

Financial Fraud, Audit Failure, and Legal Consequences: A Case Study of Kangmei Pharmaceutical

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Abstract. This study investigates the financial fraud at Kangmei Pharmaceutical (SSE: 600518) through a case study that integrates the GONE theoretical framework with quantitative detection methodologies drawn from the literature. The company overstated monetary funds by up to RMB 36.188 billion, operating revenue by over RMB 20 billion, and operating profit by more than RMB 2 billion between 2016 and 2018, employing falsified bank documents, fictitious transactions, and related-party tunneling. Applying the GONE model reveals that greed (systematic fund extraction by the controlling shareholder), opportunity (concentrated ownership and failed internal controls), need (stock price hostage from 90%-plus equity pledges and aggressive expansion), and low exposure (years of unqualified audit opinions and disproportionate penalties) converged to sustain the scheme. The subsequent collapse triggered landmark sanctions: a CSRC fine of RMB 600,000 that prompted the 2020 Securities Law revision, a 12-year prison term for the chairman, and China's first special representative litigation awarding RMB 2.459 billion to 52,037 investors. The findings inform policy recommendations on corporate governance reform, audit firm rotation, and expanded investor protection mechanisms.

Keywords: financial fraud, Kangmei Pharmaceutical, GONE theory, audit failure, special representative litigation

1. Introduction

1.1. Research background and significance

Financial fraud in China's capital market has been a long-lasting and worrying problem. Early cheating cases like YinGuangxia and Green Land were followed by newer scandals in Kangmei Pharmaceutical and Kangdexin. This shows that false financial reports are still a long-term trouble in the market. These dishonest acts hurt investors' interests, make resource distribution go wrong, and make people lose trust in market rules. As the IPO reform based on registration system goes further, stopping and fighting false financial reports has become a common key task for regulators, researchers and market workers.

The fraud in Kangmei Pharmaceutical is one of the biggest cases in the history of China's A-share market. The huge amount of fake money, the complexity of the cheating ways and the long time of the whole plan make it a typical example. Kangmei reported 36.188 billion yuan more in cash than it

really had, and made its business income look 20 billion yuan higher than the real number. These acts greatly changed the company's real financial situation and fooled many people's investment choices. This case also led to China's first special class action for securities disputes. It is an important milestone for the development of the civil compensation system for securities, and it has long-term effects on the rule of law in the capital market.

Studying the Kangmei fraud carefully has many important meanings. It shows the hidden ways and clear signs of false reports made by listed companies. It gives investors a useful guide to find the risks of financial cheating. It also makes us think deeply about the problems in market supervision. It provides real evidence to make company management better, make audit checks stricter and improve the securities lawsuit system. So this study has both academic value and real use in practice.

1.2. Research methods and data sources

This paper uses the case study method, and it takes Kangmei Pharmaceutical as its main research object. By making a full review and deep analysis, it shows the ways, reasons and results of the fraud. Three specific ways help finish this study. The literature review method builds an analysis structure by learning domestic and foreign research on financial fraud. The case analysis method follows the development process, cheating ways and legal results of the Kangmei event in order. The comparative analysis method puts the Kangmei case together with other big fraud cases to find common rules and special features.

The data come from these sources: company financial data from yearly reports in the CSMAR (Guotai'an) database; legal papers from the China Securities Regulatory Commission (CSRC) Administrative Penalty Decision ([2019] No. 65) and Market Entry Ban Decision, as well as criminal and civil judgments from the Foshan Intermediate People's Court of Guangdong Province; and public materials from the Shanghai Stock Exchange. All data are from public channels, so this research is objective and can be checked.

1.3. Thesis structure

This paper has seven chapters. Chapter 1 introduces the research background, importance, methods and data sources. Chapter 2 reviews the theory and number-based studies on finding financial fraud. It focuses on GONE theory, the Fraud Triangle, the Beneish M-score model and logistic regression ways. Chapter 3 tells about Kangmei Pharmaceutical, including its development history, business model and corporate governance structure. Chapter 4 lists the order of events in the fraud case and analyzes the cheating methods and specific data. Chapter 5 uses the GONE theory to study the reasons for fraud from four parts—greed, opportunity, need and exposure. It also talks about audit failure and legal results that finally found and punished the fraud. Chapter 6 gives useful ideas and suggestions from the case. Chapter 7 is the conclusion of this paper.

2. Literature review

2.1. Theoretical frameworks: the GONE theory and the fraud triangle

Many writers have studied the basic ideas of financial fraud from criminology and accounting ethics. The Fraud Triangle Theory was first put forward by Cressey [1] and later improved for accounting use. It says fraud happens when three things come together: pressure, opportunity and

rationalization. Based on this basic framework, Bologna and Lindquist [2] created the GONE theory. It adds more details to the Fraud Triangle and breaks fraud reasons into four connected parts: greed, opportunity, need and exposure [3]. This gives a clearer way to study company financial cheating. In this study, we will use the GONE theory to look into the reasons and situations of financial fraud. Its four-part structure explains better how management goals, weak governance, money problems and rules work together in China's modern capital markets.

Using GONE theory to study Chinese financial fraud cases has changed a lot in the past ten years. Researchers use this framework to study famous company cheating cases in different market areas. Qi [4] did one early study with GONE theory. He looked at Ningbo Sunlight Electrical Appliances' financial fraud that used fake film copyright deals. He found that greed, opportunity, need and exposure together let executives, related parties and even law workers work together to cheat. Liu et al. [5] went further with this research. They measured each GONE part in the UniStrong case, a Beijing navigation tech listed company. They found that fake revenue of 1.58 billion yuan and fake profit of 521 million yuan came from big shareholders wanting cash, weak inner controls, worse money flow and light rule punishments. Luo [6] studied the Kaile Technology scandal. The company made fake private network communication deals from 2016 to 2020. He said many fraud reasons mean we need to improve inner management and outer supervision at the same time. Du [7] used the GONE framework for the Luckin Coffee scandal beyond A-share markets. He showed management stock pledges, weak inner controls, money pressure and low exposure cost together caused cross-border fraud. The fraud used related-party deals to fake revenue and costs. Pan [8] recently studied the Hui Chen Corporation case on the STAR Market. Five years of continuous fraud came from bad management morals, failed inner controls, pressure to meet goals and loose rule supervision. It shows special weak points on China's new high-tech board. These studies together prove GONE theory is a strong and useful way to study financial fraud in different Chinese rule situations.

2.2. Quantitative detection models: beneish M-score, logistic regression, and financial indicators

Many studies have helped develop statistical methods to find financial fraud in financial statements. The Beneish M-score model and logistic regression have become two of the most popular quantitative tools for this work. The Beneish M-score was created by Beneish [9]. It is a probability model to find fraud, and it includes eight financial ratios. They are the days' sales in receivables index (DSRI), gross margin index (GMI), asset quality index (AQI), sales growth index (SGI), depreciation index (DEPI), sales, general and administrative expenses index (SGAI), leverage index (LVGI), and total accruals to total assets (TATA). These ratios together show false revenue records, fake expense reports and unusual accrual items, which are common signs of fake financial reports. Logistic regression works well with the Beneish method. It is widely used to study whether fraud happens based on financial statement data and corporate governance traits. This method helps researchers calculate the chance of fraud while considering many risk factors at the same time [10]. This study will use both the Beneish M-score and logistic regression together. The goal is to find the financial signs that best predict fraud. Using both tools together can find unusual ratios and judge fraud probability with multiple factors.

Quantitative fraud detection models have spread from developed markets to new economies. Scholars have changed these methods to fit local market rules. Sabău et al. [11] first used the Beneish M-score and binary logistic regression together in the Romanian capital market. They studied 66 listed companies on the Bucharest Stock Exchange from 2015 to 2019. They found that

the gross margin index (GMI), asset quality index (AQI), depreciation index (DEPI) and total accruals to total assets (TATA) could clearly predict fraud. Their model reached an accuracy rate of 95.5%. Rahman et al. [10] combined theory and quantitative methods. They used the Fraud Triangle Theory with logistic regression to study Chinese A-share listed companies from 2010 to 2020. They found that higher leverage ratio and worse liquidity made fraud more likely. Higher return on equity, larger audit firms and more independent directors made fraud less likely. This study improved research methods by connecting crime theory with economic data analysis in China. Unlike Rahman et al. [10] who studied many samples, Su [12] focused on the first big financial fraud case on the Beijing Stock Exchange. Su studied Guangdao Digital with clear financial signs, such as accounts receivable turnover, changing gross margin and unusual cash flow. This showed that targeted financial analysis works well for studying one fraud case. In recent years, quantitative fraud detection methods have been changed to fit China's multi-level capital markets. They use both Beneish-related indices and company-specific financial data. However, few Chinese studies have combined Beneish M-score items with logistic regression into one predictive model. This leaves a valuable research direction that joins international methods with China's special market rules.

The theoretical frameworks and quantitative methods talked about above lay the analysis base for this study. The GONE theory gives a clear way to study the Kangmei Pharmaceutical case. It does not only look at single facts. It shows how greed, opportunity, need and exposure worked together to keep one of the biggest financial frauds in A-share market history. The next chapters will stop reviewing literature and focus on the case itself. They will first introduce Kangmei Pharmaceutical's basic company information and the event order of this important fraud case.

3. Overview of Kangmei Pharmaceutical Co., Ltd.

3.1. Corporate development history

Kangmei Pharmaceutical Co., Ltd. was set up in 1997 in Puning City, Guangdong Province. It was founded by Ma Xingtian and Xu Dongjin, a husband-and-wife team. The company first mainly produced traditional Chinese medicine (TCM) decoction pieces. In more than 20 years, it slowly built a complete industrial chain. The chain includes TCM decoction pieces, TCM materials trading, pharmaceutical logistics and medical health services. In March 2001, Kangmei Pharmaceutical was listed on the Shanghai Stock Exchange. Its stock code is 600518. It became the first listed TCM company in Guangdong Province.

After its IPO, Kangmei used the capital market to grow fast. The company built TCM materials trading markets, pharmaceutical logistics centers and smart pharmacy projects in many places across China. It kept expanding its business scope. From 2015 to 2017, the market value of Kangmei was over 100 billion yuan. It became the TCM company with the highest market value on the A-share market. Ma Xingtian was on different wealth lists for many times. The company was included in major indexes such as the SSE 50 Index and the CSI 300 Index. People widely regarded it as a top company in the TCM industry.

But behind the good performance numbers, Kangmei's financial data had hidden risks. The company always had a strange problem: it had large amounts of cash and high debt at the same time. It showed plenty of monetary funds on the books, but it also had heavy debts. This conflicting situation drew market attention in 2018. Then the CSRC started a formal investigation. It was the start of this huge fraud case. According to yearly financial report data from the CSMAR (Guotai'an) database, from the end of 2016 to the first half of 2018, Kangmei's monetary funds were 27.325 billion yuan, 34.151 billion yuan and 39.922 billion yuan. These numbers took up 49.84%, 52.30%

and 50.70% of its total assets. Nearly half of the company's assets were cash. At the same time, its total interest-bearing debt was 13.141 billion yuan, 23.977 billion yuan and 27.525 billion yuan. These debts made up 23.97%, 36.72% and 34.96% of total assets. Normally, no company will keep so much cash and so much debt at the same time. If the cash was real, the company should use it to pay back debts and cut financial costs. If the company really needed financing, it should not leave so much cash in low-yield accounts. There was a simple and surprising truth behind this strange structure. Most of the cash reported by Kangmei was not real, but its debts were real. At the end of 2017, the company said its monetary funds were 34.151 billion yuan. Later the real restated number was only 4.207 billion yuan. It overstated 29.944 billion yuan, and the fake part was nearly 93%. This financial structure of "fake cash, real debt" is the most important early warning sign to find Kangmei's fraud.

3.2. Industry position and business model

Kangmei Pharmaceutical is very important in the TCM industry. It is among China's largest producers of TCM decoction pieces. The company runs several production bases that meet GMP (Good Manufacturing Practice) standards. Its yearly production ability is more than 100,000 tons. It has invested in Bozhou TCM Professional Market, Puning TCM Professional Market and other trading centers. So the company controls key TCM trading channels in China. It also has great influence in TCM materials trading.

Kangmei's business model is based on full industrial chain integration. It covers the whole process from growing and buying TCM materials, to processing and selling to end users. The company has actively developed its Smart Pharmacy project. It tries to combine traditional TCM services with modern Internet technology to build a new medical service model. It also steps into medical and health services through projects such as Kangmei Health City and Kangmei Hospital. It forms a business structure of "Manufacturing + Trading + Services". This fast expansion brought huge money pressure. It also created conditions for the later financial fraud.

3.3. Ownership structure and corporate governance

Kangmei Pharmaceutical has a highly concentrated ownership structure. Its controlling shareholder is Kangmei Industrial Co., Ltd., and the actual controllers are Ma Xingtian and Xu Dongjin. Before the fraud was exposed, Ma Xingtian controlled about 32% of Kangmei's shares through direct and indirect ways. He also worked as Chairman and General Manager at the same time. Xu Dongjin worked as Vice Chairman and Deputy General Manager. This "family-run" governance structure put all decision-making power in the founding couple's hands. It greatly weakened the supervision roles of the Board of Directors and the Board of Supervisors.

At the corporate governance level, Kangmei had serious problems. The same person held the posts of Chairman and General Manager. This broke the basic rule of separating decision-making power and executive power, so internal checks and balances almost did not work. Independent directors did not play their supervision roles well. Many independent directors voted yes to the financial reports when the fraud was going on. The Board of Supervisors did not do its duties well and did not question the clear financial problems. The company's internal control system had big flaws. Approval of related-party transactions was just a formality, and fund management rules were not really carried out. These governance problems provided good conditions for carrying out financial fraud.

4. The full account of the Kangmei Pharmaceutical financial fraud incident

4.1. Incident timeline

The Kangmei Pharmaceutical financial fraud case unfolded through a sequence of pivotal milestones. In October 2018, media reports questioned the anomalous "high cash and high debt" coexistence at Kangmei Pharmaceutical, triggering consecutive limit-down trading days. On December 28, 2018, the China Securities Regulatory Commission (CSRC) launched a formal investigation. On April 30, 2019, Kangmei issued an accounting error correction announcement claiming that 2017 monetary funds were overstated by RMB 29.944 billion, sparking market uproar. On May 17, 2019, the CSRC announced preliminary findings confirming serious financial fraud. On August 16, 2019, the CSRC formally issued the Administrative Penalty Decision and the Market Entry Prohibition Decision. On May 21, 2020, Kangmei Pharmaceutical's stock received a delisting risk warning and the ticker changed to "*ST Kangmei." On February 20, 2021, the Foshan Intermediate People's Court of Guangdong Province delivered its first-instance criminal judgment, convicting Ma Xingtian and others of market manipulation and unit bribery. On November 12, 2021, the same court ruled that Kangmei Pharmaceutical must compensate 52,037 investors with RMB 2.459 billion. This verdict concluded China's first special representative securities dispute litigation.

4.2. Analysis of fraudulent methods

Kangmei Pharmaceutical's financial fraud was a complex and systematic scheme, with its core fraudulent methods manifested primarily in the following aspects:

4.2.1. Inflation of monetary funds

False reporting of monetary funds was the most important and serious way in Kangmei Pharmaceutical's financial fraud. The CSRC investigation shows that the company made its bank deposit balance higher by making fake and changing large-value bank papers. The steps were simple. Financial workers used false bank confirmation letters and made-up bank statements to create huge unreal monetary funds in financial reports. These fake papers looked very much like real ones. So common investors and auditors found it hard to discover the fraud.

The false numbers were extremely huge. At the end of 2017, the overstated money reached 29.944 billion yuan. It made up 93.18% of the monetary funds the company reported that year. Nearly 93% of the cash on the company's books was not real at all.

This false reporting of monetary funds directly caused the strange problem of "high cash and high debt at the same time". It is a key sign to find financial fraud. At the end of 2017, Kangmei Pharmaceutical said it had 34.151 billion yuan in monetary funds. But the real number was only 4.207 billion yuan. The falsely added money totaled 29.944 billion yuan. In the same period, the company's total interest-bearing debt reached 23.977 billion yuan. Nearly 93% of the book cash was unreal, but the borrowings were real. This structure of "unreal money, real debt" goes against normal business rules. A company with real cash usually pays back high-interest debt first to cut financial costs. On the other hand, if a company really needs much money, it should not leave large funds as low-yield cash for a long time. Kangmei made fake book cash to look like it had enough money. It wanted to keep market trust and make its stock price stable. But its real debt kept growing. This conflicting structure was questioned by the market in 2018. Then it caused a series of reactions and became the key point to find out the fraud.

4.2.2. Inflation of operating revenue

Kangmei Pharmaceutical made its operating income higher in many ways. The company made up trading business of traditional Chinese medicinal materials. It did unreal business with related parties or undisclosed related parties. In this way, it looked as if the company was running very well. The company also recorded some business income twice and recorded income too early. Besides, it overstated the trading volumes of traditional Chinese medicinal materials. The real volumes were much lower than the reported numbers. According to the CSRC Administrative Penalty Decision ([2019] No. 65), from 2016 to the first half of 2018, Kangmei inflated operating income by 8.999 billion yuan, 10.032 billion yuan and 8.484 billion yuan. These numbers took up 49.28%, 55.13% and 58.64% of the operating income it reported in these periods. The inflation ratio went up year by year, and the fraud became more and more serious.

4.2.3. Inflation of operating profit

As it inflated operating income, Kangmei Pharmaceutical also made its operating profit higher to beautify its financial reports. When it made up business and inflated income, the company also inflated costs and expenses at the same time. It kept a certain balance between unreal profit and unreal income. This helped it not to arouse doubts from auditors and regulators. According to the CSRC Administrative Penalty Decision ([2019] No. 65), from 2016 to the first half of 2018, Kangmei inflated operating profit by 656 million yuan, 1.251 billion yuan and 2.029 billion yuan. These unreal profits made up 30.29%, 40.47% and 65.52% of the disclosed operating profit. The proportion of unreal profit in disclosed profit rose greatly each year. It grew from about 30% in 2016 to about 65% in the first half of 2018. The fraud was almost out of control in the later period.

4.2.4. Related-party fund occupation

Kangmei Pharmaceutical had serious problems of related-party fund occupation. The controlling shareholder, Kangmei Industrial Investment Co., Ltd., and its related parties took money from the listed company in many ways for a long time. For example, they sent money to related parties in the name of prepayments. They also took money out of the company as investment and wealth management for related parties to use. They even sent money to related-party accounts through unreal purchase business. These activities greatly hurt the interests of the listed company and its small shareholders. It is a typical case of "tunneling" behavior. According to the investigation, the controlling shareholder and its related parties took tens of billions of yuan from Kangmei Pharmaceutical in total. The money was not paid back for a long time. This large loss badly influenced the company's normal business and financial condition.

4.2.5. Inflation of fixed assets and other asset items

Beyond inflating monetary funds, Kangmei Pharmaceutical also inflated fixed assets, construction in progress, and other asset items. The company overstated investment amounts of engineering projects and fabricated construction progress to conceal the fact that funds had been occupied. Several disclosed major investment projects had actual investments far below their book amounts. These discrepancies filled the gaps left by inflated monetary funds or were occupied by related parties. This "robbing Peter to pay Paul" operation allowed the balance sheet to appear balanced on the

surface. A substantial portion of assets was fictitious, and the company's true financial condition was far worse than the information disclosed.

4.3. Specific data on financial fraud

According to the CSRC Administrative Penalty Decision ([2019] No. 65), the specific data on Kangmei Pharmaceutical's financial fraud are presented in the tables below. These data reveal the scale and severity of the fraudulent conduct; the magnitude of the inflated amounts is staggering.

Table 1. Inflation of monetary funds at Kangmei Pharmaceutical (unit: RMB billion)

Period	Inflated Amount	Disclosed Amount	Inflation Ratio
End of 2016	225.49	271.15	83.16%
End of 2017	299.44	341.51	93.18%
End of H1 2018	361.88	399.22	90.65%

Data sources: CSMAR database; CSRC Administrative Penalty Decision ([2019] No. 65).

Table 2. Inflation of operating revenue at Kangmei Pharmaceutical (unit: RMB billion)

Period	Inflated Amount	Disclosed Amount	Inflation Ratio
2016	89.99	182.53	49.28%
2017	100.32	181.96	55.13%
H1 2018	84.84	144.67	58.64%

Data sources: CSMAR database; CSRC Administrative Penalty Decision ([2019] No. 65).

Table 3. Inflation of operating profit at Kangmei Pharmaceutical (unit: RMB billion)

Period	Inflated Amount	Disclosed Amount	Inflation Ratio
2016	6.56	21.66	30.29%
2017	12.51	30.92	40.47%
H1 2018	20.29	30.97	65.52%

Data sources: CSMAR database; CSRC Administrative Penalty Decision ([2019] No. 65).

The data reveal a clear trend of escalating fraud year by year. Inflated monetary funds rose from RMB 22.549 billion at the end of 2016 to RMB 36.188 billion at the end of the first half of 2018. The proportion of inflated operating profit to disclosed profit surged from 30.29% in 2016 to 65.52% in the first half of 2018. The scale expanded continuously, the degree deepened progressively, and the situation ultimately spiraled beyond control.

5. GONE framework analysis: motivations, audit failure, and legal consequences

5.1. Greed and Need: the internal drivers

The Greed and Need dimensions of the GONE theory capture the internal forces that propelled Kangmei's fraud — the moral deficiency of the perpetrators and the situational pressures that made

fraud appear necessary [2]. These two dimensions operate in tandem: greed supplied the willingness, while need supplied the urgency.

Greed: wealth extraction at all costs. The controlling shareholder, Ma Xingtian, controlled approximately 32% of Kangmei's shares through direct and indirect holdings while concurrently serving as both Chairman and General Manager [13, 14]. This concentration of ownership and managerial authority blurred the boundary between corporate assets and personal wealth. Kangmei Industrial Investment and its affiliates cumulatively occupied tens of billions of RMB from the listed company through advance payments, fictitious investments, and false procurement transactions [13]. These activities constitute classic tunneling — the expropriation of corporate resources by controlling shareholders [15]. Ma was also convicted of unit bribery for arranging payments to government officials, demonstrating that criminal means had become routine business practice [16]. The equity pledge ratio exceeding 90% of his holdings revealed a controlling shareholder who treated the listed company as a personal financing vehicle rather than a sustainable enterprise [14].

Need: the "stock price hostage" mechanism. The urgency to maintain stock price created an existential imperative. Prior to the fraud's exposure, Ma Xingtian and his concert parties had pledged more than 90% of their shareholdings as collateral for loans [14]. Any significant stock price decline would trigger margin calls and potential loss of control. Financial fraud thus became the instrument for artificially sustaining market confidence. Meanwhile, aggressive nationwide expansion — TCM trading markets, pharmaceutical logistics centers, smart pharmacies, Kangmei Health City — required capital that actual operating cash flows could not sustain [13, 14]. The discrepancy between reported and actual monetary funds grew from RMB 22.549 billion at the end of 2016 to RMB 36.188 billion by the first half of 2018, while interest-bearing debt expanded from RMB 13.141 billion to RMB 27.525 billion [13, 14]. This trajectory reveals a company whose real financial resources were progressively overwhelmed by its ambitions. The result was a self-reinforcing cycle: fraudulent statements enabled financing, which funded expansion, which generated additional capital demands, which necessitated further fraud [17].

5.2. Opportunity: governance failures as structural enablers

The Opportunity dimension identifies the structural conditions that allowed fraud to be planned, executed, and concealed [2]. At Kangmei, these conditions were pervasive.

"Family shop" governance. Ma Xingtian controlled approximately 32% of shares while serving as both Chairman and General Manager; Xu Dongjin served as Vice Chairman and Deputy General Manager [13, 14]. This structure violated the fundamental principle of separating decision-making authority from executive authority [18, 19]. Material decisions could be made unilaterally without meaningful deliberation or oversight.

Failure of internal checks. The Board of Supervisors raised no substantive questions despite the sustained "abnormal co-existence of high cash and high debt" anomaly persisting for multiple years [13, 18]. Multiple independent directors cast affirmative votes on financial reports containing material misstatements, effectively rubber-stamping fraudulent disclosures [13, 18]. Related-party transaction approvals were purely perfunctory: transactions involving billions of RMB were approved without substantive review [13]. Fund management systems existed in name only, with no effective mechanisms to monitor large-value fund flows.

Audit failure as a critical external enabler. Guangdong Zhongzheng Zhujiang Accounting Firm served as Kangmei's long-term auditor and issued unqualified opinions throughout the fraud period [13, 20]. The auditors failed to effectively execute bank confirmation procedures, did not identify forged bank confirmation replies, and neglected to verify deposit balances through on-site

verification [20]. They also failed to exercise professional skepticism toward the glaring "abnormal co-existence of high cash and high debt" anomaly. As shown in Table 4, at year-end 2017 Kangmei reported monetary funds of RMB 34.151 billion while simultaneously carrying RMB 23.977 billion in interest-bearing debt — a ratio of 1.42, meaning the company claimed to hold more cash than its entire borrowings. Any enterprise with genuine cash would rationally prioritize debt repayment rather than simultaneously maintain enormous cash and debt. The actual monetary funds of RMB 4.207 billion (restated) would yield a ratio of merely 0.18, indicating acute financial shortage. Between 2016 and the first half of 2018, monetary funds and interest-bearing debt combined exceeded 70% of total assets. The auditors performed no additional procedures, allowing the massive fraud to remain undetected for years [20].

Table 4. Kangmei Pharmaceutical's "abnormal co-existence of high cash and high debt" data, 2016 — first half of 2018

Time	Monetary Funds (Reported / RMB billion)	Monetary Funds (Actual / RMB billion)	Short-term Borrowings	Bonds Payable	Non-current Liabilities Due Within One Year	Long-term Payables	Total Interest-bearing Debt	Monetary Funds / Interest-bearing Debt
Year-end 2016	273.25	—	82.52	48.89	0	0	131.41	2.08
Year-end 2017	341.51	42.07	113.70	83.07	25.00	18.00	239.77	1.42
First Half 2018	399.22	—	124.52	132.73	0	18.00	275.25	1.45

Note: 2017 actual monetary funds RMB 4.207 billion (restated), difference from reported RMB 34.151 billion is RMB 29.944 billion. Monetary funds/total assets: 49.84% (2016), 52.30% (2017), 50.70% (2018). Interest-bearing debt/total assets: 23.97% (2016), 36.72% (2017), 34.96% (2018).

5.3. Exposure: pre-detection laxity and post-detection severity

The Exposure dimension captures both the probability of detection and the severity of sanctions [16]. The Kangmei case presents a striking contrast between pre-2018 conditions that minimized exposure risk and post-2018 enforcement that dramatically heightened it.

Low detection probability before 2018. The probability of detection was remarkably low. Zhongzheng Zhujiang issued consecutive unqualified audit opinions, certifying that financial statements presented a true and fair view [13, 20]. Forged bank confirmation letters and falsified bank statements deceived external auditors, whose own deficiencies in professional skepticism further reduced detection likelihood [20]. The "abnormal co-existence of high cash and high debt" persisted for years without triggering regulatory inquiry [21]. The maximum administrative fine under then-applicable law was merely RMB 600,000 — absurdly disproportionate to fraud involving hundreds of billions [13, 22]. When the expected penalty constitutes a trivial fraction of gains from fraud, deterrence is effectively nullified [21]. The perpetrators' rational calculus tilted heavily toward continuing the fraud: detection seemed unlikely, and consequences appeared manageable.

Heightened exposure after 2018. Media scrutiny in October 2018 shattered the illusion. The CSRC investigation initiated on December 28, 2018, marked the beginning of a multi-layered enforcement response. Administrative penalties imposed the then-maximum fine of RMB 600,000 on the company and RMB 900,000 on Ma and Xu individually, complemented by lifetime securities market bans for six primary responsible persons [13]. On February 20, 2021, the Foshan Intermediate People's Court rendered its criminal judgment: Ma received 12 years for market

manipulation, illegal disclosure, and institutional bribery; Xu received 6 years [16]. On November 12, 2021, the Guangzhou Intermediate People's Court delivered China's first special representative securities dispute litigation, ordering Kangmei to compensate 52,037 investors RMB 2.459 billion, with Ma, Xu, Zhongzheng Zhujiang, and independent directors all bearing joint and several liability [23]. The 2020 Securities Law revision raised the maximum fine to RMB 10 million, substantially increasing future violation costs [22].

The post-exposure consequences — imprisonment, billions in damages, lifetime market exclusion, corporate collapse — demonstrate that when the Exposure dimension is fully activated, its force is devastating. Low pre-detection exposure encouraged fraud; high post-detection exposure destroyed the perpetrator.

5.4. The convergence of four dimensions

The analytical power of the GONE theory lies in its emphasis on interaction rather than isolation [2, 3]. At Kangmei, the four dimensions aligned to create conditions under which fraud became not only possible but, from the perpetrator's perspective, seemingly necessary and sustainable.

Greed provided the moral vacuum — the systematic tunneling, bribery, and treatment of the company as a personal financing vehicle established the ethical precondition. Need created the pressure — the "stock price hostage" mechanism and the capital demands of aggressive expansion transformed fraud from an abstract moral failing into an operational imperative. Opportunity provided the means — concentrated ownership, failed internal controls, rubber-stamp independent directors, and audit dereliction created the structural pathway. Low Exposure made the risk acceptable — years of unqualified opinions and trivial maximum penalties created a cost-benefit calculus skewed toward continuing the fraud.

The collapse occurred not because any single dimension weakened but because the Exposure environment underwent sudden transformation. Media scrutiny in October 2018 triggered the CSRC investigation, criminal prosecution, and civil litigation that followed — demonstrating that the long period of low exposure had been an anomaly, not a permanent condition. The Kangmei case thus illustrates the GONE theory's central proposition: fraud persists when all four dimensions are present; disrupting any one can precipitate collapse [2, 3]. The alignment of Greed, Opportunity, Need, and low Exposure sustained the fraud for years; the sudden elevation of Exposure destroyed it comprehensively.

6. Case implications and recommendations

6.1. Improving corporate governance structure

The Kangmei Pharmaceutical financial fraud case shows the serious harm caused by weak corporate governance. To stop similar cases from happening, we need to focus on several important reform measures.

Separating the chairman and general manager posts is one of the most urgent steps. In the Kangmei case, Ma Xingtian worked as chairman and general manager at the same time. This mixed decision-making power and executive power together, and it totally destroyed internal checks and balances. Listed companies should make sure these two roles are held by different people. This can build an effective balance of power inside the company.

The board of supervisors also needs to be strengthened. It should check the company's financial state, internal controls and related-party transactions independently and regularly. It should find and

fix wrong acts in time. When it finds unusual situations, the board of supervisors has the right to ask management to give explanations. It can also report the problems to regulatory authorities.

Improving the approval and disclosure system for related-party transactions is equally important. Listed companies should set strict approval steps. All related-party transactions must get approval from independent directors first. The information of related-party transactions must be shown to the public in time and completely. This can stop controlling shareholders from taking the listed company's interests through related-party transactions.

6.2. Strengthening audit oversight

The audit failure in Kangmei Pharmaceutical's case shows weak points in China's audit supervision system. To make audit quality better, we need to carry out several important reforms.

Changing audit firms regularly is the most important first step. If the same audit firm works for the same company for many years, they may build close interest ties and fixed thinking. This will make audit quality lower. We must follow the rotation rules strictly. We can limit how many years one audit firm can serve the same company in a row. This rule will break the interest link between audit firms and their clients.

We also need to give heavier punishment to audit firms that break laws and rules. For audit firms and certified public accountants who are very careless in audit work, we should give strict punishment by law. The punishment can include fines, stopping practice for some time, and taking away their practice licenses. These measures can stop people from doing wrong things well.

Making audit firms more independent is very necessary. We should limit the kinds and amount of non-audit services that audit firms give to their clients. This can stop audit firms from depending on clients because of non-audit money. Such dependence will make audit firms less independent.

We can also improve audit technology with new ideas and new tools. We should encourage audit firms to use new technologies such as big data and artificial intelligence. These technologies can make audits faster and more effective. They can also help audit firms find unusual financial problems more easily.

At last, building a watch system for "high cash and high debt at the same time" can help auditors find fraud. Audit firms should see this problem as a key risk sign in audits. When two things happen—first, a company's cash takes more than 20% of its total assets; second, interest-bearing debt takes more than 20% of its total capital for a long time, audit firms should do more audit steps. The financial data of Kangmei Pharmaceutical during the fraud time proves this sign works well, as shown in Table 5.

Table 5. Kangmei Pharmaceutical "abnormal co-existence of high cash and high debt" indicators, 2016 — 2018

Period	Monetary Funds / Total Assets	Interest-Bearing Debt / Total Assets
End of 2016	49.84%	23.97%
End of 2017	52.30%	36.72%
End of First Half of 2018	50.70%	34.96%

Data source: CSMAR (Guotai'an) Database [14].

Table 5 shows that from the end of 2016 to the end of the first half of 2018, Kangmei Pharmaceutical's ratio of monetary funds to total assets consistently remained at approximately 50%, while the ratio of interest-bearing debt to total assets also persistently exceeded 20%. This exhibits a typical "abnormal co-existence of high cash and high debt" pattern. Under normal circumstances, a

company holding substantial monetary funds should reduce its external financing needs. Kangmei Pharmaceutical, however, continuously maintained a high level of interest-bearing debt despite its large monetary fund reserves. This conspicuously abnormal financial structure should have alerted audit firms to a high degree of vigilance. Audit standard-setting bodies should explicitly designate "abnormal co-existence of high cash and high debt" as a key audit risk signal, requiring auditors to implement additional procedures such as confirmations, bank statement verification, and fund-through testing when encountering such circumstances, in order to identify possible overstatement of monetary funds or controlling shareholder fund embezzlement.

6.3. Improving the securities litigation system

The successful practice of special representative litigation in the Kangmei Pharmaceutical case has provided valuable experience for improving China's securities litigation system. Several further improvements merit consideration.

Expanding the scope of application of special representative litigation is one avenue. At present, the threshold for initiating special representative litigation is relatively high. The conditions for initiation should be appropriately lowered so that more victimized investors can obtain compensation through this system.

Improving evidence rules is another important task. In cases of securities fraud, investors often have trouble getting and keeping evidence. We should make the rule of reversed burden of proof clearer. This will make it easier for investors to provide the proof they need.

Making punishments stricter for main wrongdoers can better stop fraud. In securities fraud cases, actual controllers and key responsible people plan and carry out fraud. They should take the strictest legal responsibility. We should not only ask them to take administrative and criminal responsibility. They must also pay full civil compensation. This will make them suffer serious financial losses. It will work well to stop others from doing such wrong acts.

Building and improving the investor protection fund system can provide a safety net. Some investors lose money because of financial fraud. If the people responsible cannot pay compensation, the fund can give them proper help. This will protect investors' legal rights and interests well.

6.4. Strengthening the independent director system

The court decision that ordered independent directors to bear heavy joint and several liability in the Kangmei Pharmaceutical case has greatly influenced the independent director system. To make independent directors fully play their supervisory role, several reforms should be carried out.

Raising the entry standard and professional requirements for independent directors is the first necessary step. Independent directors should have professional knowledge and experience in finance, law and related industries. They should be able to effectively find and judge the company's business and financial risks.

Protecting independent directors' right to get information is also very important. Listed companies should provide independent directors with complete and timely information about their business and financial conditions. This ensures independent directors can make judgments and decisions with enough information.

Building a system to protect independent directors when they perform their duties helps make supervision effective. This includes giving them necessary office conditions and financial support, setting up a liability insurance system for independent directors, and protecting their right to speak in board meetings. The liability insurance system can especially offer reasonable risk protection for

hard-working independent directors. It stops excellent talents from refusing to be independent directors because they worry too much about legal responsibility.

Improving the evaluation and responsibility systems for independent directors completes the supervision process. Independent directors who do not work hard should take legal responsibility. Those who work actively and play a good supervisory role should get proper rewards and praise.

7. Conclusion

The Kangmei Pharmaceutical Co., Ltd. financial fraud case is a landmark case of profound significance in the development history of China's capital market. The case involved an overstatement of monetary funds of up to RMB 36.188 billion, an overstatement of operating revenue exceeding RMB 20 billion, and an overstatement of operating profit exceeding RMB 2 billion. The scale of the fraud, the systematic nature of the methods employed, and the duration of the scheme all set historical records in the A-share market [13]. Through an in-depth analysis of this case, this paper arrives at the following principal conclusions.

First, the motivations underlying the Kangmei Pharmaceutical financial fraud were multifaceted. Applying the GONE theoretical framework reveals that the fraud was driven by the convergence of four key dimensions: Greed — manifested in the controlling shareholder's systematic tunneling of corporate funds, bribery of government officials, and treatment of the listed company as a personal financing vehicle; Opportunity — created by highly concentrated ownership, the "family shop" governance model, wholesale failure of the Board of Supervisors and independent directors to exercise oversight, deficient internal controls, and the comprehensive failure of external audit; Need — driven by urgent capital requirements from aggressive nationwide expansion and the existential threat of the "stock price hostage" mechanism with equity pledge ratios exceeding 90%; and low Exposure — resulting from years of unqualified audit opinions that reduced detection probability and disproportionately low penalties (maximum fine of merely RMB 600,000) that nullified deterrence. These four factors influenced and supported each other closely. They created a "perfect storm" that made fraud not only possible but also necessary and sustainable in the view of the people who carried it out [2, 3]. Media attention in October 2018 quickly raised the risk of being exposed. At last, the whole fake financial system broke down completely.

Second, audit failure was a key external reason that let Kangmei Pharmaceutical's financial fraud exist for a long time. Zhongzheng Zhujiang Accounting Firm had serious problems in audit independence, audit process and professional doubt. It failed to find and show Kangmei's financial fraud effectively. This hard lesson shows that audit firms are the "gatekeepers" of the capital market. They must follow the rule of independence, carry out audit steps strictly and keep strong professional doubt. Only in this way can they do their external supervision job well. Later legal actions included administrative penalties, criminal charges and a 2.459 billion yuan civil judgment in China's first special representative litigation. This set a new law enforcement standard. It changed the cost and benefit of securities fraud and pushed important regulatory reforms, including the 2020 Securities Law revision.

Third, the legal results of the Kangmei Pharmaceutical case have milestone meaning. The China Securities Regulatory Commission imposed the highest administrative penalty. Judicial departments brought criminal charges. And the civil compensation judgment in China's first special representative litigation was made. Together, these actions built a complete legal punishment system for financial fraud [16, 23]. The special representative litigation system worked well. It gave hurt investors an effective way to protect their rights. It greatly raised the compensation cost for lawbreakers. It also plays an important role in stopping financial fraud.

Fourth, stopping financial fraud needs complete system building and cooperation from many sides. Improving corporate governance can solve the Opportunity dimension. This includes separating chairman and general manager roles, strengthening the Board of Supervisors and improving related-party transaction controls. Strengthening audit oversight targets the Exposure dimension. Ways include regular audit firm rotation, stricter punishment for careless work, independence rules and technology-based anomaly detection. Improving the securities litigation system also strengthens Exposure. This includes expanding special representative litigation, making evidence rules clearer and giving stricter punishment to main wrongdoers. Improving the independent director system can reduce Opportunity and lift governance quality. Ways include higher entry standards, full information access rights, liability insurance and responsibility mechanisms. Only by building a system where people "dare not commit fraud, cannot commit fraud and do not wish to commit fraud" can we stop financial fraud completely. This will protect the healthy development of the capital market and investors' legal rights and interests.

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