

A Case Analysis of Illegal and Irregular Information Disclosure in the 2021 Annual Report of Hunan Mendale Home Textile Co., Ltd.

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Abstract: Taking the 2021 annual report disclosure of Hunan Mendale Home Textile Co., Ltd. as a case, this paper conducts research and discussion based on the Asymmetric Information Theory and principal-agent related theories. It systematically analyzes the in-depth causes of the company's information disclosure violations, and explores more effective approaches to the supervision and governance of listed companies. Meanwhile, it discusses the impact of the newly issued Securities Supervision Law on the management of listed companies, and provides reference suggestions for the research on the compliance of information disclosure of listed companies.

Keywords: Case Analysis; Audit Disclosure; China Securities Regulatory Commission (CSRC); Fraud Triangle Theory; Compliance Theory

1. Introduction

1.1 Research Background

Hunan Mendale Co., Ltd. was listed in 2010. As the first time-honored Chinese enterprise listed in the home textile industry, it has a 69-year history since its establishment in 1956, and is also the first listed enterprise in Hunan's textile industry. However, as a private enterprise restructured from a state-owned enterprise (SOE), it had defects in internal standardized management after listing, which led to the administrative penalty imposed by the Hunan Securities Regulatory Bureau in 2021 for its illegal and irregular information disclosure. In light of this situation, this case attempts to study and discuss the internal management problems that led to such information disclosure violations of the case company, as well as the dilemmas faced by listed companies in meeting the requirements of audit and professional financial management in the process of internal governance.

1.2 Research Questions

- (1) What factors led to the information disclosure violations of the case company in 2021?
- (2) Based on what management requirements did the Hunan Securities Regulatory Bureau impose penalties on the case company, and how did these requirements differ from the previous regulatory provisions under the Securities Supervision Law?
- (3) In response to this situation, what adjustment measures should the case company adopt in its subsequent internal management and director governance?

1.3 Research Significance

The research and discussion of this case can combine the regulatory adjustments of the Securities Supervision Law in recent years to analyze the emergence of problems and regulatory conflicts of the Compliance Theory and the Fraud Triangle Theory in listed companies. At the same time, it can representatively explore how traditional manufacturing enterprises with a state-owned restructuring background can effectively break through the predicament through internal management under the background of relatively lagging management thinking. This research can help enterprises better understand the regulatory requirements of the CSRC and the importance of internal and external audits.

2. Case Description

On April 27, 2022, when the 2021 annual report was long overdue, Hunan Mendale Home Textile Co., Ltd. issued a Performance Forecast for 2021. The forecast failed to comply with the provisions of the Shenzhen Stock Exchange Listing Rules for Stocks, which stipulate that a Performance Forecast shall be disclosed within one month after the end of the fiscal year—i.e., the case company failed to disclose the Performance Forecast by January 31. According to the forecast, due to the repeated COVID-19 outbreaks in the first quarter of 2022, the company's operation was affected and the collection of receivables was poor. After full consideration by the company's management and based on the prudence principle, the company re-evaluated Asset Impairment Matters. The increase in the Allowance for Doubtful Accounts of Receivables and the Allowance for Inventory Impairment resulted in the company's loss, with an expected net profit loss of RMB 140 million to 170 million. This was the first loss forecast of Hunan Mendale Home Textile Co., Ltd. since its listing in 2010, as shown in Table 1 below.

Table 1 Brief Performance of Mendale Co., Ltd. from 2017 to 2024.

Year	Operating Revenue (100 million yuan)	Net Profit Attributable to Shareholders of the Parent Company (100 million yuan)	Net Profit Margin (%)	Net Asset per Share (yuan)	Return on Net Assets (%)
2017	19.34	0.51	2.6	2.6017	3.57
2018	23.08	0.84	3.6	2.5473	4.16
2019	26.04	0.85	3.3	2.5148	4.39
2020	22.20	0.45	2.0	2.3803	2.22
2021	24.63	-1.56	-6.3	2.1053	-9.19
2022	20.33	-4.48	-22.0	1.5121	-32.77
2023	21.56	0.22	1.0	1.5492	1.95
2024	17.15	0.25	1.5	1.5827	2.13

In the two days after the release of the Performance Forecast (April 26 to April 28), the cumulative deviation of the company's closing price exceeded 20% for consecutive trading days, which met the criteria for abnormal stock trading fluctuations in accordance with the relevant provisions of the Shenzhen Stock Exchange Trading Rules. Later, on April 30, the company disclosed the 2021 annual report and the 2022 first quarterly report. This annual report was the first one with a qualified opinion issued by an accounting firm since Mendale Co., Ltd.'s listing. The board of directors also reviewed and approved the Special Explanation on the Audit Report with a Qualified Opinion and an Emphasis of Matter Paragraph Issued by the Accounting Firm, whose opinions are specifically listed in Table 2 below. On the same day, the board of directors of the case company issued the Announcement on the Self-inspection and Rectification of Non-Operating Capital Occupation, which officially stated that Mendale Co., Ltd. found in the self-inspection that the actual controller and some shareholders had occupied the listed company's funds for non-operating purposes. Although the occupied funds had been repaid with principal and interest before the release of the announcement, causing no substantial losses to the listed company and all shareholders, the announcement immediately aroused a great stir in the market and public opinion.

Table 2 Audit Opinions of Accounting Firms on Financial Reports of Mendale Co., Ltd. (2021-2025).

Year	Quarterly Report	Semi-annual Report	Third Quarterly Report	Annual Report	Audit Opinion
2025	POR	—	—	—	—
2024	POR	PON	POR	—	Unqualified Opinion with Standard Report
2023	POR	POR	POR	—	Unqualified Opinion with Standard Report
2022	PDF	POP	POP	PDR	Unqualified Opinion with Standard Report
2021	POR	POF	POR	—	Qualified Opinion

Subsequently, on October 11, 2022, the Shenzhen Stock Exchange issued the Decision on Giving a Circular Criticism to Hunan Mendale Home Textile Co., Ltd. and Relevant Parties, officially imposing a circular criticism on Mendale Co., Ltd. and relevant parties for their violations. The violations included irregular Performance Forecast, irregular Non-Operating Capital Occupation by the controlling shareholder and other related parties, and irregular provision of financial assistance to external parties. A circular criticism was imposed on all involved parties.

Later, on November 24, 2022, Mendale Home Textile issued an announcement on receiving the Case Filing Notice from the CSRC, stating that the CSRC decided to file a case against the company, its Chairman Jiang Tianwu, Vice Chairman Li Jing, Director Li Jianwei, Board Secretary Li Jun, and Shareholder Zhang Aichun on suspicion of illegal and irregular information disclosure. Affected by the announcement, Mendale Co., Ltd.'s stock opened down 9.68% to RMB 4.76 per share, with a total market value of RMB 3.591 billion.

3. Theoretical Analysis

3.1 *Asymmetric Information Theory*

George Akerlof (1970) proposed the phenomenon of asymmetric market information and its impact on the economy. In transaction activities, sellers always possess more transaction information than buyers. Sellers can profit by providing information to information-disadvantaged parties, while buyers will strive to obtain more information. Such information asymmetry is likely to lead to low efficiency of market transactions or even market collapse. As the most common defect in the transaction market, information asymmetry will result in unfairness between transaction parties, and the transaction price will deviate significantly from the fair value of the transaction itself. Therefore, the theory holds that the government should play a strong role in the market system, strengthen the supervision of economic operation, and realize the transformation from information asymmetry to symmetry, so as to correct the adverse effects caused by market mechanisms.

In the case of Mendale Co., Ltd., the company took advantage of information asymmetry and committed illegal and irregular information disclosure, which made investors and the market unable to grasp the real operating situation of the company, possibly leading to underestimation or overestimation of the company's value. The CSRC has strict regulatory requirements for market management and information disclosure of listed companies, and listed companies are also required to strictly implement information disclosure obligations. For example, based on Article 78 of the Securities Law of the People's Republic of China, listed companies must strictly disclose annual report information, and severe penalties shall be imposed for financial information fraud.

3.2 *Legitimacy Theory*

Dowling & Pfeffer (1975) introduced the Legitimacy Theory into the field of management, pointing out that enterprises need to maintain consistency with social expectations through symbolic behaviors. Suchman (1995) proposed that legitimacy includes three dimensions: Pragmatic Legitimacy, Moral Legitimacy and Cognitive Legitimacy. Max Weber (1922), the earliest scholar to put forward the concept of "legitimacy", emphasized that legitimacy means that organizations must meet the requirements of social rules to obtain social support.

In the case of Mendale Co., Ltd., the Legitimacy Theory requires that the survival and development of enterprises must align their behaviors with social values, norms and legal systems. Enterprises should obtain and maintain "legitimacy" (i.e., social recognition) through compliant operation, transparent information disclosure and fulfillment of social responsibilities.

4. Case Analysis

The causes of such information disclosure violations can be identified by sorting out the entire management process of the listed company.

Tracing back to August 2017, Mendale Co., Ltd. received the Approval on Approving the Non-public Issuance of Shares by Hunan Mendale Home Textile Co., Ltd. issued by the CSRC, which approved the company to non-publicly issue no more than 105,454,340 new shares with a validity period of 6 months. However, due to the accelerated deleveraging in the capital market at that time, which led to a rapid tightening of liquidity, coupled with the continuous downturn of the stock market, the major shareholders of Mendale Co., Ltd. signed the Deficiency Make-up Agreement with Xiamen Trust & Jinyuan Baili, and separately with Tianjin Trust in December 2017 to ensure the success of the issuance and secure the development funds for the next stage. The agreement, however, was not disclosed to the public. Later, Mendale Co., Ltd. successfully completed the additional issuance at a price of RMB 7.48 per share. Nevertheless, the company's stock price continued to decline after the private placement. As of December 28, 2018, the closing price of Mendale Co., Ltd. was RMB 3.7 per share, a 50% drop from the issuance price. Since then, the stock price has fluctuated but remained around RMB 4 per share.

As a result, Mendale Co., Ltd. triggered the deficiency make-up obligation agreed in the private placement underwriting agreement in 2021. Shareholders including Jiang Tianwu, Li Jianwei, Li Jing and Li Jun, as Concerted Actors, formed a private placement underwriting debt of RMB 360 million. This was the root cause of a series of subsequent irregularities such as Non-Operating Capital

Occupation by Mendale Co., Ltd.—the occupied funds were used to repay the private placement underwriting debt. According to the Announcement on the Reply to the 2021 Annual Report Inquiry Letter from the Shenzhen Stock Exchange, Mendale Co., Ltd. stated that the capital occupation occurred because after the triggering of the underwriting agreement, the major shareholders could not repay the underwriting debt through share reduction, stock pledge and other financing methods due to the annual share reduction quota limit.

According to the Special Audit Report on Related Party Capital Occupation and the Announcement on the Self-inspection and Rectification of Non-Operating Capital Occupation issued by Mendale Co., Ltd. on April 30, 2022, as of December 31, 2021, the balance of capital occupied by the actual controller Jiang Tianwu and some shareholders of Mendale Co., Ltd. was RMB 80.8123 million, including the principal of RMB 80.20 million and interest of RMB 0.6123 million. At the beginning of 2022, the actual controller Jiang Tianwu and some shareholders occupied an additional RMB 18 million of the company's funds, with accrued interest of RMB 0.0471 million. As of April 25, 2022, the actual controller and some shareholders had repaid all the above principal and interest in full.

In addition to personal capital occupation, among the RMB 53 million investment made by Hunan Mendale Yongchuang Venture Capital Partnership (Limited Partnership) (established by Mendale Co., Ltd.) in Jiangyin Zuanhuang Jewelry Trading Co., Ltd., RMB 26.758 million was lent by the actual controller and some shareholders without proper procedures.

However, Li Jing, one of the major shareholders involved in capital occupation, stated in the Announcement on Equity Pledge and Unpledge of Shareholders Holding More Than 5% of the Shares (2020-060) disclosed by Mendale Co., Ltd. on November 5, 2020 that she pledged 34.71 million shares of the company to Guohai Securities Co., Ltd. Li Jing's debts were mainly caused by the above equity pledge, and his internal capital occupation was mainly to repay such personal debts, rather than the aforementioned private placement underwriting debt as claimed by the company.

The Shenzhen Stock Exchange stated that the daily maximum balance of the aforementioned capital occupation by Jiang Tianwu and his Concerted Actors was RMB 126 million, accounting for 7.92% of Mendale Co., Ltd.'s audited net assets at the end of 2021, with details specifically shown in Table 3 below.

Table 3 Non-Operating Capital Occupation and Repayment by Major Shareholders and Their Affiliated Enterprises of Mendale Co., Ltd.

Name of Occupying Shareholder/Related Party	Occupation Period	Cause of Occurrence	Balance as of Annual Report Disclosure Date (Apr 28, 2022)	New Occupied Amount in 2021	Total Repaid Amount in 2021	Balance as of Dec 31, 2021	Planned Repayment Method	Planned Repayment Amount	Planned Repayment Time
Jiang Tianwu, Li Jianwei, Li Jing, Li Jun, Zhang Aichun	Oct 2021 - Apr 2022	Repaying joint debts	6500.00	800.00	5700.00	—	—	—	—
Li Jing	May 2021 - Apr 2022	Repaying personal debts	2320.00	—	—	2320.00	—	—	Apr 2022
Jiang Tianwu, Li Jianwei, Li Jing, Li Jun, Zhang Aichun	—	Accruing 2021 capital occupation interest	61.23	—	—	61.23	—	—	—

Preparation Unit: Hunan Mendale Home Textile Co., Ltd. Monetary Unit: Ten thousand yuan

Despite Mendale Co., Ltd. disclosed the self-inspection, external audit and full repayment of all capital occupation, and the non-standard audit opinion issues were resolved, the incident still caused a huge negative impact on the company. On April 30, 2022, the board of directors of Mendale Co., Ltd. issued 26 announcements in one day. On the same day, the company's stock price plummeted to the limit, falling to RMB 4 per share, with a market value shrinkage of 60% compared with the historical high, and the secondary market fell into turmoil.

However, the incident did not end there. On November 22, 2022, the actual controller and Chairman Jiang Tianwu, Vice Chairman Li Jing, Director Li Jianwei, Director & Board Secretary Li Jun, and Shareholder Zhang Aichun of Mendale Co., Ltd. received the Case Filing Notice (No.: CSRC Case Filing No. 0132022009, 0132022010, 0132022013, 0132022011, 0132022012, 0132022014) from the

CSRC. On suspicion of illegal and irregular information disclosure, the CSRC decided to file a case against the company and the above-mentioned persons in accordance with the Securities Law of the People's Republic of China, the Administrative Penalty Law of the People's Republic of China and other relevant laws and regulations.

Subsequently, on December 12, 2022, the company received the Advance Notice of Administrative Penalty ([2022] No.7) issued by the Hunan Regulatory Bureau of the CSRC, which clarified that the investigation of Mendale Co., Ltd.'s suspected illegal and irregular information disclosure had been completed, and a decision on administrative punishment and fines had been formulated. On December 23, 2022, the Hunan Regulatory Bureau of the CSRC officially issued the Administrative Penalty Decision ([2022] No.11), imposing fines and circular criticisms on the actual controller and major shareholders involved in the incident, and a circular criticism on the chief financial officer as well.

In fact, as of December 31, 2022, it was not the first time that Mendale Co., Ltd. had been penalized and criticized by the CSRC for information disclosure violations. In 2016, Mendale Co., Ltd. issued a special announcement on the regulatory measures/penalties imposed by securities regulatory authorities and stock exchanges in the past five years and the corresponding rectification situation.

On October 27, 2016, the company disclosed the 2016 Third Quarterly Report, expecting the net profit attributable to shareholders of the listed company in 2016 (hereinafter referred to as "net profit") to be RMB 140 million to 171 million. On February 25, 2017, the company disclosed the performance express, expecting the 2016 net profit to be RMB 157 million. On April 7, 2017, the company disclosed the performance express correction announcement, revising the 2016 net profit to RMB 99.70 million. On April 20, 2017, the company disclosed the audited 2016 net profit of RMB 97.27 million in the 2016 Annual Report. The company failed to correct the Performance Forecast within the prescribed time limit, and the net profit disclosed in the performance express was inaccurate. The difference between the disclosed net profit and the audited net profit was RMB 60.30 million, accounting for 61% of the audited net profit. The company failed to perform its information disclosure obligations in a timely and accurate manner. Therefore, a circular criticism was imposed on Jiang Tianwu (Chairman), Li Jing (Director & General Manager) and Long Yi (Chief Financial Officer) of Hunan Mendale Home Textile Co., Ltd.

In 2021 and 2022, the case company's information disclosure practices for listed companies, in addition to violating the moral norms of accounting and financial processing due to capital occupation and false records in financial statements, also had a serious negative impact on the correct decision-making of the secondary market and buyers due to selective disclosure, delayed disclosure of low-quality information and concealment of key information. Such deviations in information disclosure, including selective disclosure of positive information and distorted information disclosure, will aggravate investors' distrust of the entire home textile industry, affect the overall valuation and credibility of the industry, and even distort market pricing and the allocation of market resources.

The failure of internal management led to the untimely information disclosure (the delay of the 2021 Performance Forecast) and personal capital occupation caused by the solution of personal debt problems (Li Jing, the major shareholder, is the Vice President of the case company and responsible for the company's actual business management), which reflects the management risk of agent abuse of power. All these have transferred risks to the Minority Shareholders and investors of the case company, and even increased their investment risks.

The CSRC imposed severe penalties for false records in information disclosure by citing Article 78 and Article 197 of the Securities Law of the People's Republic of China, which further reflects the guiding role of the government in market management and supervision.

5. Improvement Measures

To better standardize the information disclosure management of listed companies, to ensure the relative symmetry of information between buyers and sellers in the capital market, and to prevent the transmission of malicious information; meanwhile, to help the case company effectively reverse its market reputation after being criticized for information disclosure violations, the following improvement measures are proposed:

(1) Disclose a penalty rectification report (detailing internal control defects and targeted improvement measures). With a detailed and sincere attitude, the company can not only meet regulatory requirements but also show the improvement process of internal governance to the market

and investors, so as to improve the detail and quality of information disclosure.

(2) Increase special third-party audits, such as cash flow special audit and asset special audit, and enhance the credibility of information disclosure through third-party audit certification (e.g., ESG report audited by SGS).

(3) Replace the relevant management personnel to clarify the responsibility bearing results. Replace the chief financial officer and the person in charge of business operations and make the replacement public. Introduce more Independent Directors to strengthen the supervision intensity.

(4) Reduce or prohibit the delayed release of announcements and financial statements, and disclose the company's performance in detail or even in advance. Show a sincere attitude to the market so as to reduce investors' concerns about information asymmetry.

6. Conclusions and Implications

Combined with the information disclosure of Mendale Co., Ltd. in 2021-2022, it can be found that strengthening enterprise internal control and internal audit is of great importance in the governance of listed companies, especially under the risk of agent entrustment management. It is crucial to explore how to effectively curb agency risks, strengthen the in-depth participation of the board of directors in corporate governance, and correctly use the intervention of third-party institutions to conduct enterprise evaluation, so that shareholders and the board of directors can fully grasp the first-hand real information in the process of enterprise operation and governance. The information disclosure violations of Mendale Co., Ltd. in 2021 and the subsequent case filing investigation and penalty notice by the CSRC are the typical consequences of the loss of control and failure of listed company management.

As the supervisors of enterprise operation and management entrusted by shareholders and the market, the board of directors, Independent Directors and Board of Supervisors must have failed to perform their supervisory duties when information disclosure violations occur, and the company's financial management and internal audit have lost their control functions.

Strengthening internal governance is the only way for enterprises to reverse their reputation and restore investors' confidence. The case enterprise was criticized by regulators in 2016, filed for investigation in 2022, and even involved in information disclosure irregularities again in 2024. Mendale Co., Ltd. still has a long way to go in its management transformation. The frequent replacement of internal managers is by no means the only solution to the company's credibility crisis and the reversal of negative market evaluation.

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