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FINANCIAL REPORT FRAUD IN LISTED COMPANIES: ACCOUNTING STRATEGIES INDUCED BY PERFORMANCE APPRAISAL STANDARDS

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Abstract: This study aims to explore the inducement effect of performance appraisal standards on financial report fraud in listed companies. Through literature review and theoretical analysis, it examines the accounting manipulation tactics and motivations employed by management under stringent performance standards from the perspectives of agency theory, behavioral economics, and corporate governance structure. The results show that excessively high performance appraisal standards significantly increase the likelihood of management engaging in inappropriate accounting strategies, such as inflating revenues, reducing costs and expenses, and adjusting fair values, leading to financial misreporting. The study suggests optimizing performance standards, strengthening corporate governance and external supervision, and utilizing big data and artificial intelligence to reduce financial fraud and enhance the transparency and fairness of capital markets.
Keywords: Financial report fraud; Performance appraisal standards; Accounting strategies; Corporate governance; Agency theory; Behavioral economics

1 INTRODUCTION

In the capital market, the financial reports of listed companies serve as critical information sources for investors, regulators, and other stakeholders in decision-making. The accuracy and transparency of financial reports are crucial for maintaining market order, protecting investors' rights, and promoting healthy economic development. However, financial report fraud not only undermines market fairness and efficiency but also erodes investor confidence and distorts resource allocation [1].

Financial report fraud refers to the manipulation of accounting data by listed companies, intending to mislead stakeholders about the company’s financial status and operating results. This behavior typically involves tactics like inflating revenues, reducing costs and expenses, and manipulating the timing of asset and liability recognition, aiming to boost profits, beautify financial conditions, or meet performance targets.

Performance appraisal standards are crucial criteria for evaluating the performance of listed company management, directly influencing the company's operational decisions and financial reporting behavior. Under performance pressure, some listed companies may adopt inappropriate accounting strategies to meet market expectations and performance targets, thereby inducing financial report fraud [2]. This phenomenon reflects that performance appraisal standards might induce financial fraud in listed companies to some extent.

This study aims to investigate the impact of performance appraisal standards on financial report fraud in listed companies, analyzing the motivations and methods of financial fraud under different performance standards. By conducting an in-depth study, this paper aims to reveal the relationship between performance standards and financial fraud, providing theoretical support and practical guidance for financial management, internal control, and external auditing of listed companies.

2 FRAUD MOTIVATION AND TACTICS

2.1 Motivations for Financial Report Fraud

From the perspective of motivation, one of the core drivers of financial fraud by management is to meet performance targets. Many studies indicate that management often manipulates financial data based on the motivation of maximizing short-term interests to enhance the company's market and stock performance, thereby maximizing personal or corporate short-term benefits [3]. Specifically, factors like salary incentives, equity incentives, and maintaining the company's listed status are key contributors to fraudulent behavior. Multidimensional design in performance appraisal standards inspired by interdisciplinary research can reduce fraud risk induced by single evaluation indicators [4].

Additionally, the setup of performance appraisal standards directly impacts the frequency and approach of financial fraud. Research suggests that high standards in profitability, asset quality, and capital return often impose significant performance pressure on company management, which then transforms into fraudulent motivations [5]. For instance, performance targets like "three consecutive years of profitability" or "achieving a 10% return on equity" may induce companies to engage in financial manipulation to meet the appraisal targets, including tactics like inflating revenues, underestimating costs, and reducing provisions for impairment and depreciation.

2.2 Tactics and Strategies of Financial Fraud

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Research indicates that under performance appraisal pressure, listed companies often adopt various accounting strategies to commit fraud. Revenue inflation is the most common tactic, typically achieved by overstating accounts receivable, notes receivable, and inventory [6]. This strategy enhances revenue and asset size without increasing actual business activities, thus beautifying financial statements. However, such tactics negatively affect cash flow, asset quality, and business performance in the long term, potentially leading to financial crises.

Reducing costs and expenses is another common fraud tactic. Listed companies often achieve this by reducing depreciation expenses, credit impairment losses, and asset impairment losses, thereby inflating profits [7]. This is often seen in capital-intensive and highly leveraged industries, such as manufacturing and real estate. Studies indicate that this manipulation not only impacts the accuracy of financial reports but also negatively affects the company’s future business development, as it will face higher cost and expense pressures in subsequent years.

Fair value measurement is also a common strategy for financial fraud. Fair value changes directly impact corporate profits, especially in the valuation of financial assets and investment properties. Company management can utilize market fluctuations or changes in valuation models to manipulate fair value, thereby artificially adjusting profit levels [8]. This tactic is particularly prevalent in financial and real estate sectors, where fraudulent behaviors are harder to detect by external auditors and regulatory authorities.

2.3 Impact of Performance Appraisal Standards on Fraudulent Behavior

Studies have found that the setup of performance appraisal standards significantly influences financial fraud in listed companies [9]. High-performance targets, such as "three consecutive years of profitability" or "achieving a 10% return on equity," can exert immense pressure on management, encouraging them to engage in fraudulent financial behavior. Furthermore, performance standards that overly emphasize short-term performance while neglecting long-term development often lead to short-sighted management decisions.

In different market environments and regulatory contexts, the impact of performance appraisal standards on financial fraud varies. In less regulated markets, financial fraud is more common, while in strictly regulated markets, although fraudulent behavior is somewhat suppressed, performance appraisal standards remain a key factor inducing fraud. This phenomenon suggests that financial fraud cannot be entirely eliminated through external supervision and auditing; improvements in internal control and corporate governance are also necessary [10].

2.4 The Role of Internal Control and External Auditing

Existing literature indicates that internal control and external auditing have some effect in curbing financial fraud, but the results are not ideal [11]. On one hand, the effectiveness of internal control depends on the enforcement of management and the improvement of internal supervision mechanisms. On the other hand, while external auditing can detect and correct financial fraud to some extent, its effectiveness is often limited by resources and the concealment of fraudulent behavior.

With the advancement of big data, artificial intelligence, and other technologies, financial fraud detection methods have improved. Studies show that using big data analytics and machine learning models can enhance the efficiency of detecting financial fraud [12]. However, the application of these new technologies still faces challenges such as data privacy, technical costs, and legal compliance.

To summarize, existing literature explores the motivations, tactics, and impacts of financial report fraud from different perspectives. Excessive performance appraisal standards play a significant role in inducing financial fraud, while internal control, external auditing, and new technologies can alleviate this issue to some extent. To further explore the relationship between performance appraisal standards and financial fraud, this study will conduct an in-depth theoretical analysis in the next section.

3 INDUCING FACTORS OF FRAUD

The occurrence of financial report fraud is closely related to the performance pressure faced by management in listed companies. In financial reports, performance appraisal standards not only reflect the performance goals of a company but also directly influence the decision-making behavior of management. To analyze the inducement effect of performance appraisal standards on financial report fraud more thoroughly, this section conducts a theoretical analysis from the perspectives of agency theory, behavioral economics, and corporate governance structure.

3.1 Agency Theory Perspective

Within the framework of agency theory, there exists a conflict of interest between shareholders (principals) and management (agents). Shareholders aim to restrict and motivate management through performance appraisal standards to maximize corporate interests. However, due to information asymmetry, management possesses more internal information about the company than shareholders do, motivating management to manipulate financial reports to meet performance targets and gain personal benefits. Particularly when facing stringent performance targets, management may inflate revenues or reduce costs to beautify financial data and avoid negative consequences from failing to meet targets.

Agency theory suggests that management's fraudulent behavior originates from the inconsistency of interests between shareholders and management. Some studies have indicated that the application of feedback mechanisms can improve management's adaptability to performance appraisal, reducing fraudulent motivations [13]. Although performance appraisal standards are designed to reduce this inconsistency, improper design may instead encourage management to engage in short-term speculative behavior, ignoring the company's long-term sustainable development. Higher performance standards, especially those overly focused on short-term profit indicators, may induce management to adopt inappropriate accounting strategies, resulting in financial misreporting.

3.2 Behavioral Economics Perspective

Behavioral economics reveals the behavioral biases that exist in management's decision-making process. According to Prospect Theory, decision-makers often exhibit strong risk preferences when facing losses, meaning they are more inclined to adopt aggressive strategies to avoid potential losses. Under performance appraisal pressure, management may believe that failing to meet performance targets will result in shareholder dissatisfaction or market value decline, thereby motivating them to commit financial fraud to conceal poor performance.

Furthermore, behavioral economics also indicates that management, when incentivized by short-term targets, tends to neglect long-term goals. Management may prioritize immediate benefits over long-term sustainability, especially when performance appraisal emphasizes short-term profits. This short-sighted behavior not only damages the company's long-term interests but also increases financial risks in the future. From the perspective of psychological intervention, appropriate mental adjustment can help management make more rational decisions under performance pressure, rather than resorting to short-sighted financial fraud strategies [14].

3.3 Impact of Corporate Governance Structure

Corporate governance structure significantly affects the quality of financial reports and the fraudulent behavior of management. A well-structured corporate governance framework can effectively restrict improper behavior by management, enhancing financial report transparency. Conversely, inadequate governance structures may provide opportunities for financial fraud. As part of corporate governance, performance appraisal standards should consider the company's long-term development strategy instead of merely focusing on short-term financial indicators.

In companies with weaker governance structures, the board's ability to supervise management may be limited, and internal control systems may be lax, providing management with more opportunities to manipulate financial reports. Under such circumstances, even strict external audits may find it challenging to detect management's fraudulent behavior. Additionally, if the audit committee lacks independence and expertise, or if the company lacks sufficient risk management mechanisms, performance appraisal standards may further induce management to commit fraud.

3.4 Specific Use of Accounting Strategies

Under performance appraisal pressure, management often employs various accounting strategies to achieve financial fraud. First, management may inflate revenues to meet short-term profit targets, typically by overstating accounts receivable and inventory, thus increasing sales and asset size. Second, reducing costs and expenses is also a key fraud strategy; management may lower credit impairment losses or understate depreciation expenses to reduce costs and increase net profits. Finally, management may manipulate fair value changes, particularly in investment properties or financial instruments, to adjust profits.

These accounting strategies allow management to artificially enhance financial performance in the short term. However, in the long run, these strategies inevitably harm the company's financial health and market reputation. Once exposed, financial fraud not only leads to legal penalties but also results in a loss of investor trust, potentially causing corporate bankruptcy. Therefore, although these strategies may appear effective in the short term, they actually increase financial risks and business instability.

3.5 Optimization of Performance Appraisal Standards

To prevent the inducement effect of performance appraisal standards on financial fraud, theoretical research suggests that performance appraisal systems should emphasize long-term performance and corporate sustainability. First, appraisal indicators should include long-term financial health and non-financial performance metrics, such as innovation capability, market share, and employee satisfaction, prompting management to focus on comprehensive development rather than merely pursuing short-term profits. Second, performance targets should be set reasonably to avoid overly aggressive targets that induce extreme accounting strategies. Integrating long-term performance rewards into appraisal systems can effectively reduce short-term fraudulent behavior.

Moreover, improving corporate governance structure is crucial to preventing fraudulent behavior. Enhancing the independence of the board of directors, increasing the audit committee's professional capabilities, and strengthening the internal control mechanism can effectively reduce financial report fraud risks. Continuous improvements in external regulation and market oversight also help increase the transparency and reliability of financial information in listed companies.

In summary, performance appraisal standards, as important management tools, may unintentionally induce financial fraud if poorly designed. Analyzing the impact of performance appraisal standards on financial fraud from the perspectives of agency theory, behavioral economics, and corporate governance structure can provide theoretical support and practical guidance for improving corporate governance and financial management.

4 DISCUSSION AND RECOMMENDATIONS

This study explores the relationship between performance appraisal standards and financial report fraud in listed companies, analyzing how these standards induce fraudulent behavior in financial reporting. The results indicate that financial report fraud is not merely a result of individual decisions by management but is also influenced by internal appraisal mechanisms, market environment, and corporate governance structure.

4.1 Relationship Between Performance Appraisal Standards and Financial Fraud

The research reveals that excessively stringent or singular performance appraisal standards exert immense pressure on management, prompting them to adopt inappropriate accounting strategies to achieve short-term performance targets. Under such circumstances, financial fraud becomes more prevalent and concealed. Management often utilizes multiple strategies, such as inflating revenues, reducing costs, and adjusting fair value, to beautify financial statements and meet both external market expectations and internal appraisal requirements. Specific targets, such as "three consecutive years of profitability" or "achieving a specified return on equity," further encourage management to engage in short-sighted behavior, leading to distorted financial information.

4.2 Consequences of Financial Fraud

Financial report fraud not only undermines the fairness and transparency of the capital market but also significantly impacts the company’s long-term development and market reputation. Exposure of financial fraud typically results in stock price declines, loss of investor trust, and potential legal risks. More importantly, such behavior may adversely affect the overall health of the industry and capital market, increasing market volatility and instability. Therefore, preventing financial fraud is not just an internal management task of companies; it requires the joint efforts of regulatory agencies, investors, and other stakeholders.

4.3 Measures to Prevent Financial Fraud

To prevent financial fraud induced by performance appraisal standards, several measures can be adopted. First, optimizing the design of performance appraisal standards is crucial. These standards should emphasize long-term performance and corporate sustainability rather than focusing solely on short-term financial indicators. Studies suggest that incorporating ethical education into performance appraisal systems can improve management’s ethical behavior, reducing fraudulent activities [15]. The diversification of appraisal indicators, including non-financial metrics such as market share, customer satisfaction, and innovation capability, can discourage management from adopting inappropriate strategies aimed solely at meeting specific targets. Research in educational models demonstrates that introducing diverse assessment methods helps cultivate more comprehensive professional skills, which can be applied to diversify corporate performance appraisal standards, thereby reducing financial fraud [16].

Strengthening corporate governance structures is another essential measure. Enhancing the independence of the board, improving the professional capacity of the audit committee, and increasing the effectiveness of internal supervision mechanisms can all contribute to reducing financial fraud. Improving internal control systems ensures that management adheres to generally accepted accounting principles in financial reporting, minimizing the risk of fraudulent behavior.

In addition, enhancing external supervision and auditing is vital. Regulatory agencies should intensify oversight of financial reporting in listed companies through random inspections, disclosure requirements, and market monitoring, ensuring timely detection and prevention of financial fraud. External auditing should play a more proactive role, utilizing big data analytics and machine learning technologies to enhance the efficiency and accuracy of fraud detection.

Lastly, adopting new technological methods is key to preventing financial fraud. Big data and artificial intelligence offer new possibilities for identifying fraudulent behavior. By conducting intelligent analyses of financial data, these technologies can help detect abnormal signals related to financial fraud early on, thereby increasing vigilance among management and auditing institutions.

4.4 Future Research Directions

While this study reveals the relationship between performance appraisal standards and financial report fraud, it also has some limitations. Firstly, the diversity and complexity of performance appraisal standards may be influenced by different corporate governance environments in practical applications, requiring further empirical research to verify the effects in different contexts. Secondly, future research could explore industry-specific differences in performance appraisal standards and financial fraud to provide more targeted recommendations for industry regulation and policy formulation.

In summary, listed companies should fully consider potential financial fraud when designing performance appraisal standards and improve corporate governance structures and internal control to achieve transparent and reliable financial reporting. The healthy development of the capital market relies on the accuracy and fairness of financial information. Therefore, curbing financial fraud is crucial for boosting investor confidence, optimizing resource allocation, and promoting sustainable economic development.

COMPETING INTERESTS

The authors have no relevant financial or non-financial interests to disclose.

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