

## Longtop Financial Technologies Case Study

### Accounting fraud in China

Longtop Financial Technologies (NYSE:LFT) is a software developer and technology services provider based in Xiamen. It provides technology services and creates both standardized and custom-designed software for banks in China, including three of the four largest state-controlled banks: China Construction Bank, Agricultural Bank of China, and Bank of China. LFT went public on the New York Stock Exchange on October 23, 2007. The company sold 10.4 million American depositary shares for \$17.50 per share, raising \$182 million in proceeds. By days end, the stock had jumped to \$32.40 per share. Goldman Sachs and Deutsche Bank led the IPO and Deloitte Touche Tohmatsu served as auditors. Morgan Stanley was the lead manager in a 2009 offering of more shares. In November 2010, LFT's market capitalization peaked at \$2.4 billion. In a few short months, that value would be nearly wiped out.

On April 26, 2011 Andrew Left of Citron Research published a report on his website accusing LFT of widespread fraud. Left had helped to uncover fraud at China Media Express (NASDAQ:CCME) just the month before so his report gathered considerable attention. Citron is a short-selling research firm, which takes a short position in target companies before disclosing damaging research. Citron and other short selling research firms played a key, yet highly controversial role in the demise of many China concept stocks. Read this article:

The Shorts who Popped a Chinese Bubble

<http://business.financialpost.com/2011/08/05/the-shorts-who-popped-a-china-bubble/>

Citron's research reports are here:

[http://www.paulgillis.org/citronresearchcom\\_citron.pdf](http://www.paulgillis.org/citronresearchcom_citron.pdf)

and

[http://www.paulgillis.org/citronresearchcom\\_longtop.pdf](http://www.paulgillis.org/citronresearchcom_longtop.pdf)

At the time that the reports were released Deloitte was in the process of completing its audits on LFT. Deloitte expanded its procedures related to cash, the largest item on the balance sheet. Cash totaled \$423 million or 57% of assets. Irregularities were found, which resulted in Deloitte resigning and the NYSE delisting the stock. The following links tell the story:

The Audacity of Chinese Frauds

<http://www.nytimes.com/2011/05/27/business/27norris.html?pagewanted=all>

Auditing Cash in China

<http://www.chinaaccountingblog.com/weblog/auditing-cash-in-china.html>

Deloitte's resignation

<http://www.sec.gov/Archives/edgar/data/1412494/000095012311052882/d82501exv99w2.htm>

You will find many more reports on LFT through a Google search.

Evaluate the performance of the significant players in this event:

Jia Xiao Gong – LFT Chairman

Thomas Gurnee, Chairman of LFT audit committee

Derek Palaschuk – LFT CFO

Andrew Left – Citron Research

Deloitte Touche Tohmatsu

Morgan Stanley

China Securities Regulatory Commission

LFT's unnamed bank