Economic Insights – Trends and Challenges	Vol.XI(LXXIV) No. 3/2022	67 - 77

Annual Report Readability and Agency Cost in Listed Deposit Money Banks in Nigeria

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DOI: 10.51865/EITC.2022.03.07

Abstract

The research focuses on the annual report readability and agency cost of Nigeria's listed deposit money banks. The research aimed to study the connection between annual report readability and agency cost of Nigerian deposit money banks. It used secondary data derived from the annual reports of the selected banks. Two-panel OLS were carried out, along with a correlation matrix and some descriptive analysis. The results were positive, which indicated annual report readability had a significant relationship with agency cost and the study recommends the firms should employ proper procedures when preparing their reports and further research should be done on the topic.

Keywords: *annual report readability; agency cost; Nigeria money deposit banks.*

JEL Classification: *A19; B26; B27; B29; B41; B59; C10; C15; C23; D22.*

Introduction

In the modern business world, financial data and information have increasingly played a big part in determining the performance of corporate organizations. This is so because investors rely on financial data and information as end-users to determine the investments that are worthwhile and have the best chance of yielding high dividends (Shiller, 2005). As a result, the role of annual reports in the international financial sector is becoming increasingly important. The annual statement is the responsibility statement of the Board of Directors and the Board of Commissioners to the General Meeting of Shareholders for controlling and supervising the issuers within one fiscal year (Luo, Li & Chen, 2018). The annual report also acts as a decision-making tool for stakeholders (Rahman, 2012).

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Readability is a critical aspect of textual knowledge that has been thoroughly researched in a variety of fields (Luo, Li & Chen, 2018). The readability of annual reports, according to Aymen, Sourour, and Badreddine (2018), increases the accuracy of the information and certifies that the requests of both internal and external consumers of financial statements remain met. Readability is vital because the significance of knowledge in a document can only be fully appreciated if it is well-written. (Lo, Ramos & Rogo, 2017). The costs of making an employee make decisions on behalf of a principal are referred to as corporate agency costs (Firth, Fung & Rui, 2008). Corporate agency costs can manifest themselves in a variety of ways, including self-serving behaviour on the part of managers concerned with ensuring that their interests and objectives are realized at the expense of the company (Jor & Iqbal, 2009). The negative implications of these actions are then felt by shareholders in the form of asset loss and larger effects on other company stakeholders (Lo, Ramos & Rogo, 2017). When a manager owns no or just a few shares in the business, he has a stronger incentive to gain these benefits (Firth, Fung & Rui, 2018). These occurrences can incur corporate agency costs.

Many people say that the Nigerian financial climate is unfavourable to investors (Ibadin & Dabor, 2015). The inability of financial results to fulfil the needs of investors is the primary cause of this belief (Fodio, Ibikunle & Oba, 2013). According to Aymen, Sourour, and Badreddine (2018), the persistence of bribery, excessive earnings of management, and other corporate agency costs in Nigeria has eroded investors' and stakeholders' confidence in financial reports and their ability to perform the necessary functions. According to Onwuchekwa et al. (2012), one of the major causes of instability at the management and board level, which leads to corporate agency costs, is that most annual reports of corporate organizations in Nigeria are not readable.

Furthermore, various research on the readability of corporate annual reports has been conducted. Aymen, Sourour, and Badreddine (2018), for example, used 88 businesses listed on the French CAC All between 2009 and 2014 to explore the impact of financial information readability on the actions of financial analysts. The results demonstrated a link between analyst decisions and annual report readability. Furthermore, Rjiba, Jahmane, and Abid, (2020) evaluated the impact of annual report readability on the cost of equity capital in a sample of 288 particular French enterprises between 2002 and 2006. Companies with fewer accessible annual reports have a higher cost of equity capital, according to the current data. Luo, Li and Chen (2018) examined the association between annual report readability and corporate agency costs using 19,221 firm-year observations of Chinese A-share listed businesses from 2001 to 2015. Enterprises with higher annual report readability have lower agency costs, according to the analysis, and the negative association between readability and agency costs is stronger in firms with higher external audit quality, internal control quality, or analyst coverage. Lim, Chalmers, and Hanlon (2018) investigated the role of corporate strategy in annual report readability. They discovered that companies that follow an innovation-focused prospector strategy have less readability than those that pursue an efficiency-focused defence approach. Although these studies have been conducted, many of them have not focused on the relationship between annual report readability and corporate agency expenses, particularly in the case of deposit money institutions. Furthermore, most research on annual report readability and corporate agency fees has been conducted outside of Nigeria. As a result, there are gaps in the information that needs to be addressed. As a result, the purpose of this study would be to ascertain the association between annual report readability and corporate agency costs in Nigerian publicly-traded deposit money banks.

Literature Review

This section covers the extant literature reviewed such as concepts, theories and empirics.

Conceptual Review

Annual report readability

The annual report serves as an essential means of contact between a company and its shareholders. According to Anand, Tulin and Kumar (2014), the annual report is the accountability report to the General Meeting of Shareholders of the Board of Directors and the Board of Commissioners for controlling and overseeing the issuers or public businesses throughout one fiscal year. According to Dale and Chall (1949), readability is the sum of all the elements in a piece of written material that affects the end user's comprehension. Dubay (2004) describes readability as the ability of a piece of writing to be read quickly, remembered, and understood. Furthermore, Colmer (2020) describes readability as a measure of how easy it is to read a piece of text. Complexity, familiarity, legibility, and typography may all be included. Furthermore, According to Loughran and McDonald (2010), readability is the ease with which a text may be read, understood, and memorized. As part of their equations, readability usually considers variables such as sentence length, syllable density, and word familiarity (Berger, 2011).

Lindblom (2014) notes that the more readable a written material is, the more likely it is to achieve readers' comprehension and learning. If the readability of the text is high, end-users would be able to interpret the content easily. On the other hand, if the readability is poor, it will be more difficult for people to grasp the content, which can lead to people misinterpreting the context or drawing incorrect inferences (Lo, Ramos & Rogo, 2017).

Corporate agency costs

Agency costs are those costs that arise due to the conflict of interest of the principal and the agents of the company, each of whom endeavours to optimize their own goals at the expense of the other (Ibrahim et al, 2016). The principal would then place certain limits on the agents' activities to match their conduct with the principal's objectives. Agency costs can occur in a variety of forms, including self-serving behaviours by managers seeking prestige or empire-building aims, excessive perk use, inefficient investment decision-making, or acts of accounting mismanagement or corporate fraud. The negative implications of these actions are then felt by shareholders in the form of asset loss and larger effects on other company stakeholders (Gani & Ashraf, 2005).

An agency contract is one in which one or more persons (the principal) engage another person (the agent) to provide a service on their behalf, with the principle delegating certain decision-making authority to the agent (Jensen & Meckling, 1976). There are two types of disputes here: conflicts between shareholders and management and conflicts between shareholders and the firm's creditors (Ventroux, Vidal and Marle, 2017). Agency theory recognizes that managers' and shareholders' interests do clash and that if left to their own devices, managers can make major financial policy decisions such as the firm's capital structure that are suboptimal from the shareholders' perspective (Mustapha & Ahmad, 2011). This is because managers bear the entire expense of pursuing benefit maximization while receiving just a portion of the income. Managers should not always manage the company for the benefit of their shareholders. When managers follow their interests to the detriment of the shareholders, the company incurs agency costs (Mustapha & Ahmad, 2011).

Theoretical Review

Agency theory

According to the agency theory, a firm is a network of contacts between economic resource owners (the principals) and managers (the agents) responsible for exploiting and managing those resources (Jensen and Meckling, 1976). According to the theory, agents have more knowledge than principals, and this information asymmetry undermines principals' ability to regulate whether or not agents appropriately represent their interests. As such, the theory defines firms as required mechanisms for contract maintenance, and through firms, it is possible to exercise control that minimizes agents' opportunistic behaviour (Jensen and Meckling, 1976). According to the theory, a detailed contract is written to meet the needs of both the agent and the principal to harmonize their interests. The principal's use of an expert and processes (auditors and control systems) to track the agent strengthens the agent-principal relationship even further (Junttila, Holopainen and Pystynen, 2020).

The agency theory assumes that agents know more than principals and that this information asymmetry limits principals' ability to regulate whether or not their requirements are appropriately represented by agents. (Jensen & Meckling, 1976). The theory also describes the relationship between an Agent and a Principal. According to this theory, a principal-agent relationship is formed when a person (agent) acts on behalf of or performs certain services on behalf of another individual (the principal). The Agency theory seeks to address issues that may arise in agency relationships to align priorities. The most common agency relationship in finance exists between shareholders (principal) and company executives such as managers (agents). The principal or shareholder initiates the agency arrangement when he purchases shares of stock from the firm, with the agents as company managers who have the responsibility of overseeing and making decisions on behalf of the shareholder's interests.

As a result, the agency theory seeks to emphasize the fact that investors and shareholders depend on the information quality of financial statements, which is typically supplied by management (Junttila, Holopainen and Pystynen, 2020). The implication of the preceding is that investors' decisions about whether or not to invest in a firm or group of firms are primarily focused on the information available to them.

Empirical Review of Literature

Xu, Pham and Dao (2020) investigate the effect of annual report readability on enterprises' capacity to get trade credit from suppliers. The Gunning Fog Index is the key indication of annual report readability, while the ratio of accounts payable to total assets is used as a measure of trade credit. It is based on a survey of 4,754 firms that was done between 2004 and 2016. According to the findings of a survey of 4,754 organizations conducted between 2004 and 2016, suppliers give more trade credit to companies with more accessible financial documents. Fang-Klingler (2019) investigated the impact of annual report readability on the corporate bond market. Secondary data was used in the analysis. The report employed a corporate bond universe centred on the BofA Merrill Lynch Global Corporate Index from 1999 to 2017. Companies with fewer readable annual reports have higher credit spreads, higher credit spread volatility, higher transaction costs, higher transaction costs volatility, smaller trade size, a greater number of trades, and a greater number of trades volatility in the US corporate bond sector, according to the findings.

Kazemiolum, Abdi, Zalaghi and Jalalvand, (2020) investigated whether the readability of financial statement footnotes in annual reports provides insight into audit engagement risk. The analysis relied on secondary data. According to the findings of the report, financial statement footnote readability offers additional information about audit engagement risk, which influences auditor-client contracting. Similar Tuo, Zhang, Liu, and Du (2019) investigated whether a business education's teaching of business skills, cognitive preferences, and professional ethics would shape the CEO/thought CFO's in deciding terms, languages, paragraphs, and contents provided in financial reports when the self-interested CEO/CFO appears to control the perception of financial information users. The study used a sample of S&P 1500 CEOs and CFOs, and we discovered that a CEO (CFO) with a business degree is correlated with better (worse) annual report readability and that the positive (negative) relationship is improved (moderated) by internal corporate governance and external analyst following. The findings indicate that, while business education has no direct effect on financial reporting efficiency, it is beneficial to CEOs in improving their monitoring position in the firm's financial reporting activities.

Ben-Amar and Blegacem (2018) explored the relationship between corporate social responsibility (CSR) practices and financial communication syntactic complexity. The study relied on secondary data, with company social performance evaluated using a Sensationalistic database CSR score, which ranks business environmental, social, and governance (ESG) performance. MD&A syntactic complexity is calculated using the FOG index and the number of words. The statistics point to a link between corporate social success and the syntactic difficulty of MD&A. Rjiba, Saadi, Boubaker and Ding (2021) conducted a similar study on the impact of annual report readability on equity capital expenses. The study analysed secondary data from a sample of 288 unique French enterprises between 2002 and 2006 using the partial least squares approach. Companies with less accessible annual reports have a higher cost of equity capital, according to the data.

Methodology

The purpose of this research is to determine the association between annual report readability and corporate agency costs of Nigerian banks over a ten (10) year period utilizing ten (10) listed Deposit Money Banks in Nigeria. In this investigation, the ex-post facto research design is employed to investigate the relationship between the variables under discussion.

Model specifications

The econometric model used to analyze the association between annual report readability and corporate agency costs is as follows:

$$CAC = f\ (ARR) \tag{1}$$

$$\mathrm{Y} = \beta_0 + \beta_1 \text{ Annual Report Readbility} + \varepsilon_{it} \tag{2}$$

$$\mathrm{CAC_{it}} = \beta_{0it} + \beta_1\ \mathrm{ARR_{it}} + \varepsilon_{it} \tag{3}$$

Where:

CAC= Corporate Agency Costs;

ARR = Annual Report Readability;

β_0 = Constant intercept;

β_1 = Coefficient of the independent variable;

ε = Error Term.

Methods of Data Analysis

In the data analysis procedure, descriptive and inferential statistics were used. A frequency table and percentages are used in the descriptive statistic, whereas Panel Ordinal Least Squares Regression is used in the inferential statistic.

Measurement of Variables

Table 1 shows the variables used in the study (dependent and independent variables) and how they are measured:

Table 1. Measurement of variables

s/n	Variable	Symbol	Measurement
1	Agency cost 1	AC1	$\frac{Administrative \wedge sellingexpenses}{revenue}$
2	Agency cost 2	AC2	$\frac{totalreceiveables}{totalassets}$
3	Annual report readability 1	AR1	$\frac{logofwords}{logoftotalassets}$
4	Annual report readability 2	AR2	$\frac{logofcharacters}{logoftotalassets}$
5	Annual report readability 3	AR3	$\frac{logofpagenumbers}{logoftotalassets}$

Source: Authors' Computation (2021).

Data Analysis and Interpretations

This section is divided into four parts: the first examines the descriptive statistics, the second examines the correlation matrix between the variables, the third represent the Hausman test of the variables and the fourth examines the regression analysis between the variables.

Descriptive statistics

Table 2 shows the descriptive statistics of the independent and dependent variables i.e. annual report readability and agency cost.

Table 2. Descriptive statistics

	AC1	AC2	Readability_1	Readability_2	Readability_3
Mean	1.034710	0.457665	0.622803	0.722913	0.296256
Median	0.032486	0.467248	0.549370	0.636746	0.273072
Maximum	18.79224	0.722674	0.846327	0.973148	0.424561
Minimum	0.000168	0.113207	0.447837	0.527201	0.165028
Std. Dev.	3.084344	0.119798	0.119013	0.135320	0.056304
Skewness	3.773716	-0.588072	0.554004	0.536915	0.501508
Kurtosis	18.06254	3.400587	1.690699	1.643822	2.300312
Jarque-Bera	1182.682	6.432439	12.25813	12.46804	6.231688
Probability	0.000000	0.040106	0.002179	0.001962	0.044341
Sum	103.4710	45.76654	62.28032	72.29131	29.62560
Sum Sq. Dev.	941.8044	1.420794	1.402244	1.812831	0.313840
Observations	100	100	100	100	100

Source: Authors' Computation (2020).

Agency cost 1 (AC1) had a mean of 1.034710, with a median of 0.032486. the standard deviation was at 3.08 while it had a skewness and kurtosis of 3.77 and 18.06 respectively. The probability of the analysis was at 0.0000 which entail that the results are significant at 5% significant level.

Agency cost 2 (AC2) has a mean of 0.458 and a median of 0.567. the standard deviation of AC2 was 0.1198. The probability of the analysis was at 0.0401 which entail that the results are significant at 5% significant level.

Readability was examined using 3 different variables which were specified as Readability_1, Readability_2 and Readability_3 respectively. The mean of readability was 0.62, 0.72 and 0.29. They had median of 0.549. 0.637 and 0.237 respectively. The total number of observation was 100 for all the variables. They had a standard deviation of 0.119, 0.134 and 0.0563 respectively.

The probability of Readability_1, Readability_2 and Readability_3 were at 0.00218, 0.00196 and 0.04434 respectively which entail that they were all significant at 5% significant level.

Correlation matrix

Table 3 shows the correlation levels between the variables, i.e. the independent and dependent variables.

Table 3. Correlation matrix

	AC1	**AC2**	**Readability_1**	**Readability_2**	**Readability_3**
AC1	1	0.08	0.26	0.26	0.28
AC2	0.08	1	-0.29	-0.30	-0.21
Readability_1	0.26	-0.29	1	0.99	0.94
Readability_2	0.26	-0.30	0.99	1	0.94
Readability_3	0.28	-0.21	0.948	0.94	1

Source: Authors' Computation (2021).

From Table 3, it is evident that the independent variables are highly correlated but this is not significant since each independent variable has its own separate model and are not merged in one econometric model.

Hausman tests

These experiments were performed on the different models to determine which effect better suits the model; the decision rule states that if the probability value is greater than 5%, reject the null hypothesis, and thus a random effect should be used; if the probability value is less than 5%, a fixed effect should be used.

Table 4 represent the Hausman test for the first model. I.e. model one.

Table 4. Hausman Test for Model One

Correlated Random Effects - Hausman Test
Equation: Untitled
Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	1.048916	3	0.7894

Source: Authors' Computation (2021).

From Table 4, Since the likelihood value is greater than 5%, the null hypothesis is discarded, and a random effect is used.

Table 5 represent the Hausman test for the second model. I.e. model two.

Table 5. Hausman Test for Model Two

Correlated Random Effects - Hausman Test
Equation: Untitled
Test cross-section random effects

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	3.925177	3	0.2697

Source: Authors' Computation (2021).

From Table 5, since the likelihood value is greater than 5%, the null hypothesis is discarded, and a random effect is used.

Panel Regressions

Table 6 shows the panel regression analysis of the study between the independent and dependent variables for model one.

Table 6. Panel Regression Analysis for Model One

Dependent Variable: AC1				
Method: Panel Least Squares				
Total panel (balanced) observations: 100				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	2.559011	5.347370	0.478555	0.6335
READABILITY_1	-15.84069	15.42887	-1.026692	0.3074
READABILITY_2	7.389759	12.65762	0.583819	0.5609
READABILITY_3	10.12004	10.36920	0.975971	0.3318
Root MSE	1.312060	R-squared		0.817213
Mean dependent var	1.034710	Adjusted R-squared		0.792000
S.D. dependent var	3.084344	S.E. of regression		1.406676
Akaike info criterion	3.641073	Sum squared resid		172.1501
Schwarz criterion	3.979746	Log-likelihood		-169.0537
Hannan-Quinn criteria.	3.778140	F-statistic		32.41355
Durbin-Watson stat	1.617594	Prob(F-statistic)		0.000000

Source: Authors' Computation (2021).

From Table 6, Readability_1 has a coefficient of -15.84 which entails that the relationship between Readablility_1 and Agency cost one is negative. Readability_2 has a coefficient of 7.389759. The relationship between Readability_2 and Agency cost was positive. The relationship between Readability_3 and Agency cost was positive. The findings of the study were similar to those of Rjiba, Saadi, Boubaker and Ding (2021), Hu, Liu, and Zhu (2018), Giordano (2019) as they all found a significant and positive relationship between Agency cost and annual report readability.

The Durbin – Watson statistics was at 1.617594 and an R – squared of 0.8172 which entails that 81.72% of the variation in agency cost was explained by readability.

Table 7 shows the panel regression analysis of the study between the independent and dependent variables for model two.

Table 7. Panel Regression Analysis for Model Two

Cross-section random effects test equation:				
Dependent Variable: AC2				
Method: Panel Least Squares				
Total panel (balanced) observations: 100				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.027672	0.409691	-0.067543	0.9463
READABILITY_1	0.904077	1.182089	0.764813	0.4465
READABILITY_2	-0.407207	0.969769	-0.419901	0.6756
READABILITY_3	0.714888	0.794440	0.899863	0.3707
	Effects Specification			
Cross-section fixed (dummy variables)				
Root MSE	0.100524	R-squared		0.288773
Mean dependent var	0.457665	Adjusted R-squared		0.190672
S.D. dependent var	0.119798	S.E. of regression		0.107773
Akaike info criterion	-1.496841	Sum squared resid		1.010507
Schwarz criterion	-1.158168	Log-likelihood		87.84203
Hannan-Quinn criter.	-1.359774	F-statistic		2.943647
Durbin-Watson stat	1.616715	Prob(F-statistic)		0.001785

Source: Authors' Computation (2021).

The panel OLS for the independent models reveals that readability 2 has a negative relationship with AC2, while readability 1 and 3 have a positive relationship with AC2. The coefficient of determination R squad = 28%, which was reduced to 19%. This means that the change in the independent variables causes a 19% change in the dependent variable (AC2) (Readability 1-3). The F-statistic is 2.943647, indicating that the variables are well-fitting at the Prob value of 0.001785. The value of the Durbin-Watson statistic is 1.6, indicating that there is no autocorrelation. The study shows that there is a positive association between agency cost and annual report readability in Nigerian deposit money banks, which is consistent with Rjiba, Saadi, Boubaker and Ding (2021), Hu, Liu, and Zhu (2018), Giordano (2019), Ertugrul, Lei, Qiu, and Wan (2001).

Conclusion and Recommendation

According to the findings of this study, yearly report readability is a crucial element that has a substantial impact on the agency cost of DMBs in Nigeria. It means that in Nigerian DMBs, there is a significant association between annual report readability and agency cost; the above findings are confirmed by a 5% level of significance. The conclusions of this research suggest that DMBs should not underestimate the influence of annual report readability on firm agency expenses and should follow adequate procedures when planning and delivering reports to the general public. If appropriate guidelines are followed when preparing and delivering these financial reports, it will help to increase their readability, which will favour their users. These DMBs should also maintain a proper and easily accessible financial system that would include more reliable data that would be found in the annual reports. Finally, due to the uncertainty in the findings of the current literature, this study would suggest more research on this area.

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