Educational Administration: Theory and Practice
2024, 30(5), 5792-5796
ISSN: 2148-2403
https://kuey.net/

Research Article

Corporate Social Responsibility And Financial Statement Fraud: Evidence From Indian Companies.

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Citation: Raseem Abdul Khader P (2024), Corporate Social Responsibility And Financial Statement Fraud: Evidence From Indian Companies., *Educational Administration: Theory and Practice*, *30*(5), 5792-5796, Doi: 10.53555/kuey.v30i5.3856

ARTICLE INFO

ABSTRACT

The question of whether Corporate Social Responsibility influences or affects financial outcomes including stock returns, accounting performance indicators, risk and capital costs has been a major focus of earlier studies on Corporate Social Responsibility. Here the researcher conducts an investigation regarding whether Corporate Social Responsibility influences on the financial statement fraud of Indian corporate. The logistic regression model will be use to analyses the data. This study provides theoretical implications regarding Corporate Social Responsibility research and financial fraud. Thus, this study provides research opportunities for future researchers and can be additional literature on corporate social responsibility.

Key Words: Corporate Social Responsibility, Financial Statement Fraud, B Score, Stakeholders Theory, Indian Corporates.

Introduction

The relationship between corporate social responsibility and earnings management has gaining importance in the field of academic research. Firms strategically use CSR compensate for earnings management or to deflect the stakeholder's attention from the earnings management. The term "corporate social responsibility" refers to a broader range of actions made by businesses to minimize their negative image and improve their positive effects on society. The company's stakeholders are worried about both the ethical and economic aspects. Corporate social responsibility includes many different aspects, one of which is the timely and correct presentation of accurate, reliable financial information. Through this, the business can strengthen stakeholder confidence in itself as well as its claims to be able to improve relationships with all parties involved. Earnings management occurs when the managers use judgment in financial reporting and in structuring transactions to alter financial report either to mislead stakeholders about the underlying economic performance of the firm. Earnings management has a negative influence on the quality of financial information as it portrays a false image towards different stakeholders of the firms earning. Earnings management seen as the opposite of earnings quality and can be defined as the extent to which managers exercise their discretion over accounting numbers, there by deliberately aiming to alter financial reports to mislead stakeholders about the firms underlying financial performance or to influence contractual outcome.
CSR oriented firms provide more reliable financial information as a result of managers willing to behave more ethically and meeting expectation of the society and stakeholders. The earnings management as the purposeful intervention in the external financial reporting process, with the intent of obtaining some private gain. In general, managers have two opportunistic strategies they might use to affect earnings. Managers that use accrual-based earnings management change the accrual part of earnings but do not take into account real economic effects. In contrast, real earnings management means that companies actually modify their business actions thus including real economic consequences.
Accounting earnings are among the most commonly stated performance metrics that external capital sources, suppliers, employees, customers, communities, and regulators find particularly interesting. Financial reporting should, in theory, make it easier for stakeholders to make financial decisions and enable better-performing corporations to stand out from under performers. Managers can exercise some discretion in computing earnings, without violating generally accepted accounting principles, thereby causing reported

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incomes to appear either greater or lesser than they are in reality. Earnings management as managers exercising their discretion over the accounting numbers, and that this intervention in the external financial reporting process may be intended to either mislead some stakeholders about the underlying economic performance of the company, or to influence the results of contracts that rely on published accounting figures. Employees, shareholders, communities where businesses operate, society as a whole, and managers' reputations, job security, and careers all suffer as a result of intentional managerial activities designed to conceal the true value of a firm's assets, transactions, or financial status. One of the most significant effects of acts like manipulating results is the loss of stakeholder support for the company, which may trigger more activism and vigilance from shareholders and other impacted stakeholder groups.The consequence is that the manager is under the threat of: rogue behaviour by employees; misunderstanding from customers; pressure from investors; defection from partners; legal action from regulators; boycotts from activists; illegitimacy from the community; and exposure from the media. Ultimately, these threats may destroy the firm’s reputation capital

Managers have every reason to reward stakeholders through corporate social responsibility (CSR) initiatives as a defence against stakeholder activism and vigilance, which might result in a management losing his job and harming the firm's brand.CSR handles complicated concerns like environmental preservation, human resource management, health and safety at work, local community relations, and partnerships with suppliers and customers since it is tied to ethical and moral issues about business decision-making and behaviour.Participating in socially responsible activities enhances stakeholder satisfaction while also enhancing a company's reputation. Building a positive reputation among stakeholders may be facilitated by the disclosure of information about company behaviour and results in reference to social responsibility. This positive image helps firms to establish community ties and become socially integrated and build reputation capital; hence, improving their ability to negotiate more attractive contracts with suppliers and governments, to charge premium prices for goods and services, and to reduce their cost of capital. Therefore, by resorting to CSR practices, the firm is able to gain support from its different stakeholders: employee commitment, customer loyalty, and collaboration from partners. By the same token, the company may also be eligible for more favourable regulatory treatment, endorsements from activist groups, recognition from the public, and favourable media attention. Therefore, our fundamental premise is that an executive who manipulates profitability has an incentive to present a socially-friendly image because CSR initiatives are an effective strategy for winning stakeholders' support. This, in turn, will reduce the likelihood of the manager being fired due to pressure from discontented shareholders or other stakeholders whose interests had been damaged by the implementation of earnings management practices. Under such a scheme, CSR is used as an entrenchment mechanism. This study aims to develop a linkage among corporate social responsibility and fraud in financial statements.

Research Methodology

This paper is casual-correlation. Study aims develop knowledge within a specific field. The study period is two years (2021 & 2022). Financial data of 533 NSE listed companies were collected from CMIE Prowess data base.

Data Analysis & Models

This study uses logistic regression model for hypothesis testing. Descriptive statistics and inferential statistical methods are used to analyse data.

Table 1: Variables

Variable	Description
CSR	Log CSR expenditure
SIZE	Log asset
AC	Account receivable to total asset ratio
LIQUIDITY	Current asset to current liabilities ratio
EF	Sales to fixed asset ratio
Fraud	Beneish model (1999)

H1 –There is negative and significant relationship between corporate social responsibility and fraud in financial statements.

FRAUD = Betao +CSR+AC+LIQUIDITY+EF+SIZE+AGE ----------------- 1
FRAUD = Betao +AC+LIQUIDITY+EF+SIZE+AGE ----------------- 2

Table 2: Descriptives

	CSR	Age	SIZE	AC	LIQUIDITY	EF	Fraud
Mean	1.43	44.5	4.17	0.174	1.79	4.36	0.518
Standard deviation	0.790	22.4	0.715	0.114	1.31	5.47	0.500
Minimum	-0.699	2	1.08	0.00127	0.0395	0.0121	0
Maximum	3.96	125	6.87	0.735	11.9	114	1

Source: Primary

Table 2 gives the summary statistics based on the 1066 firm-year observations. The mean value for corporate fraud was 0.518, that is, 51.8% listed companies were detected to have committed fraudulent activities from 2021 to 2022. It was found that average value of log csr is 1.43, average age of sample companies are 44.5.
Table 3 provides evidence for the hypothesis H1 test that predicted there would be fewer corporate frauds in firms that had higher socially responsible activities. From the correlation analysis it can be seen that CSR practices have a significant negative effect on fraudulent practices in financial reporting. Logistic regression analysis is conducted to understand the effect of csr on corporate fraud. Year effect is controlled by using dummy variable. The result of the logistic regression revealed that there is year effect. Efficiency, asset composition, liquidity, firm size, firm age and industry type are controlled. Asset composition and industry type are significant at 1%. Corporate social responsibility has negative relationship with fraud in financial statement at 5% significance level. Chi-square value of the model is significant at 1% level. Logistic regression was re-run by excluding csr variable to compare the accuracy, specificity and sensitivity of the two models. Table 4 depicts accuracy, specificity, sensitivity and RUC of model with csr and model without csr. Accuracy, specificity, sensitivity and RUC values of the model one is higher than model2.
The table 5 shows model 1 correctly predicts 62.45% of cases and model 2 correctly predicts 61.2% of cases. Model 1 (CSR model) is the best model to predict fraud in financial statement.\

Table 3: Binomial Logistic Regression

Model Coefficients - Mscore

Predictor	Estimate	SE	Z	p
Intercept	-0.88220	0.87640	-1.01	0.314
CSR	-0.41450**	0.20405	-2.03	0.042
EF	0.02930	0.02072	1.41	0.157
SIZE	-0.27331	0.24154	-1.13	0.258
Age	-0.00517	0.00355	-1.46	0.145
LIQUIDITY	0.08889	0.06244	1.42	0.155
AC	1.90334***	0.73085	2.60	0.009
Year effect	Yes			
Industry effect	Yes			
χ^2	57.5***			

Table 4: Predictive Measures

	Accuracy	Specificity	Sensitivity	AUC
Model with CSR	0.625	0.726	0.545	0.657
Model without CSR	0.614	0.704	0.498	0.643

Note. The cut-off value is set to 0.5

	Accuracy	Specificity	Sensitivity	AUC

Table 5: Classification Table

	Model with CSR	Model without CSR
Correctly Classified	62.45	61.2

Conclusion

This paper investigates the relation between corporate social responsibility and corporate fraud. From ethical behaviour concept, CSR firms are following ethical conduct in every aspect. There for less chance to engage in fraudulent practices. According to opportunistic behaviour, firms are engaging CSR activities to mask their malpractices. We found that CSR has negative effect on corporate fraud. This study supports the ethical behaviour perspective. Corporate social responsibility activities acting as a signal to understand weather the firm commit fraudulent activities or not. In conclusion, CSR oriented firms are more likely to act ethically, there for they are less likely to manipulate their earnings. This study is useful to regulatory agencies in india to enhance the use and publication of csr information's. The findings of the study are useful to the investors to understand the risk and quality of financial information's. The study suggests CSR activities can be a signal for investors and regulators. High CSR engagement might indicate a lower risk of fraudulent practices. Companies that take social responsibility seriously are generally less likely to cheat. While some might try to use CSR as a cover-up, this study suggests a genuine focus on social good goes hand-in-hand with ethical business practices. This can be helpful for regulators and investors to identify potentially risky companies. This study offers valuable insights for investors, regulators, businesses, and policymakers concerning the connection between CSR and corporate fraud. By highlighting a negative relationship between the two, the research suggests that CSR data can be a crucial signal for investors and regulators to identify potentially risky companies. High CSR engagement might indicate a lower likelihood of fraudulent practices, allowing for more informed investment decisions and targeted regulatory scrutiny. Furthermore, the study suggests that CSR initiatives can lead to more reliable financial reporting by fostering a culture of ethical conduct within companies. This translates to improved financial information quality for investors and regulators, ultimately enabling better decision-making. However, the research also underscores the importance of distinguishing between genuine CSR efforts and mere greenwashing. Investors and regulators should look beyond superficial CSR activities and delve deeper to understand the true motivations and impact of CSR programs.

For businesses, the implications are equally significant. A strong commitment to CSR can enhance a company's reputation and build trust with stakeholders, leading to benefits such as attracting and retaining talent, fostering customer loyalty, and securing favorable financing terms. More importantly, prioritizing CSR can potentially reduce the risk of financial misconduct, leading to long-term financial benefits and avoiding the severe consequences associated with fraud exposure. Companies that invest in CSR initiatives can foster a more ethical culture within the organization, which in turn can improve internal controls, strengthen corporate governance, and cultivate a more responsible approach to business practices.

Policymakers can also leverage these findings. By encouraging greater transparency in CSR reporting, they can ensure that companies are genuinely engaged in responsible practices. This could involve mandating standardized CSR reporting frameworks and implementing stricter enforcement mechanisms. Additionally, the study suggests a potential role for CSR in mitigating fraud risk. Policymakers could explore ways to integrate CSR considerations into regulatory frameworks, potentially offering incentives for companies with strong CSR programs.

In conclusion, this research highlights CSR's potential to be a powerful tool not just for social good but also for promoting ethical business practices and deterring financial misconduct. By understanding these implications, various stakeholders can work towards creating a more sustainable and trustworthy business environment.

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