

Analysis of the Motivations and Consequences of Financial Information Fabrication by Red Phase Inc. Based on the Fraud Triangle Theory

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Abstract. In today's era of increasingly advanced information technology across various fields, deep learning models such as large-scale AI models serve as powerful algorithmic assistants, effectively driving the positive development of numerous enterprises and capital markets. However, more complex and covert information disclosure frauds have also emerged accordingly. This paper selects Xiamen Red Phase Inc. as the research subject, which features newly implemented penalties, a complete and continuous fraud cycle, and diverse methods. The study first reviews and summarizes existing domestic and international research on information disclosure. It then traces the timeline of Red Phase Inc.'s illegal information disclosure and fraud case, using the fraud triangle theory as the research framework. From the perspectives of pressure, opportunity, and rationalization, relevant data is incorporated to analyze corporate information disclosure fraud (particularly financial fraud). Through case studies, the motivations and potential consequences of corporate information disclosure fraud are further examined, ultimately proposing relevant governance recommendations.

Keywords: Financial Statement Fraud, Financial Misreporting, Fraud Triangle Theory, Red Phase Inc.

1. Introduction

Financial information disclosure fraud is a major issue in China's capital market, with persistent financial fraud being the primary culprit undermining market fairness and disrupting market order. Red Phase Inc. serves as a typical case: the company's fraudulent activities were concentrated after its listing, involving fabricated sales transactions, continuous inflation of revenue and accounts receivable, and the use of falsified financial reports for three major financing rounds, constituting fraudulent issuance. This study examines the financial fraud case of Xiamen Red Phase Inc., detailing the chronology of the incident and illegal methods employed. It analyzes the motivations behind the fraud based on the fraud triangle theory and proposes governance recommendations and countermeasures for similar incidents.

Fraud Triangle Theory, proposed by American scholar W. Steve Albrecht [1], is one of the mainstream foundational theories in financial fraud research. This theory posits that the occurrence

of corporate financial fraud must simultaneously satisfy three key elements: pressure, opportunity, and rationalization [2, 3]. Pressure serves as the internal driving force behind financial statement fraud, referring to situations where management or actual controllers, unable to resolve public dilemmas, actively manipulate financial reports and conceal information [3]. Pressure is categorized into four types: financing pressure, stock price stabilization pressure, regulatory avoidance pressure, and personal gain pressure [2, 3]. Opportunity represents the objective conditions for financial statement fraud, arising when governance, internal controls, or external oversight mechanisms exhibit vulnerabilities, enabling management to exploit these gaps [3]. Opportunity factors are divided into internal and external categories. Internal opportunities include concentrated ownership by major shareholders, rendering independent directors ineffective and leading to dysfunctional internal controls and circumvented internal audits [2]. External opportunities involve a lack of independence in audit firms and loopholes in industry regulatory rules [2]. Rationalization, also known as the justification factor, reflects the fraudster's self-justification, where management subjectively seeks excuses for financial statement fraud, attempting to rationalize fraudulent activities [2, 3].

At present, research on information disclosure fraud mainly analyzes it from the perspectives of motives, results, and means, and multiple factors collaborate to form a relatively systematic theoretical system for its underlying logic and operational procedures. Research has shown that digital manipulation is driven by factors such as financing demand, financial performance evaluation, and avoidance of regulatory penalties, which distort financial data; Text manipulation is based on motives such as impression management, misleading information, catering to market expectations, and interfering with investors' judgments [4]. The two manipulation methods have synergistic motives, but there are significant differences in technology dependence, regulatory arbitrage, and economic consequences [4]. Regarding China, although there are certain differences in the credibility of financial reports of listed companies based on different sectors, industries, corporate nature, asset size, revenue size, profit size, and stock market value, the overall credibility index has been continuously improving in recent years, and the credibility value of financial reports has a good warning effect on risk events such as debt defaults. The credibility index of financial reports also needs to be comprehensively considered in conjunction with industry prosperity and performance growth indicators [5]. The authenticity of enterprise accounting information greatly ensures the normal operation of the capital market. The emergence of fraud cases has impacted investors' investment willingness, shaken the credit foundation of the capital market, and hindered the sustainable development and healthy ecology of the capital market [6]. Accounting fraud constitutes serious misconduct, causing investors to lose confidence in the capital market and leading to a decline in stock prices. The disclosure of past accounting fraud by enterprises (after the fact) or the prediction of future fraud likelihood (before the fact) is significantly positively correlated with the risk of future stock price collapse [7].

2. Analysis of financial fraud cases in Red Phase Inc.

2.1. Overview of Red Phase Inc. and analysis of financial fraud cases

Red Phase Inc. was formerly known as * ST Hongxiang. In January 2015, it was listed on the Growth Enterprise Market of the Shenzhen Stock Exchange, and its parent company and five wholly-owned/controlling subsidiaries jointly participated in this financial fraud. The equity of Red Phase Inc. is highly concentrated, with multiple regional subsidiaries operating in a decentralized manner and frequent changes in audit institutions. Through comparative analysis, it was found that

Red Phase Inc. fabricated a large amount of economic transactions from 2017 to 2022, reaching its peak in 2019, with an overall cumulative inflated profit of about 399 million yuan, which greatly embellished the company's financial reports [8]. Table 1 show the specific situation of Red Phase Inc.'s information disclosure fraud from 2017 to 2022 [8].

Table 1. Specific situation of information disclosure fraud by Red Phase Inc. from 2017 to 2022

Year	Fictitiously Inflated Operating Revenue(10,000 Yuan)	Proportion of Disclosed Annual Operating Revenue	Fictitiously Inflated/Deflated Total Profit(10,000 Yuan)	Proportion of Disclosed Annual Total Profit
2017	10489.44	14.10%	Inflated5972.44	38.03%
2018	25559.32	19.49%	Inflated14422.06	47.72%
2019	22706.67	16.94%	Inflated14118.25	48.19%
2020	30497.18	20.12%	Inflated7538.42	29.79%
2021	10879.80	7.80%	Deflated325.44	0.51%
2022	None	—	Total inflated&deflated profit:2487.67	33.27%

(Data source: Administrative Penalty Decision of Xiamen Securities Regulatory Bureau)

2.2. Analysis of financial fraud methods of Red Phase Inc.

Firstly, the fictitious sales business involves the company forging sales contracts, product delivery orders, equipment acceptance forms, logistics transportation documents, etc., thereby inflating operating revenue and accounts receivable. Secondly, by fabricating raw material procurement and capital circulation, Red Phase Inc. has built over 90 shell/affiliated external customers without real transactions, and fabricated costs and payments. Thirdly, inflating fixed assets and construction in progress, the enterprise uses forged equipment procurement invoices to inflate long-term assets and adjust profits. Fourth, cross-period profit manipulation. In 2021 and 2022, the company adopted reverse adjustment, inflating costs and reducing profits, and then covering up the large amount of inflated profits in the previous period.

2.3. Analysis of the reasons for Red Phase Inc. fraud based on the fraud triangle theory

Stress factor analysis: Red Phase Inc. simultaneously faced pressure from declining performance, pressure from actual controllers to cash out, and pressure from equity collateral. From 2019 to 2020, the company has continuously promoted three major capital operations. However, the capital market issuance rules have strict requirements for revenue and net profit attributable to shareholders of the listed company, and Red Phase Inc.'s actual operating data cannot meet the standards. In 2019, Red Phase Inc. issued non-public shares with a planned fundraising of 60 million yuan. The declared financial data covers the period from 2014 to 2017, but its actual profit does not meet the conditions for issuing additional shares [9]. In 2020, the company publicly issued convertible bonds with an issuance scale of 585 million yuan [10]. Regulatory requirements required the issuer to continuously make profits and maintain stable revenue growth. However, the company's actual operating situation continued to decline. In 2020, the company planned to raise funds for a major asset restructuring and

also needed to beautify its financial reports to support its valuation. Regulatory documents confirm that the cumulative inflated profits of Red Phase Inc. from 2017 to 2020 amounted to 420.5117 million yuan, with the highest proportion of inflated profits in a single year accounting for 48.19% of the disclosed profits [8], all of which were used to beautify financial reports and meet financing review standards. After going public, the actual controller continues to reduce their holdings of stocks to realize profits, and the company's high stock price relies on sustained growth in book performance to support it. From 2019 to 2021, the actual controller has cumulatively reduced its holdings and cashed out 642 million yuan [8]. The controlling shareholder's shareholding involves a large amount of equity pledge, and a decline in stock price will trigger the risk of forced liquidation, which can only be maintained by inflating profits to maintain stock price stability. The formation of a profit loop of "financial fraud → raising stock prices → reducing holdings to cash out" is also the core motivation for the six-year systematic fraud. At the same time, the downstream demand for the company's power equipment and military communication business is shrinking, and the real revenue growth rate continues to decline. If losses or slow growth are truthfully disclosed, it will trigger negative consequences such as exchange inquiries, institutional selling of shares, and bank credit compression. In 2021 and 2022, the company took the initiative to reverse the profit reduction, which indirectly confirms that its previous performance was inflated to cover up the actual business downturn.

Opportunity factor analysis: Red Phase Inc.'s internal control system is virtually non-existent, with ineffective internal governance, external audit irresponsibility, and scattered subsidiaries across regions that are difficult to supervise. The company belongs to a typical family business, and the audit committee and independent directors have no independent say and cannot raise objections to the financial decisions of the actual controller; The actual controller directly instructed the Chief Financial Officer and the heads of each subsidiary to implement fictitious sales and engage in fund circulation fraud, and all directors and supervisors were highly aware of it but did not stop it. The internal control system of the company only exists on paper, with severe alienation at the execution level. Funds transfer, contract signing, and asset entry are all approved by the actual controller alone, and the internal control balance mechanism is almost completely ineffective. This financial fraud covers the parent company and 5 cross-provincial subsidiaries. The company's business belongs to two differentiated tracks, power and military. The actual controller coordinated and forged upstream and downstream contracts, acceptance documents, logistics vouchers, etc., and the unified audit institution was unable to complete all on-site visits and inventory checks of customers in different locations. The false transactions within the subsidiaries were concealed from each other, greatly increasing the concealment of fraud, resulting in the fraudulent behavior lasting for 6 years before being registered by regulators. The continuous audit failures of external accounting firms have resulted in the loss of independent supervision functions, such as ZT Accounting Firm from 2017-2018 and RC Accounting Firm from 2019-2021, which have issued standard unqualified opinions for six consecutive years and have not identified systematic fraud worth billions of yuan. This shows that the window of opportunity for external supervision is completely open.

Rationalization factor analysis: Red management uses excuses such as performance pressure, industry operational inertia, equity control advantages, audit turnover, and team complicity to achieve psychological rationalization, in order to relax the bottom line and promote long-term financial fraud. From the self-description of the controlling shareholder, it can be summarized into the following three points: firstly, short-term embellishment is for the long-term development of the enterprise, and later operating profits can smooth out inflated data. Secondly, there is a widespread practice of financial statement adjustment in the industry, and the market tacitly approves of

moderate earnings management. Thirdly, financing expansion benefits all shareholders, stabilizes stock prices, and protects the interests of small and medium-sized investors.

2.4. Possible consequences and impact on enterprises of information disclosure fraud promoted by Red Phase Inc.

Red Phase Inc. transmitted false profit signals to the capital market, and after the fraud was exposed, the company's stock price continued to decline, resulting in a significant reduction in market value. Specifically, the maximum decline from historical highs to lows exceeded 90% [11]. The peak stock price during the fraud period was 95.6 yuan/share, while the lowest stock price range after the fraud was exposed was 3 yuan, with a maximum cumulative decline of over 90% [11]. After experiencing three major negative events, including filing, punishment, and criminal transfer, the company's stock continued to hit the limit down. The day after the announcement of the filing investigation, the stock was issued a delisting risk warning, and after the announcement of the administrative penalty landing, the company's stock price continued to hit the limit down, with a short-term total market value evaporation of over 30% [11]. After the company and its actual controller were accused of fraudulent issuance and transferred to the prosecutor's office for prosecution, the company's stock immediately hit the daily limit down and continued to fall by 3.43% the next day, with a cumulative decline of 23.43% over two days. The long-term valuation continued to suffer, with a closing price of 6.72 yuan as of July 3, 2026, and a total market value of only 3.417 billion yuan, a 62% decrease from the peak of 9 billion yuan in fraud [11].

After financial fraud was exposed, the company's reputation was damaged, financing support was lost, and business orders significantly shrank, resulting in severe losses in physical operations. The specific situation is shown in Table 2.

Table 2. Red Phase Inc.'s operating performance and profit indicators from 2023 to 2025

Year	Operating Revenue(100 million Yuan)	Net Profit Attributable to Parent Company(Loss)	Net Profit Margin on Sales	ROA(Return on Total Assets, Period-end Basis)	Total Assets at Period-end(100 million Yuan)
2023	11.54	459 million Yuan	-39.77%	-16.61%	27.63
2024	6.35	353 million Yuan	-55.59%	-20.62%	17.12
2025	7.27	19,193,800 Yuan	-2.64%	-1.18%	16.25

(Data source: Red Phase Inc.'s audited annual financial report for 2023-2025, compiled and calculated by the official disclosure announcement of Juchao Information Network)

According to the chart, the cumulative loss for the two years 2023-2024 is as high as 812 million yuan, almost offsetting twice the inflated profit of 399 million yuan from 2017-2020.

After the exposure of financial fraud, various responsible persons of the company were punished according to law, with huge fines: the company was ordered to rectify and given a warning, with a total fine of 25.13 million yuan [8], which was fully paid by the company's own operating funds, directly reducing the company's operating cash flow. The actual controller was fined 22.88 million yuan [8], banned from entering the securities market for life, and shall not serve as a director, supervisor, or senior officer of any listed company or engage in securities business for life; Multiple executives were fined ranging from 500000 to 365000 yuan, and intermediary agencies suffered huge fines and confiscation [8]. The company is suspected of fraudulently issuing securities, and the

actual controller is suspected of fraudulently issuing and disclosing important information in violation of regulations. All cases will be transferred to the Xiamen People's Procuratorate for review and prosecution. Once convicted by the court, the actual controller of the enterprise will bear criminal responsibility, and there are risks of subsequent delisting, revocation of business qualifications, etc [8].

3. Extended governance and prevention measures for financial fraud case of Red Phase Inc.

Firstly, regulatory authorities should strengthen internal and external supervision, implement the independent anti-fraud powers of audit committees, improve balanced equity and corporate internal control, and cultivate a culture of integrity and internal control in enterprises. External administrative, auditing, media, and institutional supervision form a closed loop to eliminate regulatory loopholes where actual controllers override internal controls and intermediary agencies become ineffective. Secondly, corporate entities should clarify disclosure boundaries, establish a negative list for financial information disclosure, eliminate ambiguous operational space, differentiate between mandatory and voluntary disclosure, standardize disclosure standards, and establish a cross-verification mechanism for annual reports and temporary announcements. Thirdly, regulatory authorities should increase the punishment for financial fraud, strengthen the rigid deterrence of administrative penalties, prioritize the disposal of core responsible persons, improve civil compensation mechanisms, and at the same time increase criminal crackdowns, establishing a permanent public disclosure system for dishonest markets. Finally, listed companies can apply sustainable reporting, enforce hierarchical disclosure, expand the scope of sustainable reporting disclosure, introduce independent third-party verification, and guide long-term value orientation [12].

4. Conclusion

Most financial fraud cases involve three-dimensional methods, have a long duration, have a negative impact, and seriously damage the ecology of the capital market. This article takes the long-term systematic financial fraud case of Red Phase Inc. from 2017 to 2022 as the object, and relies on the fraud triangle theory to complete a complete analysis of the causes, means, and economic consequences. This article identifies performance decline pressure, cash-out pressure of actual shareholders, and equity collateral pressure as the core stress factors of financial fraud; Internal control, internal governance, and external audit loopholes, as well as opportunities provided by dispersed subsidiaries; and reasonable psychological excuses provided by real stock investors. After the fraud was exposed, the company's stock price plummeted, its market value significantly decreased, and its operations continued to deteriorate. The enterprise, actual controllers, and intermediaries were simultaneously subject to high administrative fines, market bans, and even criminal accountability. The negative consequences were concentrated in multiple aspects of the market, operations, and law. This case reflects the common problems of internal governance imbalance and insufficient external supervision and constraints among private enterprises listed on the stock market. Based on this, governance measures are proposed from four dimensions: internal control construction, information disclosure standardization, increasing punishment, and introducing sustainable information authentication. This can provide practical reference for preventing long-term financial fraud in the A-share market and improving the supervision of capital market information disclosure.

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