International Journal of Economics and Finance; Vol. 6, No. 11; 2014
ISSN 1916-971X E-ISSN 1916-9728
Published by Canadian Center of Science and Education

Codification Theory is a Gateway for Setting Mandatory Reporting Requirements in Emerging Economies

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Received: August 6, 2014 Accepted: August 19, 2014 Online Published: October 25, 2014

doi:10.5539/ijef.v6n11p21 URL: http://dx.doi.org/10.5539/ijef.v6n11p21

Abstract

This study provides an explanation of how the process of setting new mandatory disclosure requirements in the financial reporting environment takes place by using codification theory. An empirical investigation was undertaken on the Jordanian financial reporting practices by measuring the association between the voluntary and mandatory disclosure practices of 51 manufacturing corporations before and after imposing the new Jordanian Securities Commission (JSC) mandatory requirements in 1998. The results indicate a significant, positive relationship that reflects that in 1998 the JSC took the existing Jordanian companies' voluntary financial disclosure practices and codified this practice into mandatory disclosure requirements. This paper provides evidence that will benefit future accounting standard setters as the codification of an existing optimal voluntary practice as a mandatory requirement increases the future level of compliance. This might be due to familiarity and cost effectiveness through reduced costs of compliance and analysis from a corporation's side, as well as through reduced costs associated with setting financial reporting standards, as the process can be costly for government. This paper addresses a topic that has not received appropriate attention in the extant literature, which offers a new platform for future research exploring new developments of financial reporting in relation to codification theory.

Keywords: codification theory, mandatory and voluntary disclosure, developments of financial disclosure regulation, emerging economies

1. Introduction

Much of the international accounting regulation and corporate annual reporting literature assumes that the form and the content of accounting and corporate reporting practices in a country is a function of its regulations' environment that exist at that time and in that place (Gray, 1988; Cooke & Wallace, 1990; Xiao et al., 1996; Nobes, 1998; Roberts et al., 1998; Radebaugh & Gray, 2002). These regulations are not static but change over time as they are subject to environmental factors (Von Alberti-Alhtaybat et al., 2012). However, the prior literature has not addressed any theoretical context in order to explain such developments. As an attempt to bridge this gap Von Alberti-Alhtaybat et al. (2012) raised the issue of codification theory as a theoretical foundation in the context of financial reporting requirements' developments.

Codification theory, as discussed by Von Alberti-Alhtaybat et al. (2012), argues that the development of corporate reporting regulation in the form and in the content at any time and in any place may depend upon the existing practices at that time and in that place. This theory emphasises that the already existing voluntary disclosure practices can be a major factor behind forming and developing financial disclosure standards, i.e. mandatory disclosure requirements. On the other hand, the preparers of corporate reporting and the auditors provide an optimal level of both financial and non-financial disclosure to meet users' needs, which will then be codified by regulatory bodies and regulatory setters as mandatory disclosure requirements (Von Alberti-Alhtaybat et al., 2012).

The nature of the interaction between levels of mandatory and voluntary disclosures regarding corporations' financial reporting was the concern of a few prior studies which investigated and explained how the levels of mandatory or voluntary disclosure may affect each other positively, thus resulting in increased levels of both types of disclosures (e.g. Al-Razeen & Karbhari, 2004; Dye, 1985, 1986; Einhorn, 2005; Naser & Nuseibeh, 2003). However, none of these studies investigated how the existing voluntary disclosure practices affect the increase of mandatory disclosure requirements. Furthermore, these studies do not provide a sufficient theoretical background for financial reporting research, which has resulted in a lacuna in the guidance of academic researchers.

This paper attempts to test codification theory in order to explain how the development in mandatory disclosure requirements could depend upon voluntary disclosure practices in the corporate reporting environment, to provide first time evidence based on the emerging markets' context. Jordan, like many of the emerging markets around the world, recognised a need for a change in accounting and financial reporting regulations to create a more attractive investment climate, and adopted new reform programmes aiming to create new markets and to facilitate trade with other countries (Al-Akra et al., 2009; Hutaibat et al. 2011). These reform programmes include restructuring and privatisation procedures (Al-Akra et al., 2009; Hutaibat et al. 2011). The Jordanian financial reporting environment, as one of emerging markets, is seen as a rich area to examine this theory, as in September 1997 a new Securities Law, No. 23, was issued and the Jordanian financial market was transformed into a modern capital market with a new legal framework. This included new financial disclosure requirements imposed upon companies listed on the Amman Stock Exchange (ASE) since 1998. For the first time according to the new Jordanian financial market regulations, the listed Jordanian companies were required to apply IASs in periodic financial statements. The underlying aim of the accounting regulation modifications in Jordan was to create an attractive investment climate to encourage both domestic and foreign investors. This raises the research question of whether the new implications of mandatory disclosure requirements by the JSC in 1998 were associated with voluntary financial disclosure practices prior to 1998. Therefore, an empirical investigation to examine codification theory in Jordan, as one of the emerging economies with a new reform programme, is considered useful.

The next section of this paper outlines the current research objectives, questions, hypotheses, research method, and sample. The third section illustrates the analyses, which is then followed by discussion and conclusion.

2. Literature Review

In the corporate reporting literature, there are hundreds of prior studies that measured the levels of both voluntary and\or mandatory printed and Internet financial disclosure. A list of prior empirical studies on financial reporting since 1961 is provided in Table 1.

Table 1. Prior empirical studies of printed financial disclosure

Year	Authors	Countries	Mandatory (M)	Voluntary (V)	Both (M+V)
A: Studies of developed countries					
1961	Cerf	USA			●
1971	Singhvi and Desai	USA			●
1975	Buzby	USA			●
1979a,b	Firth	UK		●	
1980	Firth	UK		●	
1982	McNally *et al.*	New Zealand		●	
1989	Cooke	Sweden			●
1991	Cooke	Japan		●	
1992/3	Cooke	Japan			●
1993	Malone *et al.*	USA			●
1994	Wallace *et al.*	Spain	●		
1995	Raffournier	Switzerland		●	
1995	Meek *et al.*	USA, UK and Europe		●	
1997	Inchausti	Spain			●
2000	Depoers	France		●	
2001	Watson *et al.*	UK		●	
B: Studies of developing countries					
1967	Singhvi	India			●
1987	Chow and Wong-Boren	Mexico		●	
1988	Wallace	Nigeria			●
1990	Benjamin *et al.*	Hong Kong (HK)	●		
1993	Mutter	Jordan	●		
1993	Abayo *et al.*	Tanzania			●

1994	Ahmed and Nicholls	Bangladesh	●		
1994	Hossain *et al.*	Malaysia		●	
1994	Solas	Jordan	●		
1995	Wallace and Naser	Hong Kong	●		
1995	Al-Modakhi	Saudi Arabia			●
1997	Al-Mulhem	Saudi Arabia			●
1997	Suwaidan	Jordan		●	
1997	Patton and Zelenka	Czech Republic	●		
1998	Naser	Jordan		●	
1998	Owusu-Ansah	Zimbabwe	●		
1999	Alrazeen	Saudi Arabia			●
1999	Curuk	Turkey	●	●	●
2000	Naser and Al-Khatib	Jordan		●	
2001	Al-Hussaini	Kuwait			●
2002	Chau and Gray	HK and Singapore		●	
2002	Haniffa and Cooke	Malaysia		●	
2003	Naser and Nuseibeh	Saudi Arabia			●
2005	Akhtaruddin	Bangladesh	●		
2009	Dahawy	Egypt	●		
2009	Hossain and Hammami	Qatar		●	
2010	Abdur Rouf	Bangladesh		●	
2010a/b	Al-Akra et al.	Jordan	●	●	
2011	Omar and Simon	Jordan			●
2011	Hutaibat et al.	Jordan	●		

Reviewing the prior studies listed in Table 1 shows that prior empirical studies examined financial disclosure focusing mainly on developed countries or developing countries by using a disclosure index approach. Also the review of these studies, see Table 1, shows that there were three main research dimensions to measure the extent of financial disclosure: Firstly, researchers that sought to measure the extent of *voluntary* disclosure assumed either that there was full compliance with mandatory disclosure requirements or mandatory disclosure requirements were not existent in their research setting. Secondly, researchers measured the level of mandatory disclosure without looking at voluntary disclosure as well. Thirdly, researchers measured the overall level of financial disclosure, including mandatory and voluntary items.

These studies also measured the relationship between the level of financial disclosure and various company characteristics as independent variables, which range from one variable (ownership form, that is, whether or not family owners are dominant – Chau & Gray, 2002) to fourteen variables (company size, assets in place, industry type, listing age, complexity of business, level of diversification, multiple listing status, foreign activities, gearing, top ten shareholders, foreign ownership, institutional investors, profitability, and type of auditors – Haniffa & Cooke, 2002). Ahmed and Courtis (1999) documented that company size, listing status, leverage, profitability, and size of auditor were the most frequently tested company characteristics in prior studies. Furthermore, Wallace et al. (1994), Ahmed and Courtis (1999), and Haniffa and Cooke, (2002) stated that the selection of the company characteristics as independent variables was mainly justified by using signalling theory, agency theory, cost benefit theory and capital need theory.

These theories were used to explain different sub-points of financial disclosure and provide explanations for variations in financial disclosure among companies. These include the agency problem (Jensen & Meckling, 1976) and information asymmetry (Akerlof, 1970), the need for disclosure regulations (Posner, 1974; Cooper & Keim, 1983), the reasons behind managers' incentives for more disclosure (Watts & Zimmerman, 1978, 1986), and the objective to raise company capital as cheaply as possible (Choi, 1973). Also theoretical explanations are utilised to distinguish the value or quality of a company's product (Akerlof, 1970; Strong & Walker, 1987). Prior scholars explained the variations in the financial disclosure practices among countries, based on the environmental factors underlying financial disclosure differences (Gray, 1988; Cooke & Wallace, 1990; Nobes, 1998; Roberts et al., 1998; Radebaugh & Gray, 2002). Recently, a technological factor, the Internet, was included as a new element influencing the form and content of financial reporting, and this particular technology has fortified the development from the printed to the Internet financial reporting format (Xiao et al., 1996; Xiao et al., 2002).

These theories suggest that managers have their own reasons to disclose accounting information to users in order to reduce agency cost, political costs, to raise capital as cheaply as possible, or even to distinguish their companies from other companies (Von Alberti-Alhtaybat et al., 2012). Also these incentives are based on the trade-off between the costs and benefits of providing such information, due to which the managers' choices to provide more information are based on a comparison between the costs of information that will be provided and the benefits that might arise from disclosing such information (Cooke, 1992). This is referred to as "cost-benefit theory" (Haniffa & Cooke, 2002, p. 327). Nevertheless managers' incentives are different from one company to another according to several company characteristics which create variation at the level of voluntary disclosure practices, and which are used in prior studies to explain the differences in the levels of printed and Internet financial disclosure among companies (Von Alberti-Alhtaybat et al., 2012).

During the last two decades the emergence of technology in corporate disclosure, in the form of voluntary Internet reporting, has opened up a new research arena for voluntary financial disclosure practice (Al-Htaybat, 2011). Managerial incentive theories were employed since the late 1990s to explore the practices of voluntary Internet reporting, which resulted in an extensive research in various Western, Australasian and Middle Eastern countries. These include in the US: Ashbaugh et al. (1999), and Ettredge et al. (2002). Other research studies were undertaken by Craven and Marston (1999) in the UK; Gowthorpe and Amat (1999) in Spain; Pirchegger and Wagenhofer (1999) in Austria; Bonson and Escobar (2002) in 15 European countries; Marston and Polei (2004) in Germany; Andrikopoulos (2007) in Cyprus; Bozcuk et al (2008) in Turkey and Despina and Demetrios (2009) in Greece. Also several studies have focused on Australasian countries, including studies by Oyelere et al. (2003) in New Zealand; Marston (2003) in Japan, Lai et al. (2010) in Taiwan, Verma (2010) in India, Xiao et al. (2004) and Zhang et al (2007) in China. Finally, Middle Eastern countries were subject to a number of studies for instance: Joshi and Al-Modhahki (2003) in Kuwait and Bahrain, Desoky (2009) and Aly et al. (2010) in Egypt, and Momany and Al-Shorman (2006), Al-Htaybat and Napier (2006), Al-Hayale (2010), and Al-Htaybat (2011) in Jordan.

Methodologically, prior printed and Internet financial disclosure studies have extensively employed one research method, a disclosure index approach, either weighted or un-weighted, as the main research tool to measure the quantity of financial disclosure, depending on their research objective (Hanafi et al., 2009). The un-weighted dichotomous disclosure index is used to measure the quantity of disclosed items within the annual report, as items are scored as one or zero depending on whether or not they were disclosed in the annual report (Hanafi et al., 2009). The weighted disclosure index is used to assess quality of disclosed items by weighting the index, either by researchers themselves or by others, to reflect the importance of each item disclosed in the annual report (see Hanafi et al., 2009; Marston & Polei, 2004; Xiao et al., 2004).

The disclosure index approach was analysed by many studies in the context of printed and Internet financial reporting studies, such as Marston and Shrives (1991); Ahmed and Courtis (1999); Coy and Dixon (2004); Guthrie and Abeysekera (2006) and Hanafi et al. (2009). These authors summarised the disclosure index as a well-established research method in the area of financial reporting, which is based on the general principles of thematic analysis. Such analysis can be used to undertake a manual content analysis that is converted to measure structured and/or unstructured narrative and/or non-narrative, regulated and/or voluntary financial and/or non-financial disclosures by classifying a checklist of particular items and using a specific coding scheme to demonstrate the disclosed and/or not disclosed information in both the main text and/or companies' accounts in the annual reports, and calculating the ratio of items disclosed to the maximum disclosure set (see for example Beattie et al., 2004; Coy & Dixon, 2004; Guthrie & Abeysekera, 2006; Hanafi et al., 2009). However, these prior checklists in terms of items included have varied from one study to another based on each study's objectives, and as there is no generally agreed upon theory on constructing disclosure indices in the area of financial reporting (Wallace & Naser, 1995).

Similarly, the method of the disclosure index was utilised to investigate mandatory and voluntary disclosure requirements. With regard to the interaction between mandatory and voluntary disclosure, Dye (1986) states that in practice mandatory disclosure requirements do not develop due to exogenous reasons, but that the existence of these disclosure requirements could originate from companies' voluntary disclosure practices. Accounting standard setters could use these voluntary practices to issue new mandatory financial disclosure requirements by codifying the existing voluntary practices. Already existing practice influences and inputs on the standard setting process because what is currently done in practice is likely to represent a great experience and knowledge base of the standard setters regarding an issue on which standard practice is being considered (Taylor & Turley, 1986, p. 70). For instance, the mandatory financial disclosure requirement setters in the UK, the Accounting Standards Committee (ASC), depend upon companies' voluntary disclosure practices to develop a series of Statements of

Standard Accounting Practices (SSAPs) from the 1970s to early 1990s, which comprise submissions of current practice and simple requirements of standard formats (see Taylor & Turley, 1986). Furthermore, in 2002 and early 2004, the US Financial Accounting Standards Board (FASB) commenced a project to codify the entire generally accepted accounting practice literature into a single authoritative source (FASB, 2004). In July 2009, the FASB released the authoritative version of the FASB Accounting Standards Codification as the single source of authoritative nongovernmental U.S. Generally Accepted Accounting Principles (information available at www.fasb.org).

Furthermore, Dye (1986) proposes a positive relationship between increasing mandatory disclosure requirements and a subsequent increase in managerial incentives for voluntary disclosure. This is based on the idea that an increase in mandatory disclosure leads to an increase in managerial incentives to disclose more voluntary information for value maximisation expressed in a company's share price, which subsequently attracts investors, and then to raise their corporate capital as cheaply as possible, or to distinguish the value or quality of a companies' product. This is contrary to the assumption that increasing mandatory disclosure requirements will lead to a decline in the level of voluntary disclosure (Dye, 1986). Thus, in practice voluntary financial disclosure develops as a result of homogenous reasons. For instance, the existence of new mandatory disclosure requirements enhances managers' incentives to voluntarily disclose more information to distinguish their companies in the market from others in order to increase their market value so as to increase wealth.

Although Table 1 shows that there are many prior studies in the financial disclosure literature, only in recent years accounting scholars have turned their attention to examining the nature of the interaction between levels of mandatory and voluntary disclosures in corporations' financial reporting, to explain how the levels of mandatory or voluntary disclosure may affect any incremental reporting regarding both types of disclosures. Al-Razeen & Karbhari (2004) tested the relationship between existing mandatory disclosure and an increase in the level of voluntary disclosure in the Saudi Arabian environment. They tested this relationship by constructing three separate disclosure indices: (1) an index containing mandatory disclosure items, (2) an index containing voluntary disclosure items that are closely relate to mandatory disclosure, and (3) an index containing voluntary disclosure items that are not closely related to mandatory disclosure. Their analyses revealed that there was a significant, positive correlation between mandatory disclosure and voluntary disclosure related to the mandatory disclosure index. Their study focussed only on one reporting year, unlike the current study, which examines the relationship between mandatory and voluntary financial disclosure before and after the developments in mandatory disclosure requirements to provide a full image of how increasing mandatory disclosure could impact on the practice of voluntary financial disclosure. Naser & Nuseibeh (2003) undertook another empirical investigation in the Saudi Arabian environment and found a positive and significant association between mandatory and voluntary disclosure. Similarly, Abayo et al. (1993) found a significant, positive relationship between mandatory and voluntary information in annual reports of Tanzanian companies. Furthermore, Einhorn (2005) established a model for analysing how companies' voluntary disclosure strategies are affected by their own mandatory disclosures. The model shows that voluntary disclosure can be significantly affected by the scope of mandatory disclosure.

However none of these studies investigated how the existing voluntary disclosure practices affect the incremental content of mandatory disclosure requirements. Furthermore, none of the prior studies provide any level of theoretical background to explain how mandatory disclosure requirements can be a product of voluntary disclosure practices. The lack of theoretical background has created a lacuna in the financial reporting context and in the guidance among accounting researches. This paper attempts to bridge this gap by testing codification theory as a theoretical foundation considering the issue of financial reporting requirements' developments. Also this paper is the first to examine this theory in the emerging economies' context.

3. Research Design

3.1 Research Hypotheses' Development

The main objective of this study is to test codification theory. The Jordanian financial reporting environment is seen as a rich area to examine this theory because significant developments changed the Jordanian financial reporting system. The Jordanian financial reporting framework before 1998 lacked clear financial reporting requirements and guidance for what should be disclosed and how companies should prepare their annual reports (Al-Akra et al., 2009; Hutaibat et al., 2011). However, a new regulatory system was introduced for what was in effect a new Jordanian capital market in 1998, as the Jordanian financial market was transformed into a modern capital market with a new legal framework, under the Securities Law 1997. This included a new capital market, which was divided among three institutions, the Jordan Securities Commission (JSC), the Amman Stock

Exchange (ASE), and the Securities Depository Centre (SDC) (Al-Akra et al., 2009; Hutaibat et al., 2011). Furthermore, in 2002 the JSC introduced new extensive financial disclosure requirements imposed upon companies listed on the ASE, and for the first time listed Jordanian companies were required to adopt the full version of International Financial Reporting Standards (IFRS) in periodic financial statements (Al-Akra et al., 2009; Hutaibat et al., 2011). Based on these facts, it is concluded that voluntary financial information formed the major part of Jordanian corporations' annual reports before 1998.

This study tests codification theory by examining the association between the voluntary financial disclosure practices before 1998 and the new developments in the mandatory financial disclosure requirements by the JSC in 1998. This may explain how the development in mandatory disclosure practices depends upon voluntary disclosure practices, as codification theory asserts that in practice mandatory disclosure requirements and standards do not develop due to exogenous reasons (Von Alberti-Alhtaybat et al., 2012). The existence of these requirements depends upon companies' voluntary disclosure practices. The first question here is whether the new mandatory disclosure requirements by the JSC in 1998 are associated with voluntary financial disclosure practice before 1998. The answer to this question will be provided through testing the following hypothesis:

H1: *There is no association between companies' voluntary disclosure practices before 1998 and the new JSC mandatory disclosure requirements* imposed upon listed companies on ASE in 1998.

The second question of the current study is the extent to which Jordanian companies' compliance level with *the new JSC mandatory disclosure requirements* imposed upon sampled companies is associated with Jordanian *companies' voluntary disclosure practices before 1998.* The answer to this question will be provided through testing the following hypothesis:

H2: *There is no association between companies' voluntary disclosure practices before 1998 and the* Jordanian companies' compliance level with *the new JSC mandatory disclosure requirements* imposed upon sampled companies.

3.2 Research Method and Sample Selection

To test these hypotheses, a disclosure index was developed and used as a research instrument, which has dominated academic financial reporting research (Marston & Shrives, 1991; Ahmed & Courtis, 1999; Coy & Dixon, 2004; Guthrie & Abeysekera, 2006; Hanafi et al., 2009). Using a disclosure index as research method for testing codification theory is possible by empirically analysing the Jordanian corporations' annual reports before and after the first introduction of the new mandatory disclosure requirements by JSC in 1998, specifically, by studying the contents of Jordanian corporations' voluntary disclosure before 1998 and *assessing their association* with new financial disclosure requirements imposed upon companies listed on ASE in 1998. Furthermore, Jordanian corporations' compliance with new financial disclosure requirements imposed upon companies listed on ASE in 1998 can be measured, and *their association* with voluntary disclosure before 1998 can be assessed.

To achieve these objectives the years 1997 and 2008 were chosen for the current investigation. 1997 was chosen as the last year before the disclosure changes in 1998, while 2008 was chosen as year after 1998 because it was the last year during which all firms of the original sample had published annual reports available. After 2008 the world financial crisis led to the insolvency of several firms of the original sample. The researcher was able to only collect 51 useable published annual reports of Jordanian manufacturing corporations listed on the ASE in 1997 and 2008, which represent 73% of total listed manufacturing companies in 1997 and 56% of total listed manufacturing companies in 2008. Only manufacturing companies were included in this study as other companies, such as banks, insurance and investment companies have specific accounting issues (and in some cases are subject to particular accounting requirements not relevant for most companies), thus this study is limited to manufacturing companies. This study, however, does not measure the extent of voluntary financial reporting in Jordan in 1997 or mandatory financial disclosure in Jordan in 2008, nor does this study evaluate, explain or judge such practices among Jordanian companies in both years.

The current mandatory disclosure requirements' index represents the Jordanian financial reporting environment as it was based on mandatory items required by JSC's Securities Law and the 2002 Securities Law with its amendments in 2004. Table 2 summarises and itemises these requirements in form of a checklist including 45 mandatory items. It was decided to use the dichotomous approach to coding whether an item listed on the current checklist was disclosed by Jordanian corporations in 1997 and 2008 (coded as '1') or not disclosed (coded as '0'). For each annual report being studied one score was determined, 'Total disclosed Items' (TDI). The total score for each index is computed by dividing the *TANDI* by 45, '*Total Index Items'*. (TII)

Table 2. The mandatory disclosure requirements by JSC

1. The Chairman's speech
2. The Board of Director's report, included
3. Description of any governmental protection or privileges with the period such is applied thereto.
4. A description of any patents or concessions that were granted to the company
5. Description of any decisions adopted by the Government, international organizations or otherwise which has material effect on the company's operations, products or competitive ability.
6. To which extent the company abides with the international quality standards
7. The company's accomplishments with figures
8. A description of significant events that the company encountered during the fiscal year.
9. The competitive status of the company within the sector of its activities
10. The company's main market is shared between the domestic market and in foreign markets if possible
11. Degree of dependence on specific providers and/or main customers where such constitutes (10%) or more of aggregate purchases and/or sales or revenues respectively
12. The financial effect of extraordinary transactions
13. Time chain of incurred profits or losses, distributed profits, the shareholder's net equity and , the prices of securities issued by the company, for a period of no less than five years
14. Analysis of the company's financial status and actions results during the fiscal year.
15. Significant future developments including any expansions or new projects,
16. The company's future plan for at least one coming year
17. The expectations of the board of directors of the company's actions results
18. Amount of auditing fees for the company and the affiliates thereof
19. Description of the main company's activities, and geographical locations for each activity
20. Volume of capital investment in each activity
21. Number of employees in each activity
22. Description of affiliated companies
23. Nature of affiliated companies' work and fields of their activities
24. Names of the members of the board of directors
25. Names and titles of senior executive managers and a resume of each
26. Number of securities issued by the Company
27. Securities owned by any member of the board of directors and senior executive manager and their relatives, and companies controlled by any of them, compared with the preceding year.
28. Privileges and bonuses that the Chairman and members of the board of directors and senior executive managers enjoy during the fiscal year
29. All amounts received by them as wages, fees, salaries, bonuses and others
30. Amounts paid to them as travel and transportation expenses inside and outside the Kingdom.
31. Donations and grants made by the Company during the fiscal year
32. Names of senior shareholders of shares issued by the Company
33. The number of shares owned by each of senior shareholders where such ownership amounts to 5% or more, compared with the preceding year.
34. Organizational structure of the issuing company
35. Company appointing policy
36. Number of employees
37. The employees' qualification categories
38. The employees' turn-over ratio
39. The employees' rehabilitation and training programs
40. Contracts, projects and commitments concluded by the issuing company with the chairman or members of the board of directors, the director general, any employee of the company or their relatives.
41. The company's contribution in serving the environment and the local society
42. The company's annual financial statements audited by its auditors, compared with the preceding year, which shall include the following: balance sheet, profits and losses account, cash-flow list, changes in the shareholders equity.
43. The company's auditor's report on the company's annual financial statements including a statement that auditing procedures have been conducted according to IAS.
44. A declaration from the company's board of directors that, according to the board's knowledge and beliefs, there had been no significant matters affecting the continuity of the company during the following fiscal year.
45. A declaration from the company's board of directors of its responsibility for preparing the financial statements and for providing effective control system in the company

4. Analysis

The main finding of the paper, as shown in Table 3, is that Jordanian manufacturing companies disclosed a considerable level of JSC's disclosure requirements voluntarily in 1997. Also Table 3 exhibits the average of JSC's requirements voluntarily disclosed by Jordanian manufacturing companies was around 39% of 45 JSC's mandatory items. Table 3 shows that Jordanian manufacturing companies did not fully comply with the JSC's mandatory disclosure requirements in 2008. Although full compliance with the JSC's requirements was expected, given that these requirements were entirely voluntary items in 1997, 73% level of compliance with the disclosure requirements of the JSC in 2008 is considered a significant level of compliance. Comparatively, no full compliance was found in different countries around the world, for instance, Ahmed & Nicholls (1994) found that none of the companies in Bangladesh disclosed all mandatory items; and they found only 58.7% of the mandatory disclosure index items were disclosed on average. Owusu-Ansah (1998) found 74.43% as a mean score of companies' compliance with mandatory disclosure requirements in Zimbabwe. Tower et al. (1999) found a variation in the level of companies' compliance in six countries namely: Australia with an average compliance of 94%, Thailand with an average compliance of 93%, Singapore with an average compliance of 90%, Malaysia with an average compliance of 90%, Hong Kong with an average compliance of 89%, and Philippines with an average compliance of 88%. Finally, Glaum & Street (2003) found that 83.7% was the level of compliance with mandatory disclosure requirements in Germany.

The significant level of compliance with JSC's requirements in 2008 confirms that reporting mandatory requirements in practice do not change due to exogenous reasons, as accounting standards depend on what disclosures companies provide voluntarily. Therefore, this is considered pioneer empirical evidence supporting codification theory.

Table 3. Descriptive statistics of Jordanian companies total disclosed items and total index score of JSC's requirements in year 1997 and 2008

Year 1997	**Mean**	**SD**	**Minimum**	**Maximum**
Total JSC's Item score	17.47	5.53	12	36
Total JSC's Index score	0.390	0.123	0.27	0.80
Year 2008				
Total JSC's Item score	30.25	7.39	10	41
Total JSC's Index score	0.7257	0.15728	0.26	0.95

Furthermore, codification theory is tested in this paper through measuring the association between the level of voluntary disclosure in the companies' annual reports in 1997, measured by using JSC's requirements in 1998, and the level of compliance with JSC's disclosure requirements in 2008. Table 4 shows the results of Kendall's correlation test for the association between the disclosure indices in 1997 and disclosure indices in 2008. This result indicates a significant, positive relationship between the level of voluntary disclosure practices in 1997 and the level of compliance with the JSC mandatory disclosure requirements in 2008. This relationship suggests that in 1998 the JSC took the existing Jordanian companies' voluntary financial disclosure practices and codified these practices into mandatory disclosure requirements.

Table 4. The correlation between the values of disclosure indices in 1997 and 2008

Kendall's tau_b		Total JSC's Index score **2008**
Total JSC's Index score in 1997	Correlation Coefficient	0.341(*)
	Sig. (1-tailed)	0.000
	N	51

Note. * Correlation is significant at the 0.01 level (1-tailed).

Based on this result the alternative hypotheses *H1, H2* can be accepted. These results provide empirical evidence supporting the argument for codification theory that, in practice, reporting mandatory requirements depend on what companies disclose voluntarily (Dye, 1986).

5. Discussion and Conclusions

Prior literature on developments of the legal financial reporting environment has neglected to deal with any theoretical foundation in explaining the developments in mandatory disclosure requirements. Codification theory addresses the development of financial reporting regulation in the form and in the content at any time and in any place depending upon the existing practices at that time and in that place (Von Alberti-Alhtaybat et al., 2012). This paper focuses on codification theory as an attempt to fill the gap in the accounting theoretical legal literature by arguing that an optimal voluntary disclosure practice is the hybrid stand in which regulation setters could codify this optimal voluntary practice as mandatory requirements. This may balance the costs and benefits to all issuers and to the government.

The analyses in this paper show that there was a considerable level of JSC's requirements voluntarily disclosed by Jordanian manufacturing companies, and a significant level of compliance with these requirements in 2008. In the same context, several studies measured the level of compliance with mandatory disclosure requirements before and after 1998, and reported that that level of Jordanian compliance had significantly improved overtime. For instance, Solas (1994) measured the level of compliance of Jordanian listed companies with what was known as mandatory disclosure requirements in 1988, and reported a mean disclosure index of 46.35%, which he considered to be unacceptably low. Al-Akra et al. (2010a) examined the effects of privatisation, changes in mandatory disclosure requirements and governance mandates on the levels of disclosure of 80 listed nonfinancial companies comparing compliance with disclosure requirements in 1996 and 2004. Al-Akra et al. (2010a) found that Jordanian companies' compliance with the disclosure requirements had significantly improved in 2004, e.g. a mean disclosure level of 79%, compared to 55% in 1996. Hutaibat et al. (2011) investigated mandatory disclosures in Jordan in 2008 after the regulatory changes in 1998, and they reported that aggregate levels of mandatory disclosure had increased in comparison to prior studies, and that Jordanian companies' compliance with mandatory disclosure requirements was at 83%. Based on these prior studies the development trend of the level of Jordanian compliance with disclosure requirements during the last 20 years is illustrated in Exhibit 1 below:

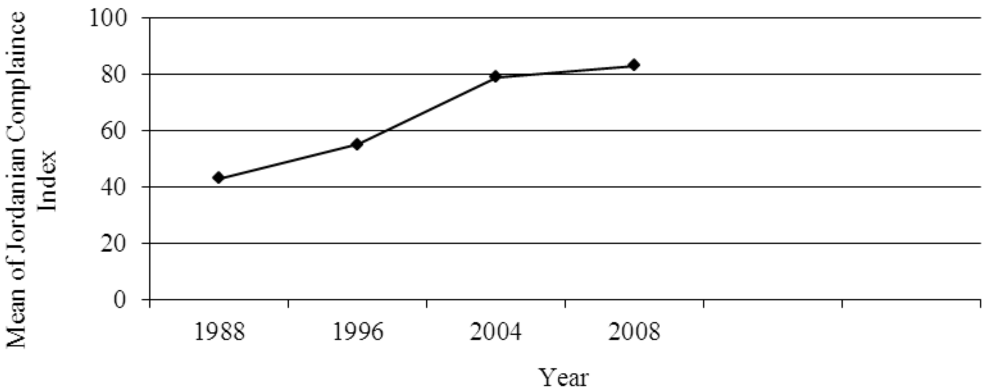

Figure 1. The development trend of the level of Jordanian companies' compliance with the disclosure requirements

These developments of the level of compliance with mandatory disclosure requirements in Jordan over the last 20 years can be explained through codification theory. Voluntary disclosure in the Jordanian companies' financial reporting before 1998 was the major part of its practices, and mandatory disclosure requirements were imposed in 1998 for mandatory disclosure to be the major part of Jordanian companies' annual reports after 1998. Based on the above it can be argued the JSC in 1998 was involved in a role similar to the UK Accounting Standards Committee (ASC) role of formulating a series of SSAPs from the 1970s to early 1990s, which comprised submissions of current practice and were simply requirements of standard format (see Taylor & Turley, 1986). Thus, codifying an existing optimal voluntary practice in Jordan as a mandatory requirement will, firstly, increase the level of compliance with the new mandatory disclosure requirements due to familiarity, as these items before being mandatory were disclosed voluntarily by Jordanian companies. In a similar context, Abd-Elsalam & Weetman (2003), in their study of the adoption of international standards in Egypt, suggest that lack of familiarity with some requirements of international standards could have lead to under-compliance. Secondly, codifying existing optimal voluntary practices as mandatory requirements supports cost effectiveness through reduced costs of compliance and analysis from the corporations' side, as well as reduces the costs associated with forming financial reporting standards, as regulation setting can be a very costly process to the government.

This paper benefits future accounting standard setters in emerging economies, thus opens a gateway for these standard setters, as codification theory emphasises that the already existent voluntary financial disclosure practice can be a major factor behind forming and developing mandatory disclosure requirements and standards. The preparers and the auditors provide an optimal level of financial disclosure to meet users' needs, which will then be codified by regulatory bodies and regulatory setters as mandatory disclosure requirements. The familiarity and the cost reduction in dealing with the new mandatory requirements that used to be voluntary practices are expected to yield a high level of compliance. This paper also offers a new platform for future research exploring new developments of financial reporting in relation to codification theory.

Acknowledgment

This research was undertaken during my sabbatical leave in 2012/2013, at the Accounting Department, Faculty of Economics and Administration, King Abdulaziz University Jeddah, Saudi Arabia. I would like to thank Al-Hussein Bin Talal University, Ma'an – Jordan, for their support.

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