

The Impact Management Commentary Report in Reduce Information Asymmetries at Iraqi Stock Exchange

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Abstract— The research aims at show the impact of management commentary report (MC) in Information Asymmetries □By analyzing the annual financial reports of a sample of banks listed on the Iraq Stock Exchange (the regular market), their number reached (11) bank for the period (2009-2018). MC measured through the management commentary Index (Ma.Co.I) which consists of (88) item distributed on four axes according to the elements of the content of MC report, which are business model, operating environment and risks, strategy and performance, financial position and progress. To measure Information Asymmetries, stock return volatility measure was used. The results of the research reached the absence of an acceptable level of reporting in MC report and for the period of the research sample, which leads to a phenomenon Information Asymmetries and thus leads to an increase in the cost of financing for companies and reducing the efficiency of financial markets. The results of the research also found that there is a negative impact of MC report in the Information Asymmetries This makes MC report impact ive mechanism in reducing Information Asymmetries. MC Report contributes to limiting Information Asymmetries, so the Iraq Securities Commission should give importance to the possibility of adopting MC Report by the listed companies for its effective role in providing useful information to the parties involved, especially for shareholders outside the company and potential capital providers.

Keywords— Management commentary Index (Ma.Co.I), adverse selection, moral hazard, stock return volatility.

I. INTRODUCTION

The efficiency of financial markets depends on a set of factors, one of which is the availability of useful information. financial markets have always faced challenges that affected their efficiency, which resulted from the failure to share useful information between the informed and the uninformed parties, which is known as a problem Information Asymmetries. authorities specialized in regulating accounting are employed to ensure the availability of useful information for their users and thus ensure the efficiency of financial markets. The work of the International Accounting Standards Board (IASB) On the practice statement MC report comes in the context of organizing the disclosure process by identifying useful information for parties outside the company, especially for potential investors and in a modern style. With the availability of useful information about the company's business model, its strategies, the operating environment, the risks to which it is exposed, and information on performance, financial position and progress, well-informed parties within the company

demonstrate their work to protect shareholders 'interests and reduce the imbalance in information sharing, thereby show their good intentions to potential capital providers, which leads to lower financing costs Thus the efficiency of financial markets.

The research seeks to achieve several goals, including measuring the level of reporting in MC report to the banks of the research sample. The research also aims to measure the level of compliance with the reporting requirements of MC report after diagnosing what it contains of the axes and paragraphs that need to be reported; and test the strength of the relationship between MC report and Information Asymmetries; and measuring the impact of MC report in the Information Asymmetries the banks of the research sample.

Problem Description

A sample of banks listed on the Iraq Stock Exchange suffers from a low level of disclosure of MC. where the analysis of the financial reports of the banks in the research sample shows a low level of disclosure on MC and the presentation of financial reports in an inappropriate way, so it may be difficult for users of financial reports to determine useful information, especially with no interest in preparing MC report, and this is what leads to Information Asymmetries. This affects the interests of shareholders and raises the concerns of capital providers regarding the feasibility of investing in such companies, which will be reflected in the cost of financing and the efficiency of financial markets. According to the above, it is possible to express the research problem with the following questions:

- 1- Is there an acceptable level of reporting in MC Report in the banks of the research sample?
- 2- Is there a relationship between MC Report and Information Asymmetries in the banks of the research sample?
- 3- What is the impact MC report on Information Asymmetries in the banks of the research sample?

II. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

A- MC report.

A narrative report (descriptive) that relates to financial reports that have been prepared in accordance with IFRSs. MC report provides users with historical explanations of the amounts presented in the financial reports , specifically the

company's financial position, financial performance and cash flows. It also provides commentary on an company's prospects and other information not presented in the financial reports. MC report also serves as a basis for understanding management's objectives and its strategies for achieving those objectives IASB (2010).

The objective of MC report is to support primary users in assessing an company's prospects for future cash flows and assessing management's stewardship of the company's economic resources by providing useful information and analysis which: (i) enhance the primary users' understanding of the company's performance and position as depicted in the related financial reports; and (ii) give insight into factors that could affect the company's prospects IFRS (2020).

Content elements for MC report:

IFRS Practice Statement MC was issued by the IASB in December 2010. MC report provides management with an opportunity to explain its objectives and its strategies for achieving those objectives Arshad (2011). in its current form, MC report tends to look at history and provides a simple analysis or biased explanation of the financial results. This simple analysis of financial results that is included in MC report adds no value to an informed reader as it can be independently performed by simply referring to the financial reports and notes to the financial reports, which usually accompany MC report. Tlou (2012). Under the update project Issued in 2017, the IASB is working to reformulate the content elements of MC report in the form of major content elements that come in a sequential and coherent manner to enable Users of Financial Reporting to understand MC report and Processing the defect in the previous practice statement 'the report elements are: -

- 1- Business model.
- 2- Strategy.
- 3- Operating environment and risks.
- 4- Performance, position and progress.

B- Information Asymmetries:

The information structure of a company refers to the three groups: that subject to mandatory disclosure, that which is voluntarily disclosed, and that which is undisclosed Wan (2009). Because some information is private, Information Asymmetries arises between those who hold that information and those who are likely to make better decisions if they obtain it Connelly et al (2011). Information Asymmetries is the condition when one party of a transaction possesses better information than the other party or parties, which puts her in a potentially favorable situation Lech (2019). Information Asymmetries is a condition where there is an imbalance information among management as an information provider (preparer), with the shareholders and other stakeholders Sihombing and Pangaribuan (2017). Information Asymmetries as a situation in which the informed parties within the company have internal information (private) that is not disclosed to the uninformed parties outside the company either because of a conflict of interests resulting from the separation of ownership from management or because there is no unified framework for disclosure that organizes and determine for

informed parties what It should be disclosed from useful inside information.

Models of Information Asymmetries

- At the market level (adverse selection)

When potential investors are unable to verify whether the companies has transfer the information accurately, and If investors cannot somehow beat their informational disadvantage generated by the depressed level of disclosure , they will tend to evaluate all company as 'average. High performing companies have an incentive to withdraw from the market instead of accepting lower terms than they deserve. Investors are faced with adverse consequences because the only companies willing to accept their terms are low-quality companies, who do so enthusiastically because they receive more favorable terms than they deserve. The occurrence of adverse selection is an indication of the occurrence of moral hazard when it is not potential for managers of companies to perform the conditions and pay returns to investors Dutta and Folta (2015).

- At the level of the company (moral hazard)

Moral hazard problems arise when managers misuse company resources to serve personal interests rather than maximize the value of the company. Such problems are exacerbated when shareholders do not have sufficient information to monitor economic decisions made by managers or to provide managers with biased or unrealistic information, especially if the information is related to measuring their performance Harakeh (2017).

Impact's Information Asymmetries

- *Investment and market efficiency*

The greater the Information Asymmetries, the more uncertain investors will be regarding growth predictions , As a result, investor will expect for higher premium for the risk that they risking. When the premium is too high and the company does not have capacity to push, it, the companies will reduce investment. So, there is less investor interested to invest due to the undisclosed information. Asymmetric information leads to inefficiency in the capital market Yoon and Ciganek (2011).

- *Liquidity in the markets*

Information asymmetries among market participants create an adverse selection problem, which is typically manifested in increased trading costs and reduced levels of stock liquidity, because when liquidity providers perceive increases in the adverse selection risk, they protect themselves by widening the bid-ask spread, thereby reducing liquidity and increasing the cost of capital Abad et al. (2018).

- *Capital cost*

That the existence of Information Asymmetries is assumed to result in misallocation of resources. When companies issue stocks, the transaction costs arising from adverse selection inhibit investment by investors with varying degrees of informedness. This Information Asymmetries forces diversely endowed investors into price protection to facilitate share purchases, increasing the cost of capital (García-Sánchez and Noguera-Gámez (2017).

Impact MC Report in Information Asymmetries.

MC report allows investors to increase their ability to understand financial reports, as it is an opportunity to see financial reports from the management point of view, which leads to a reduction that does the Information Asymmetries between the managers and the shareholders or between investors at the market level. The researchers discusses below the impact of MC report in reducing the phenomenon Information Asymmetries by assuming that MC report can be an impact ive way to communicate information that is outside the scope of financial reports such as non-financial information related to company strategies to develop its business model and the risks to which it is exposed and information on Intangible resources and future information as an endeavor to meet the needs of financial data users, especially capital providers, with high-quality disclosure.

MC Report and Disclosure of Non-Financial Information.

MC report is supposed to provide useful financial and non-financial information to users of financial reports from the managers' viewpoint and according to the criteria set by the Accounting Standards Board as it falls within the conceptual framework of financial reports.

1- MC report and disclosure of risks.

Modern portfolio theory would suggest that improving risk disclosure would in turn enable investors to deal more impact ively with risk diversification. Indeed, institutional investors would also require information on the unsystematic risks faced by their investee companies, so as to build up a comprehensive profile of corporate risk and to form expectations about the company as a going concern Solomon et al (2000). This disclosure is sure to have a major role in influencing investor convictions and reducing information asymmetries.

2- MC report and disclosure of intangible resources:

Company' disclosures of their intangible assets nevertheless contain only a restricted number of indicators and remain compromised by a lack of consistency and comparability, resulting from a lack of standards and diversity of indicators. Thus, Information Asymmetries on financial markets has not diminished, and resource allocation continues to be inefficient Labidi and Gajewski (2019).

3- MC report and disclosure of future information:

In some cases, the Information Asymmetries is high, yet the investor decides to invest in the company since he has information that in the next period the company would evolve investment to widen business activity and thus ensure that earnings growth are to meet long-term investor interests Marcel et al (2010).

4- MC report and disclosure of the strategy

Analysts generate information about strategy and business model through their forecasting and valuation activities. For company with low analyst coverage, externally-generated information on strategic goals and models for long-term value creation is likely to be more limited relative to their more intensely followed counterparts. In such cases, MC on strategy and business model is expected to provide a particularly valuable source of information for investors.

The findings of the study Said et al. (2018) show that most of the information disclosure by Malaysian Listed companies was not offered in a complete and balanced manner and not providing an insight because they are more concentrate on describing the process. Besides, there was no clear relate between companies' performance measure and strategies. Then, the reporting is not balanced and cannot help the shareholders in understanding risk and the opportunities associated with the business. The IASB believes that the practice statement provides useful guidance for companies to communicate information, from management perspectives, for users to expound the financial performance, financial position and cash flows of company. The flexible application of the practice statement, as it is nonbinding, is expected to benefit companies in jurisdictions that have local requirements or regulations. In addition, the practice statement can also promote companies that are not usual to presenting MC report to provide such disclosures in their annual reports. Overall, the provision of MC report ary in companies' annual reports is expected to make comparisons of financial reports more meaningful across borders Arshad et al (2011). The voluntary information disclosed in MC report provides opportunities for managers to communicate information beyond mandatory disclosure requirements. This can potentially smooth a company to develop its' standing for providing more thorough information to parties outside the company. Developing such standing can eventually support investors' relationship and correct investors' perception. At the same time, such disclosures grant managers to decrease uncertainty touching the company's current and future performance Graham et al (2005). The evaluation of the MC report in the corporate reports of the sample of airport companies revealed that not all the MC report Contained in the corporate reports of airport companies contains all the elements of what can be expected from a good and balanced report. With respect to the extent of incorporation of new trends and guidelines in MC report, the study showed that the current guidelines on MC report are still in the process of evolution and do not appear to have been fully embraced by all the airport companies in the sample in order to improve the quality of MC report Tlou (2012). Thus, according to the aforementioned literature review as well as the provided background about MC report and Information Asymmetries, first and second hypotheses are mentioned as follows:

Hypothesis 1: There are no statistically significant differences between the acceptable level of reporting in MC report and Average reporting It is in the banks of the research sample.

Hypothesis 2: There are no statistically significant between MC report and Information Asymmetries in banks the research sample

Hypothesis 3: There is no statistically significant effect of MC report and the controlling variables in the Information Asymmetries the banks of the research sample.

III. RESEARCH METHODOLOGY

A. *Statistical Society and Samples*

The research community consists of all banks listed on the Iraq Stock Exchange (the regular market) and their number

(19) bank according to the website of the Iraq Securities Commission (ISC2018) for the period (2009-2018). we choice of the banking sector comes from the fact that this sector represents the essence of the financial system of any country and the clear importance of banks in supplying the national economy with the funds necessary for development and progress on the one hand, and on the other hand, any crisis that banks are exposed to reflects on the entire national economy.

B. Sampling Method

The research sample was represented by (11) banks, the details of which were chosen as follows: - The Islamic banks, numbering (5) banks, were excluded, two banks were excluded because of the lack of condition No. (2) And bank (1) due to the absence of condition No. (3). For the final size of the sample to be (11) banks, it constituted (58%) of the research community and the conditions below for the inclusion of banks in the research sample.

- 1- Listed on the Iraq Stock Exchange (the regular market) for the period in question.
- 2- Availability of financial reports for the bank for the period in question.
- 3- Continuing to trade the bank’s shares for the period in question.

The sample is achieved after enforcing limitations on the statistical society. Then, the information related to the variables of the companies is achieved.

C. Variable Measurements

Measuring MC

To measure the percentage of disclosure of management commentary in MC report for the banks of the research sample. The researchers uses the index of MC. MC Index (Ma.Co.I) is a measurement indicator developed to provide the ability to detail the quality of MC disclosure of an companies, which has been identified by the Financial Accounting Standards Board and the International Accounting Standards Board Garefalakis and Dimitras (2018).

$$T = \frac{NID}{TII} * 100\%$$

T = total percentage of disclosure
 NID = the number of items disclosed
 TII = the total of the index items

Information asymmetries measures

The market-based measures that depend on adverse selection are among the most widely used metrics in accounting research, so for a measurement the Information Asymmetries for banks, the research sample is based on market-based metrics. According to studies Yu (2012), Wu and Sorensen (2013), Borghei et al. (2018) the researchers adopts a stock return volatility scale to measure the Information Asymmetries. Stock return volatility is defined as the change or standard deviation of the ratio of changes in prices or daily returns to stock Yu (2012). Stock return volatility is calculated by calculating the daily return of the stock of banks, the research sample for the period (1/2/31/5). This period was chosen in the belief the researchers that it is

sufficient to provide information to all parties related to the financial market; on the other hand, the period that was approved is the same period that was set by the Iraq Securities Commission for companies listed on the Iraq Stock Exchange as a maximum limit for the issuance of its financial reports. The researchers uses the following equation to measure the Information Asymmetries:

$$VOLA = STDEV.P \text{ (daily stock returns } t-1)\%$$

VOLA = stock return volatility.

STDEV.P = standard deviation.

$$STDEV.P : S_x = \sqrt{\frac{\sum(x-\bar{x})^2}{n-1}}$$

Daily stock returns = (opening price - closing price)

t-1 = returns calculation period

Age of the bank: The age of the bank is calculated from the date of its establishment through the date of the research period.

Size of the bank: The size of the bank i in the year t which is achieved through natural logarithm of total assets at the end of each year ElGhouti (2015).

Leverage (Lev): Financial leverage of bank i in the year t, which is achieved through debts, divided by total assets of the company Alfraih and Almutawa (2017).

Return on Shareholders' Equity (Roe): The return on shareholders' equity was calculated by dividing the net income attained at the end of the year by the total shareholders 'equity at the end of the year ElGhouti (2015).

D. Fitting Research Models

Entering research data into SPSS.25 software, the models are fitted. In such analyses, the p-value of final output shall be paid attention to figure out significance or insignificance of hypotheses; if p-value of a variable is less that (0.05) the hypothesis equals 0 and is rejected.

E. Testing First Hypothesis

The Statistical Test (One-Sample T-Test) is used to measure the level of reporting in MC report for the banks of the research sample. The researchers specifies a ratio of (50%) as an acceptable level for reporting in MC report and as a test value to implement the test. The test shows the following results: -

TABLE 1. One-Sample T-Test result for Second Hypothesis

One-Sample Statistics				
MC	N	Mean	Std. Deviation	Std. Error Mean
	110	0.4723	0.097	0.00926
One-Sample Test				
MC	Test Value = 0.5			
	T	Sig.	Mean Difference	
	-2.995-	0.003	-0.0277	

The table above and in the (One-Sample Statistics) section shows the results of the statistical analysis of the test data; the sample size is (110) views; the mean of the sample is (0.4723) and its standard deviation (0.9711) and the mean error rate (0.00926). The section of the table above for (One-Sample Test) shows that the difference between the assumed mean and the mean of the sample is (0.02773), which is a significant difference (0.003) less than (0.05), while the calculated value

(t) reached (2.995) It is greater than its tabular value of 1.984. According to the above data, the null hypothesis is rejected and the alternative research hypothesis is accepted (there are statistically significant differences between the acceptable level of reporting in MC report and the average reporting on it in the banks of the research sample).

Testing Second Hypothesis

To test the above hypothesis, the researchers uses the statistical program (SPSS.25) and uses the (Pearson Correlation) test to test the strength and direction of the relationship between the two variables (MC report and Information Asymmetries); the test results show the following results: -

TABLE 2. Pearson correlation of variables used in this research

		MC	Asy
MC	Pearson Correlation	1	-0.281
	Sig. (2-tailed)		0.003
	N	110	110
Asy	Pearson Correlation	-0.281	1
	Sig. (2-tailed)	0.003	
	N	110	110

The test results of the Pearson Correlation coefficient show an inverse relationship between MC report and Information Asymmetries with a correlation coefficient of (-0.281) with a significant significance of (0.001) less than (0.05), meaning that the increase in MC report is offset by a decrease in Information Asymmetries.

According to the above results, the null hypothesis is rejected and the alternative research hypothesis is accepted which states (There is a statistically significant relationship between MC report and Information Asymmetries for the banks of the research sample).

E. Testing Third Hypothesis

To test the above hypothesis, the researchers uses the statistical program (SPSS.25) and uses multiple linear regression analysis to predict the impact of the independent variable (MC report) and the controlling variables in the dependent variable (Information Asymmetries), and the multiple linear regression equation for the above hypothesis test is used using the model The following statistic: -

$$Asy = \beta_0 + \beta_1 MC + \beta_2 Size + \beta_3 Age + \beta_4 Roe + \beta_5 Lev$$

The tables below show the results of a multiple linear regression analysis with an explanation of the most important results.

TABLE 3. Multiple regression result for Second Hypothesis

R		0.69		
R Square		0.471		
F		18.509		
Sig.		0.000		
Model	B	Beta	T	Sig.
Constant	1.684		2.921	0.004
MC	-2.017	-0.285	-3.567	0.001
Age	-0.022	-0.192	-2.528	0.013
Roe	2.536	0.220	2.228	0.028
Lev	1.655	0.435	4.224	0.000
Size	-0.004	-0.015	-0.192	0.848

The above table shows the value of the correlation coefficient (R) between the independent and control variables and between the dependent variable (Information Asymmetries) and value is (69%) which is a good value that shows the strength of the relationship between the independent variables and the dependent variable, as the table shows that (R Square) equals (0.471) That is, the independent variables explain (47.1%) of the variance or the variables that affect the dependent variable and that the remaining percentage is due to other reasons, including random error.

The above table for the analysis of variance (ANOVA) shows the results of the analysis of variance for multiple linear regression that the regression has a statistical significance with a significant level of (0.00) less than (0.05). So the null hypothesis is rejected And acceptance of the alternative research hypothesis, which states (there is a statistically significant impact of MC report and control variables in Information Asymmetries the banks of the research sample).

The above table shows that the independent variable (MC Report) has a negative impact on the dependent variable (Information Asymmetries) with a rate of (2.017-) and with a significant significance of (0.001) less than (0.05). That is, every rise in the independent variable MC report by one degree, is offset by a decrease of (2.017-) in the dependent variable (Information Asymmetries). Based on the above table, the multiple linear regression model for the above hypothesis is:

$$Asy = 1.684 - 2.017 MC - 0.022 Age + 2.536 Roe + 1.655 Lev - 0.004Size$$

A. Results of Hypotheses

First Hypothesis Test Results

The first hypothesis of the study says: “There are statistically significant differences between the acceptable level of reporting in its MC report and the average reporting in banks for the research sample. There is no acceptable level of reporting in its MC report to the banks, the research sample, and with statistical significance, this is concompained by the lack of interest of the banks in the research sample to disclose its strategy to develop the business model and the weak interest in disclosing the risks to which it is exposed, and This leads to Information Asymmetries.

Testing Second Hypothesis

There is an inverse relationship between MC report and Information Asymmetries In statistical terms, this result is consistent with the ultimate goal of MC report in reducing Information Asymmetries.

Testing Third Hypothesis

The second hypothesis of the study says "There is a statistically significant impact of MC report and the control variables in Information Asymmetries the banks of the research sample There is a negative impact of MC report in the Information Asymmetries and statistically. This result is consistent with the supposed ultimate goal of MC report. The availability of information on the content elements of the report meets the needs of the stakeholders, especially the minority shareholders and potential investors, and is clearly reflected in a reduction Information Asymmetries.

IV. RECOMMENDATIONS

- 1- Banks listed on the Iraq Stock Exchange should pay more attention to raising the level of reporting in MC report. This is imposed by the unacceptable level of reporting MC.
- 2- Banks listed on the Iraq Stock Exchange should give adequate attention to disclosing their short, medium, and long-term strategies to develop their business model and the impact of these strategies on future cash flows.
- 3- Banks listed on the Iraq Stock Exchange should give adequate attention to disclosing the risks to which they are exposed and the impact of these risks on future cash flows.
- 4- MC Report contributes to limiting the Information Asymmetries, so the Iraq Securities Commission should give importance to the possibility of adopting MC Report by the listed companies for its active role in providing useful information to the parties involved, especially for shareholders outside the company and potential capital providers.

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