secretary	15
Ma suqing	CFO	10
Xiao Peng	vice-president	5
Wu Zhihua	Director and vice president	3

### 3. Analysis of Financial Fraud Motivation of Selen Technology

Fraud triangle theory believes that pressure is the direct cause of fraud. This paper refers to the annual report of Selen Technology from 2015 to 2020 and relevant data in wind database, and believes that the pressure of financial fraud of Selen Technology has the following aspects:

(A) the pressure brought by the transformation of enterprises

Under the new economic guidance, the development of some traditional industries has been restricted, the performance of the industries where some of the Company's businesses were originally located has declined, and the growth rate has continued to slow down. As a result, the market competition of the

Company's traditional businesses has become increasingly fierce, and the profitability of the Company's traditional businesses is much lower than before. In order to respond to the national policies and the pressure from external competition and development, Selen Technology must make changes and decide to carry out the traditional business transformation in 2015.

In order to meet the needs of the transformation, the Company has started to transform from scattered small customers to large customer service, transforming the customer scope of purification engineering business to high value-added industries such as pharmaceutical and food, and to the functional materials field. In addition, the Company terminated the implementation of projects with inefficient use of assets such as fresh air purifier products and shut down units such as purification equipment plants and packaging materials plants with poor profitability. The transformation measures implemented by Selen Technology have brought a lot of pressure to the operation of the enterprise. On the one hand, shutting down some old businesses significantly increased the current non-operating expenses; On the other hand, the new business expansion increases the expenses of the current period. At the same time, as the new business is under construction, it cannot bring new profits to the enterprise. Affected by this double pressure, the Company's profit level dropped significantly. As shown in Table 2, in 2015, the Company realized operating income of RMB1,024,096,600 and net profit of RMB106,152,000, representing a loss of approximately RMB194 million as compared with the corresponding period of last year. In addition, in order to ensure the smooth progress of the transformation, Selen Technology has made special long-term financing for a total of RMB3 billion in 2016. To sum up, the operating pressure brought about by the transformation of Selen Technology has set the stage for financial fraud of Selen Technology.

**Table 2. Comparison of 2014-2015 Financial Data (Unit: RMB10,000)**

project	2015	2014	change
Operating income	102,409.86	134,897.27	-24%
cost of operation	75,839.18	90,954.30	-17%
Cost of sales	10,111.67	10,739.42	-6%
Management cost	16,348.68	12,303.00	33%
financial expenses	5,977.74	6,606.07	-10%
trading profit	-11,226.69	10,453.19	-207%
Net profit attributable to owners of parent	-10,661.52	8,708.44	-222%

Data Source: 2015 Annual Report of Selen Technology.

## (2) delisting pressure

According to the regulations of Shenzhen Stock Exchange on delisting of listed companies, if a listed company has negative net profit for the first time in the fiscal year of the past year, negative net assets

and operating income of less than RMB100 million, the delisting risk warning will be implemented for stock transactions of listed companies; If this occurs for two consecutive years, the listing of its shares will be terminated. This will have a negative impact on the company's stock trading, so some listed companies have taken to the road of fraud in order to avoid being delisted. Selen Technology recorded its first significant net profit loss in 2015, and was unable to make up for the loss in the short term due to business expansion and industry transformation. According to the correction of accounting errors made by Selen Technology in the previous period, the actual net profit of Selen Technology in 2016 was -286,198 million yuan. If the actual situation is followed, Selen Technology will face the risk of terminating the listing of its shares. Therefore, in order to avoid the pressure of delisting, Selen Technology began to conduct financial fraud in 2016, inflated revenue and profit, and turned losses into profits, which made the enterprise avoid special treatment.

#### 4. Analysis on Financial Fraud Means of Selen Technology

##### 4.1 Inflated Revenue and Profit through Fictitious Trading Business

From 2016 to 2018, Selen Technology first signed purchase contracts with a number of suppliers controlled by Zhang Chunhe through its subsidiary Changzhou Selen, and then forged corresponding receipt documents for acceptance and warehousing; Then Changzhou Selen sells goods to many companies controlled by Zhang Chunhe, and forges corresponding outbound orders. The purchase and sale of materials in the whole trade business forms a closed loop. Of course, there is no real logistics in the above trade business. While forging the trade business, Selen Technology transferred a sum of money in the name of purchasing, including the tax payable and handling fee accrued according to a certain proportion, to the bank account controlled by Zhang Chunhe, and then transferred it to the bank account actually controlled by Selen Technology on the sales return date, and the corresponding receipts and payments formed a closed loop of funds, forming a fictitious business. From this, Selen Technology achieved the purpose of inflating income through these fictitious trades, and finally inflated profits.

##### 4.2 Failure to Disclose Related Party Transactions as Required

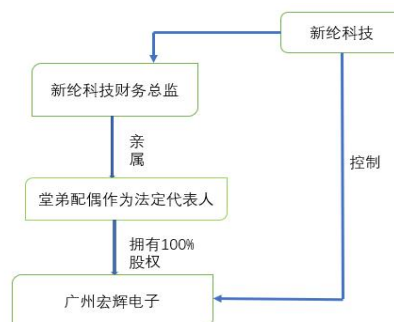


Figure 1. Relationship between Selen Technology and Guangzhou Honghui Electronics

According to the information obtained, the relationship between Selen Technology and Guangzhou Honghui Electronics is shown in Figure 1. And from January 2017 to September 2018, the daily operation activities and loan matters of Honghui Electronic are controlled by Selen Technology, so Guangzhou Honghui Electronic is a related party of Selen Technology. Figure 1 Relationship between Selen Technology and Honghui Electronics

Selen Technology paid a total of RMB483.2 million to Honghui Electronics during 2017 and 2018, and then Honghui Electronics transferred the funds back to Selen Technology with the same amount. In addition, between 2017 and 2018, Selen Technology and its wholly-owned subsidiary, Jin Yaohui, successively provided time deposit certificate pledge guarantee for the loans applied by Honghui Electronic to the banks, with the total amount of time deposit certificate pledge amounting to RMB603 million. The related party transactions between Selen Technology and Honghui Electronics in 2017 and 2018 totalled RMB1,086.2 million, and none of these related party transactions and external guarantees were disclosed in the notes to Selen Technology's 2017 and 2018 annual reports. Selen Technology chose to conceal its transactions with related parties, fabricate the cash flow of the enterprise, and use the time deposit certificate pledge guarantee provided by Selen Technology to Honghui Electronics to finance, and conceal the risks that the enterprise will bring with the guarantee, so as to achieve the purpose of inflated profits.

## 5. Analysis on the Causes and Economic Consequences of Financial Fraud of Selen Technology

### 5.1 Financial Fraud Analysis of the Causes

#### 5.1.1 Internal Factors

First, the ownership structure of the company is unreasonable. This paper intercepts the 10 shareholders holding more than 5% of the shares of Selen Technology in 2016. From Table 3, it can be seen that Hou Yi, then the chairman of Selen Technology, held 27.04% of the shares, which was far higher than the other shareholders. According to the principal-agent theory, Hou Yi, then the chairman of Selen Technology, had certain control over the company as a professional manager and had an absolute advantage in holding the shares. He did not put the interests of the company first in choosing financial fraud in order not to damage his own interests. Therefore, the unbalanced equity structure creates conditions for financial fraud.

**Table 3. Shareholders Holding more than 5% or the top 10 Shareholders of Selen Technology**

Shareholder name	Shareholder nature	shareholding ratio
Hou yi	Domestic natural person	27.04%
Guangxi Wansai Investment Management Center	Domestic non-state-owned	5.73%

(Limited Partnership)	legal person	
Shenzhen Xinlun Technology Co., Ltd.-Phase I Employee Stock Ownership Plan	other	5.01%
Shenzhen Qian Hai Ding Tai Hong Yuan Investment Partnership Corporation (Limited Partnership)	Domestic non-state-owned legal person	2.87%
China Industrial and Commercial Bank Co., Ltd.-Huaan Reverse Strategy Hybrid Securities Investment Fund	other	2.25%
Shenzhen Guo neng Jin hai investment management enterprise (limited partnership)	Domestic non-state-owned legal person	1.72%
citic securities co.,ltd	Domestic non-state-owned legal person	1.49%
Zhangyuan	Domestic natural person	1.46%
Shenzhen Hua hong run ze investment development co., ltd	Domestic non-state-owned legal person	1.43%
Zhang Qiang	Domestic natural person	1.25%

Secondly, the internal control mechanism fails. In its annual report for 2016-2018, Selen Technology clearly stated that the Company had carried out effective internal control, and the Board of Directors and the Board of Supervisors actively performed the audit and supervision functions. The fact is that the Company has committed financial fraud for three consecutive years. In addition, the management of the Company provided guarantees for bank loans to Guangzhou Honghui Electronics, Shenzhen Former Haibesman and Shenzhen Yixin Zhikong between 2017 and 2018 without the approval of the Board of Directors and the Board of Supervisors. It can be seen from this that the internal control of Selen Technology has the defect that the management is superior to the control, and the enterprise cannot effectively use its supervision and supervision functions, resulting in significant defects in the internal control related to financial reporting.

#### 5.1.2 External Factor

First, the audit institutions have failed in their duties. The auditors of Shin Lun Technology in 2016-2018 are all Asia Pacific (Group) Certified Public Accountants (Special General Partnership) firms, and the firm's audit opinion on Shin Lun Technology in 2016-2018 is standard unqualified opinion with emphasis of matter. According to the penalty announcement of the SFC, it can be found that during the audit of Asia Pacific Certified Public Accountants (SGP) in 2019, the risk of material misstatement was not properly identified and assessed. It can be seen from this that the internal management and quality control systems of Asia Pacific Certified Public Accountants (special general partnership) are not sound and cannot ensure the quality of audit practice. Selen Technology has indirectly provided an opportunity for fraud by selecting Asia-Pacific firms for cooperation.

Second, there is insufficient supervision. The external supervision of listed companies is mainly exercised by the China Securities and Exchange Commission, the Shanghai Stock Exchange (the "SSE") and the Shenzhen Stock Exchange (the "SZSE"). Before Selen Technology was investigated by the CSRC, the Shenzhen Stock Exchange would conduct inquiries against the Company's annual report from 2016 to 2018. However, it did not conduct in-depth investigation to discover the fraud of Selen Technology in a timely manner. It was not until 2019 that the CSRC began to investigate it. From this, we can see that our country's external supervision is still insufficient.

Third, the cost of financial fraud is low. The cost of fraud mainly refers to the punishment after being found, but the administrative punishment in our country is too light. According to the relevant laws of our country, the penalties for financial fraud are more fines and the amount of fines is small. For those who commit fraud, they are only fines or forbidden to enter the market, with few criminal penalties or criminal liabilities. The SFC imposed the maximum penalty on Selen Technology, but only 600,000 yuan. It gave a warning to Hou Yi, the head of the company, and imposed a fine of 300,000 yuan. The total fine was only 1.77 million yuan. The amount of punishment is not directly proportional to the benefits brought to the company by the fraud, so the low-cost punishment greatly breeds the ambition of financial fraud.

### *5.2 Analysis of the Consequences of Financial Fraud*

First, the market value of the Company has dropped significantly.

Since the listing of Selen Technology in 2010, the market value of the Company has been continuously rising. Since the disclosure of financial fraud, the reputation and reputation of the Company have been seriously affected, and the total market value of the Company has been significantly reduced. Especially after 2019, as of June 28, 2024, the closing price of Selen Technology shares has been lower than that of 1 yuan for 18 consecutive trading days. In addition, after the financial fraud incident, the company's senior executives resigned on a large scale, which had a negative impact on the company's long-term development.

Second, the company's operating conditions are worrying.

Since the financial fraud was reported in 2019, the operating results of Selen Technology have been declining year by year, as shown in Table 4. According to the new "Securities Law" and "Some Opinions on Strengthening Supervision and Preventing Risks to Promote High-quality Development of Capital Markets" issued by the State Council in 2024, as the lower of net profit before and after deducting non-profit for three consecutive years in 2021, 2022 and 2023 is negative, and the Company's audit report in 2023 shows that "there is uncertainty in the Company's ability to continue as a going concern", Selen Technology was ST in 2024 and is facing delisting risk.

**Table 4. Operation of Selen Technology from 2019 to 2023 (Unit: RMB10,000)**

age	2019	2020	2021	2022	2023
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Operating income	332,196.96	224,699.97	133,210.38	97,877.38	66,290.19
trading profit	-1,010.70	-117,521.86	-112,253.25	-117,837.34	-77,914.12
net profit	-109.27	-130,315.89	-127,667.29	-123,870.50	-94,967.73

Source: based on the annual report of Selen Technology.

Third, disrupting the development of capital markets

As a listed company, Selen Technology has financial fraud and related party transaction information disclosure irregularities, which have brought adverse impact on the development of the securities market. Investors' trust and investment in listed companies is the foundation for the development of the securities market. The irregularities of Selen Technology have caused a crisis of investors' trust in listed companies, and this crisis of trust is irreversible, which to a large extent affects the development of the securities market. At the same time, it also harms the interests of small and medium-sized investors.

## 6. Regulatory Measures and Suggestions

(A) to optimize the company's equity structure

A reasonable ownership structure can allow shareholders to check and balance each other, and can effectively suppress the occurrence of fraud. Optimize the ownership structure to prevent the individual interests of the majority shareholder from overriding the corporate interests and collective interests. As far as Selen Technology is concerned, the shareholding ratio of major shareholders should be reduced, so as to diversify the equity and avoid the situation of a single dominant shareholder, so that the shareholding ratio of each shareholder should not differ too much; Secondly, the enterprise can also increase the equity incentive to allow the small and medium shareholders of the company to obtain more benefits, which can effectively supervise the large shareholders.

(B) to strengthen the internal management of audit institutions

Audit institutions are an important part of external control, and effective audit can nip most financial frauds in the bud. Audit institutions should give full play to their roles and make good use of the rights granted by the market. The accountants selected by the audit institutions should have certain professional competence and good professional ethics. The audit institutions should strengthen the professional suspicion of the auditors and strictly follow the audit procedures to perform the audit work. Secondly, we must ensure the independence of audit institutions. Finally, the audit institutions should be flexible, the means of fraud of listed companies are more and more hidden and complex, which brings great difficulty to the audit. Sometimes the traditional audit methods cannot identify fraud, so the audit institutions should continuously improve the audit methods.

(three) to strengthen the Commission's penalties for illegal disclosure and financial fraud

It is the duty of the CSRC to protect the interests of the stakeholders of the listed companies. In order to ensure that the listed companies disclose the related party transaction information timely, truly and



completely in accordance with the relevant regulations to reduce the risk of financial fraud, the CSRC should strengthen the punishment and increase the illegal cost. Only when the illegal cost is far higher than the obtained benefit can the illegal behavior of the listed companies be controlled.

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