

Analysis on the Motivation, Means and Governance of Financial Fraud of Listed Companies -- A Case Study of Evergrande Real Estate

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Abstract. Financial fraud seriously damages the order of the capital market and the interests of investors. This paper takes Evergrande real estate, a typical case of major financial fraud, as the research object. Based on the dual perspectives of fraud triangle theory and gone theory, it deeply analyzes its motivation, means and governance path of financial fraud. The study found that Evergrande's fraud is the result of the joint action of four-dimensional factors: pressure (need), opportunity, rationalization (greed) and exposure. The fraud means are very covert and systematic, mainly by falsely increasing income and concealing liabilities, falsely increasing income by 564.1 billion yuan and falsely increasing profit by 91.9 billion yuan in two years, the highest in history. On this basis, this paper puts forward targeted governance suggestions from the four dimensions of pressure/need, opportunity, rationalization/greed and exposure, so as to provide reference for preventing financial fraud in real estate enterprises, maintaining the order of the capital market and protecting the legitimate rights and interests of investors.

Keywords: fraud triangle theory, gone theory, evergrande real estate

1. Introduction

In recent years, financial fraud cases have occurred frequently in China's capital market. Typical cases such as Keller, Kangmei Pharmaceutical, and Kangde Xin have caused huge losses to investors and seriously disrupted the market order. The research shows that there are some problems in China's capital market, such as "the implementation of the delisting system for low-quality companies is not strict enough" and "the punishment for financial fraud on major shareholders and related intermediaries in the capital market is not enough", which leads to repeated prohibition of financial fraud.

In March, 2024, the CSRC made an administrative punishment decision on the illegal case of fraudulent issuance and information disclosure of Evergrande real estate bonds, which shocked the market: in 2019, the false income increased by 213.989 billion yuan and the false profit increased by 40.722 billion yuan; In 2020, the false income increased by 350.157 billion yuan, the false profit increased by 51.289 billion yuan, and the scale of fraud was much larger than that of any previous A-share company. As an estate giant with sales of more than 500 billion yuan, Evergrande's collapse

not only exposed its own governance crisis but also triggered a profound reflection on the causes and governance of financial fraud from all walks of life.

Scholars at home and abroad have carried out a lot of research on financial fraud, including motivation, means, impact and governance. In terms of foreign research, Albrecht's fraud triangle theory provides a classic framework for the analysis of the causes of financial fraud. Subsequent scholars have expanded on this basis, such as incorporating factors such as corporate governance and internal control into the triangle theory framework, which enriches the theoretical connotation. The gone theory proposed by Bologna further improved the analysis system of financial fraud motivation, emphasizing the important role of greed, exposure and other factors. In addition, foreign scholars also found that excessive concentration of equity, defects in the internal control system, and lack of audit independence are the main factors leading to financial fraud. At the same time, they put forward governance suggestions such as strengthening internal control, improving corporate governance, and strengthening supervision.

In domestic research, with the increase in large-scale financial fraud cases in recent years, domestic scholars' research on financial fraud is also deepening. Zhao Yanling and Li Tianfang, based on the theory of cones and taking Zeda Yisheng as an example, analyzed the causes of financial fraud of listed companies on the science and innovation board, and put forward suggestions on building an incentive and restraint mechanism and reshaping the internal control and defense chain [1]. Taking Guangdao digital as an example, Yao Xinyuan analyzed the causes of financial fraud based on the theory of gone, and found that the main reasons were equity concentration, internal control failure, and audit dereliction of duty [2]. Based on the fraud triangle theory, Xiang Yanshan analyzed the financial fraud case of Xilong Science, found that the operation and capital pressure, internal control defects were the main factors of fraud, and put forward suggestions on optimizing internal control and strengthening supervision [3]. In addition, for financial fraud in the real estate industry, Xu Yi analyzed the audit risks of real estate enterprises from the case of PWC auditing Evergrande Group [4]. Yu Xingxi suggested that the relevant laws and regulations should be clarified and that the punishment of the responsible person should be strengthened in view of the issue of Evergrande's false increase in profits and payment of dividends and salaries [5]. Evergrande Real Estate Group was established in 1996. At present, the legal representative is Zhao Changlong and the chairman is Liang Weikang. The company has developed more than 500 real estate projects in more than 180 cities across the country and has the first-class development qualification in China. Its projects include Evergrande Splendor World, Evergrande Oasis, and other series. At the beginning of its establishment, Evergrande Group rose rapidly with the expansion mode of "high turnover, high leverage and high debt". In terms of the mode, Evergrande relied on a large amount of short-term debt financing, bank loans, bond issuance and other channels to raise funds, resulting in the accumulation of a huge amount of debt in a short time. Finally, it had to cover up this fact through financial fraud. In 2020, the "three red lines" policy was introduced, and Evergrande's asset liability ratio, net debt ratio and cash short debt ratio after excluding advance receipts exceeded 70%, 100% and less than 1 times, respectively. In 2021, the commercial ticket is overdue and the cashing of financial products is difficult. It defaulted on its overseas bonds in 2022 and was filed for liquidation in 2023. The winding-up order was issued in 2024.

Among the theoretical tools for analyzing the causes of financial fraud, the most representative are the fraud triangle theory and the gone theory. Previous studies have used the fraud triangle theory to analyze the cases of Xilong Science and Jintongling, and used the gone theory to analyze the cases of Zeda Yisheng and Kangdexin. At present, there are more studies using a single theory for analysis and fewer studies on the integration of two theories, which makes it difficult to fully

reveal how financial fraud is formed. In particular, the case of the Evergrande group, which involves a huge amount of money and has a wide range of influence, still needs further research. Most of the governance suggestions put forward by the existing research are relatively general and lack pertinence to the real estate industry. Based on the fusion framework of fraud triangle theory and gone theory, this paper takes the financial fraud case of Evergrande group as the research object, verifies the applicability of the two theories in China's real estate enterprises, studies Evergrande's financial fraud cases to make up for the existing shortcomings, helps enterprises identify potential fraud risks and take preventive measures, and provides a more targeted reference for the prevention and control of financial fraud [6].

2. Analysis of the motivation of evergrande fraud based on the fusion of two theories

2.1. Fusion analysis of pressure dimension (triangle theory) and need dimension (gone theory)

Evergrande's strategic expansion pressure comes from its long-term pursuit of the development model of "high debt, high leverage and high turnover", which requires continuous investment of a large amount of funds. After the introduction of the "three red lines" policy in 2020, Evergrande stepped on all the lines, the financing channels were sharply narrowed, and the cycle of borrowing new to repay the old was unsustainable, facing huge financing regulatory pressure. In the same year, Evergrande's debt exceeded 700 billion yuan, with a high proportion of short-term debt and huge debt repayment pressure. The huge "need" has formed unbearable "pressure" and become the direct motivation for fraud. By inflated revenue and profits, Evergrande tried to maintain its financing capacity and cover up the debt crisis.

2.2. Common analysis of opportunity dimension

First, the ownership structure has major defects. Xu Jiayin holds more than 70% of the shares, forming the absolute control right of "one share dominates", and the decision-making lacks checks and balances. The CSRC found that Xu Jiayin "organized and directed the implementation of the above-mentioned illegal acts in the process of counterfeiting, with particularly bad means and serious circumstances". Second, the internal audit supervision is invalid. Evergrande's internal audit department lacks independence and authority. The appointment, removal and remuneration of auditors are determined by the management, so it is difficult to carry out audit work independently. Internal audit did not pay attention to the authenticity of financial statement data, major capital transactions and other core areas, resulting in more than 560 billion yuan of financial fraud not found by internal audit within two years. Third, the external audit supervision dereliction of duty. As Evergrande's external audit service provider for 14 years, PwC has obvious omissions in the relevant audit process. It has neither fully recognized the huge risks of Evergrande's ability to continue as a going concern nor solved many problems exposed in the audit process, but it still issued an unqualified audit report for Evergrande. These practices lack audit prudence, and whether they are due diligence is questionable.

2.3. Integration analysis of rationalization dimension (triangle theory) and greed dimension (gone theory)

First, driven by the fluke mentality of "big but not falling". The company believes that Evergrande is huge in scale, and the government will help it when there are huge risks, thus driving enterprises to commit fraud. Second, rely on the excuse of "industry practice". The enterprise believes that similar

operations are common in the whole industry, not just in Evergrande's case, so as to "normalize" the fraud. Third, guided by the value of "scale first". Under the value of "Being big is right", people believe that the means are not important, and the results are important.

Xu Jiayin's ambition to pursue "the world's top 500" has become the psychological driving force of fraud. Fourth, the lack of high-level ethics in enterprises. Greed, as a characteristic of the behavior subject and a psychological factor, makes it easy for the management to commit fraud [7]. It is reported that before and after the accident, Xujiayin transferred assets overseas by means of "technical divorce". This behavior of pursuing the maximization of personal interests fully reflects the role of the "greed" factor.

2.4. Independent analysis of exposure dimension (unique contribution of gone theory)

First, the audit exposure probability is low. PWC has issued unqualified opinions for 14 consecutive years, making the probability of fraud being found by audit almost zero. Some scholars pointed out that there were institutional defects in the determination mechanism of audit institutions, "people can not expect the accountants employed by the company to give adverse opinions on the company". Second, regulatory exposure lags. The CSRC needs an average of 1.76 years to disclose a fraud case, while Evergrande's fraud continued from 2019 to 2021 after the crisis broke out, and the exposure was seriously delayed. Third, the punishment is insufficient. Evergrande falsely increased its income by 564.1 billion yuan in two years and was fined 4.175 billion yuan. Xu Jiayin was fined 47million yuan, equivalent to 8300 yuan for every 100 million yuan of false income. Studies have pointed out that China's capital market "does not strictly enforce the delisting system for low-quality companies" and "does not adequately punish financial fraud", and the low cost of punishment weakens the deterrent effect of the "exposure" factor [8].

3. Analysis of evergrande's financial fraud means

3.1. Main methods of falsely increasing income

First, revenue should be recognized in advance. The revenue recognition of the real estate industry is usually based on the completion and delivery of the project. However, in order to inflate the revenue, Evergrande Group included the unfinished real estate projects in the revenue in advance. For example, some real estate projects of the Evergrande group have not been completed and have not reached the revenue recognition standard, but the company recognized the sales revenue of these projects in advance and included them in the current operating revenue by forging the project progress certificate, sales contract and other vouchers, thus falsely increasing the revenue. This method takes advantage of the complexity of income recognition in the real estate industry and has a certain degree of concealment. Second, fictitious sales. Evergrande Group's fictitious real estate transactions and inflated revenue by "buying and selling" with related parties. For example, a hidden related party is set up. The related party signs a false sales contract with the company and pays false fees. The company recognizes this part of the false transaction as revenue, thereby falsely increasing the operating revenue. Third, cross-period adjustment of income. Evergrande Group recognized the income in the later period in advance of the current period by adjusting the income over time, thus falsely increasing the income in the current period. For example, Evergrande Group will recognize part of the sales revenue in 2021 in advance of 2020, or recognize the unrealized sales revenue in advance of the current period, so as to achieve the purpose of falsely increasing the current revenue and profits and beautifying the performance.

3.2. Main methods of concealing liabilities

In order to beautify the company's solvency, Evergrande Group concealed its liabilities by various means. The main techniques include the following. First, not recognizing accounts payable. Evergrande Group has generated a large amount of accounts payable in the process of purchasing raw materials and engineering construction, but the company reduces the amount of current liabilities by not recognizing accounts payable. For example, after the company signed a purchase contract with the supplier and received the goods, it did not include the accounts payable in the financial statements, but concealed the accounts payable by delaying bookkeeping and other means, thus undervaluing the liabilities. Second, concealing contingent liabilities. Evergrande Group has a large number of contingent liabilities, such as illegal guarantees and pending litigation, but the company did not disclose them as required, nor included them in the financial statements, which is the real liability risk. For example, concealing the illegal guarantee provided for related parties involves a huge amount of money, which makes investors and creditors unable to understand the true debt status of the company. Third, underestimating the amount of liabilities. Evergrande Group reduced the total liabilities in the financial statements by underestimating the amount of liabilities when recognizing them. For example, when recognizing bank loans, bonds and other liabilities, the company underestimates the principal or interest of the liabilities, or underestimates the amount of liabilities by adjusting the measurement method of liabilities, so as to beautify the company's solvency.

3.3. Related party transaction manipulation

First, fictitious connected transactions. Evergrande Group has set up several hidden affiliated companies. These affiliated companies have equity or personnel connections with the Evergrande group, but they have not disclosed the relationship as required. Subsequently, it signed false transaction contracts with these hidden related parties, such as real estate sales contracts, engineering construction contracts, etc., fictitious transaction matters, and inflated revenue and profits. Second, unreasonably priced related party transactions. Evergrande Group used unreasonable pricing methods to transfer assets and profits when conducting transactions with related parties. For example, the company sells real estate projects to related parties at a price higher than the market price, falsely increasing the current income and profits, or sells the assets to related parties at a price lower than the market price, transfers the assets of the company, and damages the interests of the company. This unreasonable pricing method not only inflated the company's performance but also led to the loss of company assets. Third, concealing related party transaction information. Gu Qingyang and other researchers found that related party transaction manipulation is an important means of corporate profit manipulation, which is consistent with the case of Evergrande Group [9,10]. Evergrande Group failed to disclose the related information of related transactions as required, including the name of related parties, transaction amount, transaction content, pricing policy, etc., violating the relevant provisions of information disclosure, making investors unable to understand the true situation of related transactions and misleading investors' decisions.

3.4. Amount and impact of fraud

According to the decision on administrative punishment issued by the China Securities Regulatory Commission, in 2019, the false income increased by 213.989 billion yuan and the false profit

increased by 40.722 billion yuan. In 2020, the false income increased by 350.157 billion yuan and the false profit increased by 51.289 billion yuan. From 2020 to 2021, five corporate bonds were issued, raising a total of 20.8 billion yuan. They were issued based on false financial data and were eventually punished by 41.75 billion yuan. The financial fraud of the Evergrande group led to the fact that the financial data were completely inconsistent with the facts, misleading investors to make wrong decisions and thus suffered losses. In addition, Evergrande Group also guided banks, trusts and other financial institutions to provide financing by concealing liabilities and falsely increasing profits. Finally, the capital chain was broken, and the financial institutions were unable to repay the matured debts, resulting in huge bad debt risk. At the same time, as a leading enterprise in the real estate industry, the Evergrande fraud case led to a serious decline in consumer confidence in real estate enterprises, and the entire industry was impacted. At the same time, the debt crisis of Evergrande Group also affected other enterprises, such as suppliers and contractors, resulting in losses for these enterprises. Evergrande Group's financial fraud has also seriously damaged the order of the capital market, damaged the credibility of the capital market, and led investors to question the quality of information disclosure of listed companies. At the same time, this case also exposed loopholes in capital market supervision, auditing and other aspects, indicating the capital market's demand for improving laws and regulations. The suspension of several real estate projects of the Evergrande group led to the owners' failure to collect the houses on time. Since Evergrande was punished, the owners' rights protection incidents have occurred continuously, which has also jeopardized social stability. The huge financial crisis has also led to the unemployment of a large number of employees, increasing the pressure on social employment. Yu Xingxi pointed out that the dividends and remuneration paid by Evergrande Group for its inflated profits should be returned, which also reflected the damage of its fraud to social equity.

4. Conclusion

Based on the double perspectives of fraud triangle theory and gone theory, this paper systematically analyzes the financial fraud case of Evergrande Real Estate, and draws the following conclusions. First, Evergrande fraud is the result of the joint action of four-dimensional factors of "pressure+opportunity+rationalization+lack of exposure". The huge financing pressure and performance pressure (need) caused by radical expansion are the original motivation of fraud. The ownership structure of "one share dominates", the failure of internal control and audit dereliction of duty provide opportunities for fraud. The management's fluke mentality and greed provide a psychological excuse for fraud (rationalization/greed). The lag of audit and supervision and the lack of punishment have led to a low probability of fraud exposure and less punishment (exposure), which further connived at fraud. Second, Evergrande's fraudulent means are mainly to falsely increase income and conceal liabilities, which are large in scale and long in duration, causing huge losses to investors and seriously disrupting the order of the capital market. Third, governance of financial fraud needs to be multi-pronged. At the pressure/need level, people should optimize the financing structure and establish a reasonable assessment system. At the opportunity level, people should improve the equity balance, strengthen internal control and audit supervision. At the greed/rationalization level, people should build a culture of integrity and cultivate professional ethics. At the exposure level, people should improve the punishment, strengthen media supervision, and improve the reporting mechanism.

Corporate fraud needs to be dealt with from four aspects. At the pressure level, it is necessary to improve the performance evaluation and incentive mechanism, broaden the financing channels of enterprises, formulate rational strategic objectives, and prevent blind expansion. At the opportunity

level, it is necessary to improve the corporate governance structure and internal control system, such as improving the independence of the internal audit department, expanding the scope of audit, focusing on the compliance of connected transactions and the effectiveness of major investments. At the same time, the responsibilities of audit institutions are clarified, and AI technology is introduced to assist fraud identification. At the rationalization level, people should strengthen the moral training of employees and cultivate the enterprise culture of integrity. At the regulatory level, it is necessary to strengthen the supervision of information disclosure, improve transparency, and increase the punishment to improve the deterrent force. People will improve the investor protection mechanism, support investors to claim compensation from fraudulent enterprises through litigation, and improve relevant laws and regulations to effectively protect their legitimate rights and interests. In the future, research can be carried out in combination with technical tools for a large sample empirical test to further verify the universality of the research conclusion.

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