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RESEARCH ARTICLE

IMPACT OF SOCIAL RESPONSIBILITY ACCOUNTING ON THE FUTURE PROFITABILITY OF LISTED FIRMS IN KENYA

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ABSTRACT

Social responsibility accounting is the ability to provide accurate information in the financial statements regarding the estimated social cost occasioned by the production externalities on the environment and the public and how much deliberate intervention cost had been incurred to bridge the gap between the marginal social cost and the marginal private cost by a firm. The objective of this paper is to establish whether there is any significant relationship between social responsibility accounting and profitability of selected firms listed in Kenya. The study would employ a cross-sectional descriptive survey design. Secondary data would be collected on Return on Capital Employed (ROCE), Earnings per Share (EPS), Net Profit Margin (NPM) and Dividend per Share (DPS) as a measure of profitability of firms over a period of five years. The data would be analyzed using multiple regression models. The paper suggests that there is a significant relationship between Social Responsibility Accounting and Return on Capital Employed (ROCE) and Earnings per Share (EPS), Profit Margin and Dividend per Share. Based on this it is recommended that government should give tax credit to organizations that comply with its environmental laws and that environmental reporting should be made compulsory in Kenya so as to improve the performance of organizations and the nation as a whole. The paper also recommends that there is a need for the Institute of Public Accountants of Kenya (ICPAK) to hold ongoing training courses and workshops regarding social responsibility accounting, methods for their implementations and their effects on the future of companies.

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INTRODUCTION

Accountants have an important contribution to make to the debate surrounding corporate social responsibility (CSR). The major element of accountants' contribution is based on the fact that they have the ability to provide a mechanism for holding corporations accountable for what they do (Lehman, 2007). The term CSR encompasses a variety of issues revolving around companies' interactions with society. The sorts of issues covered include ethics, governance, social activities such as philanthropy and community involvement, product safety, equal opportunities, human rights and environmental activities. The current cases of corporate scandals are a reason enough to create a concern for how companies comply with codes of good corporate governance. Social responsibility accounting first emerged in developed countries as a result of pressures exerted by environmental and human rights groups, and has been known by various terms such as; social and environmental accounting, corporate social reporting,

corporate social responsibility reporting and non-financial reporting. Specifically, social responsibility accounting was a product of the early social responsibility movement of the 1960s (Drucker, 1965) and it also appeared around the same time the environmental movement emerged (Gray and Guthrie, 2007). According to Waddock (2004) social responsibility accounting is the branch of accounting that aims to define the results of an institution or organization and its financial position from a social perspective since companies are relevant and affect societies as a whole. When considering corporate social responsibility from the perspective of the accounting profession, such consideration is necessarily and inextricably linked with social and environmental reporting or accounting. It is the process of communicating the social and environmental effects of organizations' economic actions to particular interest groups within society and to society at large (Gray, Owen and Maunders, 1987). Social accounting emphasizes the notion of corporate accountability. Adams, Hill and Robert (2008) defines social accounting as an approach to reporting a firm's activities which stresses the need for the identification of socially relevant behavior, the determination of those to whom the company is accountable for its social

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performance and the development of appropriate measures and reporting techniques. Social responsibility accounting reports can be issued by an organization with information that allows stakeholders to understand the organization's performance in dealing with social issues (positive and negative) (Richmond & Etal, 2003). The process activities include to collect, measure and report transactions and interactive effects of these transactions between the business and society. Corporations around the world are struggling with a new role, which is to meet the needs of the present generation without compromising the ability of the next generations to meet their own needs. Organizations are being called upon to take responsibility for the ways their operations impact societies and the natural environment. They are also being asked to demonstrate the inclusion of social and environmental concerns in business operations and in interactions with stakeholders (Van Marrewijk and Verre, 2003). Organizations have developed a variety of strategies for dealing with this intersection of societal needs, the natural environment, and corresponding business imperatives with respect to how deeply and how well they are integrating social responsibility approaches into both strategy and daily operations worldwide. A firm cannot ignore the problems of the environment in which it operates. In its stronger form, the concept of Corporate Social Responsibility (CSR) asserts that corporations have an obligation to consider the interests of customers, employees, shareholders, communities, as well as the ecological footprint in all aspects of their operations. Little (2006) maintained that corporate social responsibility initiatives can lead to innovations through the use of social, environmental, or sustainability drivers to create new products and services. Shane and Spicer (1983) asserts that firms which actively account for the corporate social responsibility risk factor are seen as less risky investments relative to the firms that ignore it. Consequently, on a risk-adjusted basis, their expected returns are predicted to be lower.

Objectives of the Study

General Objective

To establish the effect of social responsibility accounting on profitability of selected listed firms listed in Kenya.

Specific Objectives

- i. To establish the relationship between social responsibility disclosures and profitability of listed firms in Kenya.
- ii. To determine the relationship between environmental reporting and profitability of listed firms in Kenya.
- iii. To establish the effect of manpower development practices on profitability of listed firms in Kenya.

Problem Statement

Corporate social responsibility (CSR) and sustainability reports are increasingly gaining importance globally as stakeholders' concerns have expanded beyond conventional financial considerations to matters such as safety and health as well as the impact of businesses on the environment and the community. The current globalization trend and growing demand from stakeholders toward companies in adopting corporate social responsibility (CSR) practices have

encouraged the involvement of companies in CSR practices (Chapple and Moon, 2005). Kok, Weile, McKenna and Brown (2001) have stated that CSR could be a general statement which could indicate a company's obligation to utilize its economic resources in the business activities in order to provide and contribute to its internal and external stakeholders. The social responsibility (SR) includes environmental, social and human rights based impacts. The present study takes cognizance of Kenyan public concern over adverse impact of businesses on society and initiatives of companies (Suwaidan, 2004) and many countries, in both industrialized and the third world, take the concept and practices seriously (Hossain, Islam and Andrew, 2006). In fact, the recent emergence of various NGOs and environmental pressure groups in Kenya for example the Green Belt Movement suggests that stakeholders are concerned with the manner in which businesses are responding to social responsibility concerns. Accordingly, businesses wishing to respond to this increased public concern may use their annual reports and websites as a means of communication. This is the concept of social responsibility accounting. There are very few studies done in Kenya to ascertain the effect of social responsibility accounting (SRA) on performance of firms. Most of the studies focus on the effects of CSR on firm performance. In a foreign study, Sabha and Shoubaki (2013) studied the importance of implementing social responsibility accounting (SRA) in public shareholding companies in Jordan and Its Impact on their sustainability. The study arrived at a conclusion that Jordanian public shareholding corporations are concerned with providing social services and this reflects positively on their reputations, and institutional continuity. In another study, Makori and Jagongo (2013) studied environmental accounting and firm profitability: An empirical analysis of selected firms listed in Bombay stock exchange. The key findings of the study showed that there is significant negative relationship between Environmental Accounting (EA) and Return on Capital Employed (ROCE) and Earnings per Share (EPS) and a significant positive relationship between Environmental Accounting and Net Profit Margin and Dividend per Share (DPS).

In another study Abiodun (2012) studied the impact of corporate social responsibility on firms' profitability in Nigeria. The findings from the analysis showed that the sample firms invested less than ten percent of their annual profit to social responsibility. The co-efficient of determination of the result obtained depicted that the explanatory variable account for changes or variations in selected firms performance. Specifically, it showed that variations in profit after tax are caused by changes in corporate social responsibility. Locally, Mwasu, Sira and Leonard (2013) examined Social accounting practices among Kenyan firms: an empirical study of companies quoted at Nairobi securities exchange. They established that community involvement and environment themes were leading in practice of social accounting. They also established that companies prefer non-monetary form over monetary form of presentation and also they prefer using separate location to using chairman's report in annual reports. Finally, Musau (2015) studied the effect of CSR on the Performance of Banks in Kenya. The findings of the study were that most customers at Equity Bank had knowledge of the existence of CSR in the Commercial Banks, the main source of information being through mass media, initiatives like sports, friends and others were beneficiaries.

In the foregoing discussion, CSR is believed to have a significant influence on corporate sustainability. In the business context, CSR has emerged as a form of sustainability governance with advantages to the economic, environment and social progress of firms. Without sufficient research regarding SRA and profitability of firms, the intention of this paper is to increase knowledge and to incite more research in the new area of social responsibility accounting.

Theoretical Framework

The study is anchored on the following theories:

Utilitarian Theories

The old idea of laissez faire business gives way to determinism, individualism to public control, and personal responsibility to social responsibility. Utilitarian could also be taken synonymously with instrumental theories (Garriga and Mele, 2004) in which the corporation is seen as only an instrument for wealth creation and its social activities are only a means to achieve economic results. The utilitarian theories are related to strategies for competitive advantages. The proponents of these theories are, for instance, Porter and Cramer (2002) and Litz (1996) viewed the theories as bases for formulating strategies in the dynamic usage of natural resources of the corporation for competitive advantages. The strategies also include altruistic activities that are socially recognized as instruments for marketing. The utilitarian theory, therefore, suggests that the corporation needs to accept social duties and rights to participate in social co-operation. Within it, the functionalist theory, specifically advocates that the corporation is seen as a part of the economic system, which one of the goals is profit making. The firm is viewed as an investment, and investment should be profitable to the investors and stakeholders. The assumptions that govern the theory are surrounded by moral agent. Utilitarians believe that moral agents always have to promote the best possible outcome seen from an impartial perspective.

Managerial Theory

Secchi (2007) stresses the logic of managerial theory that emphasizes corporate management in which corporate social responsibilities are approached by the corporation internally. This makes the difference between utilitarian and managerial perspective of corporate social responsibility. This suggests that everything external to the corporation is taken into account for organizational decision making. Managerial theories are also strongly related to political theories based on the conceptualization by Garriga and Mele (2004) and supported by Wood and Lodgson (2002) as well as Detomasi (2008). They stress that social responsibilities of businesses arise from the amount of social power a corporation has and the corporation is understood as being like a citizen with certain involvement in the community. The origin of the political power of CSR is based on Davis's (1960) idea who proposed that business is a social institution and it must use power responsibly. It is also noted that causes that generate the social power are from inside and outside of the corporation.

Positive Accounting Theory

The theory was proposed by Watts & Zimmerman (1986). Positive Accounting Theory (PAT) is an expression of neo-

classical economic theory. Fundamental to it is a belief in rational choice theory, that is, material self-interest usually referred to as opportunistic behavior as the basis for all economic activities. Therefore, in Positive Accounting Theory (PAT), self-interest is the reason for the choice of accounting methods and techniques as well as policy decisions. In PAT, the firm is described in terms of a collection of contracts; a nexus of contracts. Contracts are necessary in order to get self-seeking individuals to agree to cooperate. For example, there are contracts with managers, suppliers of capital and employees (including the managers). The contracts are necessary to get individual parties to act to maximize the wealth of the owners (shareholders). PAT holds that firms will seek to minimize the contracting costs and this will affect the policies adopted, including the accounting policies (Graffikin, 2007). Watts and Zimmerman (1986) argue that the objective of positive accounting theory is to describe, explain and predict accounting practice of managers. So it will be clear which firms publish certain information like corporate disclosure. The positive accounting approach says nothing about which method of reporting should be used as a positive theory is based on empirical information and is not normative. Watts and Zimmerman (1990) identified three key hypotheses that have been frequently used in the PAT literature to explain and predict whether an organization would support or oppose a particular accounting method. These hypotheses can be called management compensation hypothesis, the debt hypothesis and the political cost hypothesis.

Empirical Studies

There are a number of past studies that helps to understand the area of CSR as a relevant area of financial performance. Sabha and Shoubaki (2013) studied the importance of implementing social responsibility accounting (SRA) in public shareholding companies in Jordan and its impact on their sustainability. This study aimed to gauge the level of understanding that senior management, internal and external auditors have of the importance, requirements and constraints to the implementation of Social Responsibility Accounting (SRA) in Jordanian public shareholding corporations and its impact on their institutional continuity. In addition, to gauging their ability to identify laws, standards and legislation governing implementation mechanisms pertaining to SRA. The study concluded that Jordanian public shareholding corporations are concerned with providing social services and this reflects positively on their reputations, and institutional continuity. The study recommended the implementation of SRA at these corporations, even if it was to be on an experimental basis. Makori and Jagongo (2013) studied environmental accounting and firm profitability: An empirical analysis of selected firms listed in Bombay stock exchange, India. The objective of this study was to establish whether there is any significant relationship between environmental accounting and profitability of selected firms listed in India. The data for the study were collected from annual reports and accounts of 14 randomly selected quoted companies in Bombay Stock Exchange in India. The data were analyzed using multiple regression models. The key findings of the study showed that there is significant negative relationship between Environmental Accounting and Return on Capital Employed (ROCE) and Earnings per Share (EPS) and a significant positive relationship between Environmental Accounting and Net Profit Margin and Dividend per Share. Based on this it was recommended that government should give tax credit to

organizations that comply with its environmental laws and that environmental reporting should be made compulsory in India so as to improve the performance of organizations and the nation as a whole.

Mwasa, Sira and Leonard (2014) examined social accounting practices among Kenyan firms: An empirical study of companies quoted at Nairobi securities exchange. The Significance of the study was to determine how companies are reporting positive and negative externalities to the society. The main objectives of the study was to establish the most popular themes of social accounting in Kenya, determine how and location for disclosure of social accounting information. The population of the study was fifty seven companies quoted in NSE and longitudinal study was carried from 2008-2010. Census method was used to collect data. Secondary data was collected from published annual financial statement of all listed companies. The population of companies was categorized into four market segment. Content analysis and descriptive analysis was used in analyzing data. It was established in the year 2008, companies practicing social accounting were 72%, while 2009 were 75% and in 2010 were 81%. It was also established that community involvement and environment themes was leading in practice of social accounting. Finally, it was established that companies prefer non-monetary form over monetary form of presentation and also they prefer using separate location to using chairman's report in annual reports.

Musau (2015) studied effect of corporate social responsibility on the performance of banks in Kenya, a case of Equity bank, Kitale. The purpose of the study was to assess the effect of corporate social responsibility on the performance of banks in Kenya. The objectives of the study were to assess the effect of corporate social responsibility on the profitability of Equity bank, to establish the effect of corporate social responsibility on customer attraction at Equity bank and to assess the effect of corporate social responsibility on employee retention at Equity Bank. The research adopted Edward Freeman, stakeholder theory. On the basis of this theoretical framework, a conceptual framework was developed. Descriptive survey design was employed. Stratified and random sampling techniques were used to select respondents who participated in the study. The research instruments that were employed were questionnaires. Descriptive statistics and inferential statistics were used to analyze the data collected. The findings of the study were that most customers at Equity Bank branch had knowledge of the existence of Corporate Social Responsibility in the Commercial Banks, the main source of information on CSR was through mass media, initiatives like sports, friends and others were beneficiaries, there was significant improvement on the performance of Banks, improvement in Bank profitability, customer satisfaction, customer retention and improved service delivery after the introduction of CSR in the financial sector. Abiodun (2012) examined the impact of corporate social responsibility on firms' profitability in Nigeria. It involved the use of secondary data, sourced from ten (10) randomly selected firms' annual report and financial summary between 1999-2008. The study made the use of ordinary least square for the analysis of collected data. Findings from the analysis showed that the sample firms invested less than ten percent of their annual profit to social responsibility. The co-efficient of determination of the result obtained showed that variations in selected firm's performance (PAT) are caused by changes in corporate social responsibility

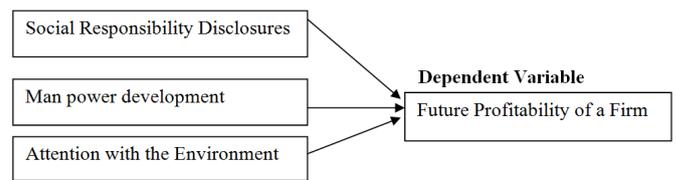
(CSR) in Nigeria. The study recommended that laws and regulations should be formulated to obligate firms to be recognized and adequate attention should be given to social accounting in terms of social costs.

Conceptual Framework

The CSR programmes are aimed at satisfying the joint and several needs of the various stakeholders of the organization. Therefore, the nature and effectiveness of CSR programmes determines the extent to which an organization delivers on its promises to its stakeholders (performance) and the eventual attainment of its strategic intent. Social responsibility accounting is the public communication of this commitment to the companies' stakeholders. Mugenda (2003) asserts that a conceptual framework gives an explanation of how the researcher perceives the relationship between variables deemed to be important in a study. In this study the two variables include social responsibility accounting as the independent variable and future profitability being the dependent variable. Such relationship is given in figure 2.1 below:

Figure 1. Conceptual Framework

Independent Variables



Source: Research data, 2015

Figure 1 represents the study's independent and dependent variables. Future probability of a firm is the dependent variable. It is measured by the financial and operational performance as well as the competitiveness of the company. In the case of this study, social responsibility accounting, the independent variable will be studied in the context of social responsibility disclosures, interest in human resource and attention with the environment. Social responsibility is the brilliant face in the activities of business organizations from the standpoints of public. Business firms are required to incur direct expenses in fulfilling this type of activities, while the ending economic results of these activities need long time to appear. No doubt that these activities are beneficial to business organizations, despite the long required time to be clear and tangible.

Research Methodology

The study would employ a cross-sectional descriptive survey design. Descriptive survey design is systematic, empirical inquiry into which the researcher does not have direct control of independent variables as their manifestation has already occurred or because they are reflecting the state of happenings and qualify the obtained findings through the use of quantitative analysis (Mugenda & Mugenda, 1999). It involves gathering data that describe events and then organizes, tabulates, depicts, and describes the data collection. The population of study will consist of all the 20 companies forming the NSE20 – share index by December 31, 2015. The sample will consist companies continuously forming the NSE 20-share index between the periods January 2011 – 31st

December, 2015. Data for this research study would be secondary data generated from Annual Reports and Accounts of the companies forming the NSE 20-share index. Secondary data would be collected on Return on Capital Employed (ROCE), Earnings Per Share (EPS), Net Profit Margin (NPM) and Dividend Per Share (DPS) as a measure of profitability of firms over a period of five years. Social responsibility accounting (SRA) would be represented by the cost involved in the SRA. In order to find out the relationship between different variables, the data would then be analyzed using multiple regression analysis through the use of a regression model.

The model is as stated below:

$$Y = a + b_1X_1 + b_2X_2 + b_3X_3 + \varepsilon,$$

Where:

Y = Future profitability of a firm (Dependent variable).
 a = Constant
 b₁, b₂ and b₃ are constants
 X₁ = Social responsibility disclosures
 X₂ = Manpower development programs
 X₃ = Attention with the environment
 ε = Error term.

The multiple correlation coefficient R will be used to test the strength of the relationship between the independent variables and the dependent variable.

Conclusion

Social responsibility accounting has significant relationship with the various variables used in measuring firm profitability. SRA costs cover all cost incurred concerning environmental protection such as emissions treatment as well as wasted material, capital and labour which so called 'non product output' as a result of inefficiency production activities. Different firms may consider different elements into environmental costs but it is important that all significant and relevant costs are incorporated for sound decision making purpose. The general picture, which emerges from current reporting, is that since the disclosures of environmental information are voluntary, there is a diversity of reporting practice. Large companies tend to report more environment information in their annual reports than the medium-scale businesses; and the disclosure, tend to be more qualitative than quantitative despite the fact that there is a significant relationship between environmental accounting and Firm Profitability. Companies also face challenges and limitations as they implement CSR. These usually relate either to political issues or to organizational-level concerns and are often embedded in culture. The complexity of operating in a global society places new demands on organizations and their leadership.

Recommendations

Based on the findings of this study the following recommendations would be made:

1. Government should make Environmental Reporting in annual reports compulsory since most organization

hardly report their environmental activities in their report.

2. Government agencies should give tax credit to organizations that comply with its environmental laws of the land which will encourage environmental reporting.
3. Corporate organizations on their part should ensure that they comply with the environmental laws of the nation as it will go a long way in enhancing their performances.
4. Firms should adopt added value statement, to report on social corporate responsibility. These statements provide clear breakdown of costs and benefits accrued in practice of social accounting.
5. Companies should adopt reporting of social and environmental accounting in separate section particularly they should use sustainability report to give more details of company's practice in social corporate responsibility.
6. Companies in Kenya particularly the profitable one should give greater priority to CSR. This has the tendency to assist them to survive and maintain their profitability. Attention should be given to social accounting and social costs by firms in Kenya.
7. There is a need for the Institute of Public Accountants of Kenya (ICPAK) to hold ongoing training courses and workshops regarding social responsibility accounting and social auditing, methods for their implementations and their effects on the future of companies.

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