

Audit committee and the quality of financial reporting information - evidence in the new organisational structure of Vietnamese listed companies

Le Doan Minh Duc^{1*}, Huynh Loi¹, Phung Quoc Viet¹

¹University of Economics Ho Chi Minh City (UEH), Ho Chi Minh city, Vietnam; duclm@ueh.edu.vn (L.D.M.D.).

Abstract: The Audit Committee (AC) is a new part of organisational structure of a joint-stock company (JSCs), which has just been legislated in Vietnam since 2021. The AC aims to supervise activities to enhance the truthfulness and fairness of financial reporting information. The article aims to analyze and evaluate the actual effectiveness of the AC in improving the quality of financial statement information. The secondary data including 255 observations from listed companies that have established AC. We carried out analysis and forecast using the binary logistic model. The results show that the AC has played a primary role to improve the quality of financial statement information.

Keywords: *Audit committee, Financial reporting, Information quality, Joint-stock company.*

1. Introduction

The AC is a new part of organisational structure, directed at inspecting and monitoring activities to enhance the truthfulness and reasonableness of financial statement information (Deloitte, 2014; KPMG's Audit Committee Institute, 2017; PricewaterhouseCoopers (PwC), 2018). The implementation of the AC originated from the Sarbanes Oxley Act of 2002, passed by the US Congress, and apply to all companies that are registered with the US Securities and Exchange. Moreover, the AC is increasingly being applied in countries worldwide to meet the requirements of administrators and stakeholders and in line with the international integration trend.

Around the world, there are many studies on the AC. Such committees form in JSCs due to the influence of a number of factors (Paul Collier, 1992; Grange, Ackers & Odendaal, 2021) such as: (i) Attributes of the board of directors; (ii) Company size; (iii) Independent audit. The effectiveness of the AC's activities depends on attributes (Compernelle & Richard, 2018; Drogalas et al., 2020) such as: (i) Personnel characteristics; (ii) Characteristics of the meetings; (iii) Professional skepticism. AC positively affects related subjects (Javed et al., 2021; Elkinawy et al., 2021) such as: (i) the company's operating results; (ii) Profit management; (iii) Financial statements and integrated reports.

The practical approach in Vietnam demonstrates that JSCs are now starting to pay attention to the role of the AC. A few businesses developed such a panel in 2017. Enterprise Law No. 59/2020/QH14, which was published by the National Assembly on June 17th, 2020, and becomes operative on January 1, 2021, establishes the AC's first legal corridor beginning in 2020. Since then, a lot of businesses have replaced the Supervisory Board with the AC in their governance structure. Although forming a new AC or changing the Supervisory Board into an AC has numerous benefits for businesses, there is no need to coordinate many personnel. Due to a lack of clear criteria and corporations' incomplete understanding of the AC's function, organizations often struggle to organize the AC. Analysis and review are now needed to determine if the AC serves the purpose of enhancing the quality of financial statement information. In contrast to other structures such as the supervisory board, the benefit-cost relationship, the effectiveness of the AC in improving the quality of financial statement information is a relatively new

topic in Vietnam that has not been studied and empirically evaluated. From here, the article examines the idea of how the establishment of the AC in the management hierarchy of a JSCs affects the quality of the financial statement information by comparing the differences in financial report quality between the two periods, before and after the AC's formation, with the hope of advancing the theory and practice of corporate governance in Vietnam.

In the following section, this paper will provide an overview of the research directions involving the AC. Evidence to support the necessity of the AC is also mentioned, accompanying with its role and characteristics. Next, the methodology of the research is presented. In the first phase, the paper reviews the studies of important foreign academics, as well as the AC instructions of the Big4 audit firms introduction of the AC, in order to identify relevant aspects, identify patterns, and formulate hypotheses. The study then employs the Binary Logistic model to test the hypothesis, assess the connection between the elements, and determine the suitability of the research model. Afterwards, the findings and recommendations are stated and discussed.

For the purpose of guiding the proper implementation procedures, research questions are proposed. First research question (Q1) is: What factors influence the establishment and selection of the AC within the management structure of a JSCs? The second research question (Q2) is: How does the AC impact the quality of financial statement information before and after the JSCs establishes and maintains an AC?

2. Literature Review

As an attempt to explain the research directions in relation to AC, the article provides a summary of recent studies that are representative of the field. Therefore, the authors present three prospective primary study directions for future analysis concerning the AC in Figure 1.

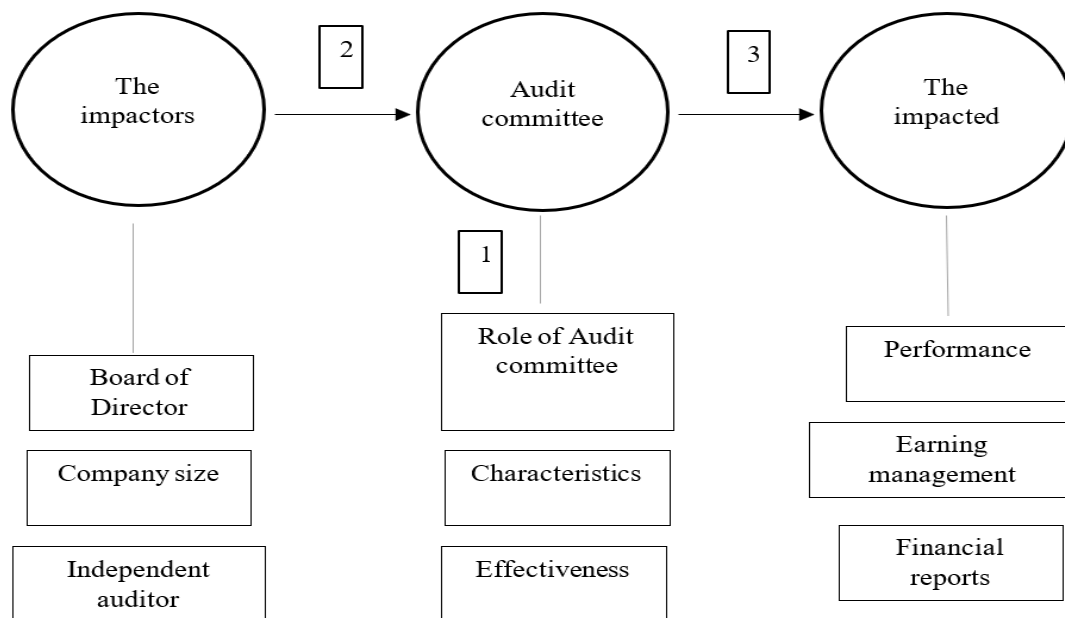


Figure 1.
Research directions on AC.

2.1. Research Direction 1 – The Role and Effectiveness of the AC and Characteristics

The problem of information asymmetry comes from the separation of ownership and management rights in a JSC due to a conflict of interest between the owner and the authorized manager (Spence & Zeckhauser, 1978). Consequently, enterprises need to have an independent department or mechanism to

monitor, control, and enhance operational efficiency, compliance, and information reliability. Several departments, including the Supervisory Board, the Internal Audit Department, and the Independent Audit Department, were established to fulfill this obligation. However, these divisions have not yet met expectations about the truthfulness of financial statements. Therefore, the AC is a new part of corporate governance that is being researched and applied to businesses in recent times.

The AC is claimed to increase the reliability and truthfulness of financial statement information, limits risks, and enhances compliance with business ethics (Deloitte, 2014; KPMG's Audit Committee Institute, 2017; PricewaterhouseCoopers (PwC), 2018) by performing the following functions: (i) review of financial information; (ii) supervising internal audit; (iii) auditor co-operation; (iv) risk control; (v) information supplier to the board of directors and shareholders; (vi) ethical issue monitor. Therefore, the presence of the AC in the management structure of a JSC can add value to the company and its stakeholders (Grange, Ackers and Odendaal, 2021a).

The efficiency of the AC is a factor that organizations continuously evaluate, and capitalize on its values. The contributing qualities of AC members (qualification, experience, and independence) are crucial factors influencing the Committee's performance (Grange, Ackers and Odendaal, 2021b). Particularly, the Chairman of the AC's leadership style (Compennolle and Richard, 2018) and their approach to overcoming work obstacles (Free, Trotman, and Trotman, 2021) contribute to the AC's high efficiency. It is notable that the AC's independence must be maintained by frequent evaluation and prompt identification of possible concerns. Attributes that need to be assessed are: the number of board members, the number of independent directors on the board, and relevant charters (Drogalas et al., 2020; Ali & Meah, 2021).

2.2. The Second Research Direction - Factors Affecting the Formation of the AC

The AC was established in response to the requirement to enhance control in publicly traded corporations in order to address the issue of information asymmetry (Chiu, Chung and Hung, 2022). The AC is regarded as a novel management structure with several benefits and is consistent with worldwide standards. Most nations have a legislative framework for publicly traded firms to freely select an AC, but not obligated to do so. Therefore, the formation of the AC in these firm depends on the decision of the Board of Directors and a variety of other variables. In the few studies following such direction, frequently discussed factors include: (i) attributes of the Board of Director; (ii) firm size; and (iii) independent audit (Elad, Ngan, & Bongbee, 2017; Hernández-Trillo, Pagán, & Paxton, 2005; Lynn, 1985).

Through the process of corporate governance, the Board of Directors directly influences the creation of the AC. The Board of Directors will identify and select the management system's components (Elad, Ngan, & Bongbee, 2017) and implement and utilize management tools. Consequently, the Board of Directors deliberates and makes a decision about the AC's organizational structure within the management hierarchy. The degree of directors' ownership impedes the creation of audit committees from a governance perspective (Jensen & Meckling, 1976) since they have little willingness to control independent financial information.

The advantages from the oversight of the AC are much greater than the expenses of maintaining the AC (Paul Collier, 1992). This is because the benefits from the oversight of the AC are significantly greater than the costs of maintaining the AC. The number of shareholders is correlated with the size of a firm (Hernández-Trillo, Pagán, & Paxton, 2005), which encourages the development of an AC in an organization to avoid conflicts of interest and information asymmetry (Paul Collier, 1992).

In addition, major and respected independent auditing companies advise businesses to establish an AC (Lynn, 1985) to assist them with their audit work and boost the information's dependability and transparency. Big audit firms frequently conduct research and offer guidance and support to businesses in establishing and operating the AC (Deloitte, 2014; KPMG's Audit Committee Institute, 2017; PricewaterhouseCoopers (PwC), 2018).

2.3. Third Research Direction - The AC Influences Relevant Subjects

The AC enhances the company's operational efficiency. The AC generally lowers asymmetric information, conflicts of interest in agency relationships, hazards, and operational inefficiency (Chiu, Chung and Hung, 2021). Specifically addressing the qualities involving the AC, attributes impacting the performance of the firm include: the number of members, the number of meetings, the structure of the AC (Al -Homaidi et al., 2021), and the ownership concentration level (Javeed et al., 2021). In addition, the AC actively promotes internal audit (Weickgenannt, Hermanson, & Sharma, 2021) in order to strengthen the successful implementation of internal recommendations (Alzeban, 2021).

Earnings management negatively affects operating results and financial information reliability (Alia et al., 2020). The AC serves as a monitor to prevent such misconduct (overstating revenue, manipulating inventory systems, changing accounting policy). There are several papers focusing on the characteristics of AC personnel, such as age (Komal et al., 2021), financial accounting expertise (Setiawan et al., 2020), base gender structure (Setiawan et al., 2020), member independence (Mohammed Dakhllalh et al., 2021), and the number of members (Agyei-Mensah and Yeboah, 2019). Additionally, the number of meetings also has an impact on earnings management (Elkinawy et al., 2021).

The AC enhances the informational quality of financial statements (Ashfaque Ali Banbhan et al., 2021), integrated reports (Erin and Adegboye, 2021), and audit quality (Rani, 2018). The following AC characteristics serve this function: number of members, frequency of meetings, independence (Raimo et al., 2021), gender (Ud Din et al., 2021), reputation (Khoo, Lim, and Monroe, 2020), technical proficiency (Ashraf, Michalek, and Russomanno, 2019), and professional qualifications (Bédard and Paquette, 202).

The literature review reveals that international studies primarily examine the role of the AC in theory and practice via its constitutive characteristics. The existing studies have not analyzed the real efficacy of the AC before and after the formation of the AC in a JSC, leaving a gap in the literature.

Practice demonstrates that JSCs are now interested in the AC's role. Due to the lack of defined standards, therefore, JSCs confront several challenges in creating the AC. Enterprise Law No. 59/2020/QH14, adopted by the National Party Congress on June 17, 2020, and taking effect on January 1, 2021, opens the AC's first legal corridor. Accordingly (Article 137), a joint stock corporation has the option to select between two forms for management and operation:

- (i) the first model: General Shareholders' Meeting, Board of Directors, Supervisory Board, and Director or General Director;
- (ii) the second model: General Shareholders' Meeting, Board of Directors, AC, and Director or General Director. This model stipulates that at least 20 percent of the Board of Directors must have independent members and that the Board must have an AC. With the assistance of this legislative framework, the authors anticipated that all JSCs, particularly listed corporations, will begin to include the AC into their management structures in 2020 and 2021.

The AC is responsible for the following duties (National Assembly, 2020): (i) overseeing the veracity of financial statements; (ii) reviewing internal control and risk management systems; (iii) reviewing transactions with related parties; (iv) supervising internal audit; (v) recommending the selection of an independent audit firm, remuneration, and terms of the audit contract; and (vi) monitoring and evaluating the audit firm's independence, objectivity, and the quality of the audit.

Studies about the AC by Vietnamese researchers are scarce at the moment. Consequently, there is no in-depth research on the AC in Vietnam, according to the literature review. Particularly, a trending research topic is the analysis of the AC's actual efficacy when the firm chooses to establish one according to the corporation's management model. Therefore, how the formation and functioning of the AC impact the quality of financial statements information in Vietnamese listed firms needs to be addressed.

3. Research Method

3.1. Research Methodology

The paper employs a mixed approach and mixed research technique based on the methodology and framework of Olalere (2012). The issue of how the formation of the AC within the management structure of joint stock companies impacts the quality of financial statements information is investigated using a mixed approach in a business perspective.

3.2. Research Model

Through previous studies and comparison with practice in Vietnam, the authors present a research model (Figure 2) that influences the quality of financial statements information.

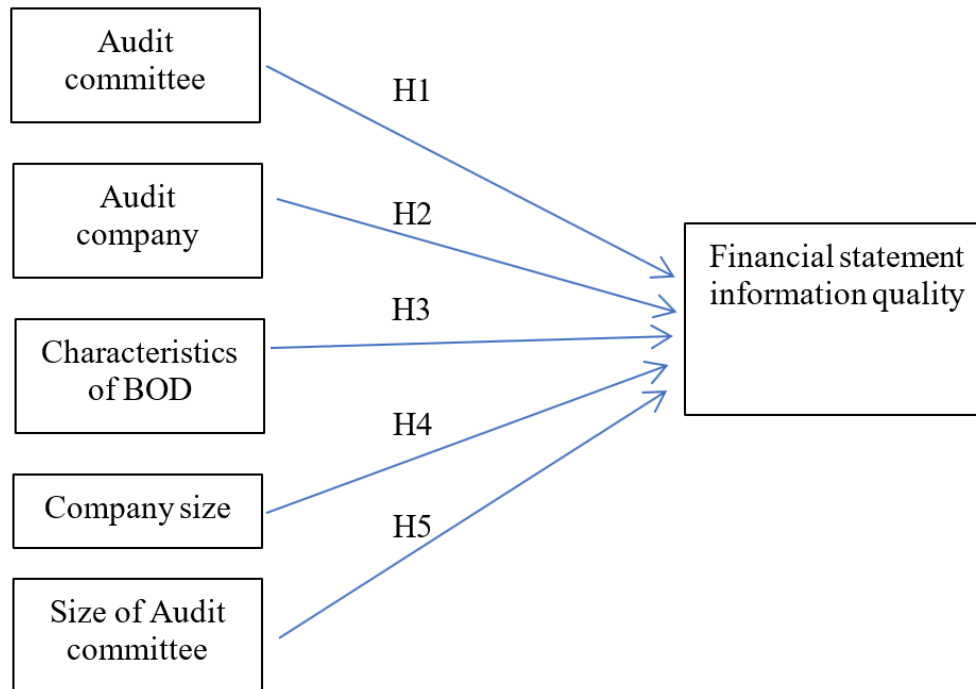


Figure 2.
Proposed research model.

The Binary Logistics regression model is used to analyze the quality of financial statement information. The dependent variable is measured in binary. The independent variables are continuous, binary or ordinal variables. The model is built as follows:

$$\ln\left[\frac{P(Y=1)}{P(Y=0)}\right] = \beta_0 + \beta_1\text{ACM} + \beta_2\text{COM} + \beta_3\text{BOD} + \beta_4\text{SIZE} + \beta_5\text{SOA}$$

Where:

+ Y=FRQ: Quality of financial statement information; ACM: Audit Committee; COM: Auditing company; BOD: Board of Directors; SIZE: Size of the company; SOA: Size of the audit committee.

+ $P(Y=1)=P_0$: Probability of qualified financial statements.

+ $P(Y=0)=1-P_0$: Probability that financial statement information is unqualified.

+ Ln: Logarithmic base e ($e=2.714$).

+ β_i : The bases of the independent variables.

+ Approach the coefficient of Odds, with the estimate Odds = $P_0/(1-P_0)$. The model is shown below:

$$\ln(\text{Odds}) = \beta_0 + \beta_1\text{ACM} + \beta_2\text{COM} + \beta_3\text{BOD} + \beta_4\text{SIZE} + \beta_5\text{SOA}$$

To forecast the quality of financial statements information according to the factors ACM, COM, BOD, SIZE and SOA, the forecasting probability function is expressed as follows: $E(Y/X) = e^{\text{Ln}(\text{Odds})} / (1 + e^{\text{Ln}(\text{Odds})})$. $E(Y/X)$ is the probability of predicting the dependent factor reaching the value 1 when the independent factors have a specific value.

3.3. Research Hypothesis

The AC is responsible for selecting an auditing firm, supervising the audit process, controlling risks, monitoring business ethics, and supervising the preparation and presentation of financial statements (Deloitte, 2014; KPMG's Audit Committee. Institute, 2017; PricewaterhouseCoopers (PwC) 2018). Therefore, the involvement of the AC within the management structure of a joint stock company can contribute to an improvement in the quality of financial statement information.

[H1]: The AC is anticipated to improve the quality of financial statement information.

Auditing companies serve as independent third parties capable of inspecting and verifying financial accounts. The larger the size and reputation of the auditing company, the more trustworthy the financial statement data (Jerry & Saidu, 2018).

[H2]: A renowned and large-scale independent auditing company has the power to positively influence the level of financial reporting accuracy.

The Board of Directors has an independent inspection and oversight mechanism to improve operational efficiency, compliance, and data integrity. Therefore, the Board of Directors with a large number of members (Ali & Meah, 2021) may efficiently carry out its responsibilities, thereby enhancing the quality of financial statements.

[H3]: Large board size can have a positive effect on the quality of financial statement information.

The greater the company's size, the more resources it owns to manage its accounting, financial, and oversight procedures efficiently. In Soyemi and Olawale's study (2019), bigger companies are strongly encouraged to establish an AC to improve the accuracy of financial statement information.

[H4]: The scale of a large firm can have a favorable effect on the quality of its financial statements.

Insufficient manpower will prevent the AC from effectively promoting job. The larger the AC (Raimo et al., 2021), the more effectively it will carry out its duties and increase the quality of financial statement information.

[H5]: The larger the audit committee, the more likely it is to increase the quality of financial statements information.

3.4. Measurement Method

Measurement methods are designed for the factors (Table 1) and data were collected from sources of financial statements, management reports, annual reports, audit reports:

Table 1.
Scale design.

No.	Factor	Scale	Scale Basis
1	Audit committee (ACM)	Audit committee that exists in the enterprise is measured by 1, if not, it is measured by 0.	Author elaborated
2	Financial report information quality (FRQ)	Financial statements that receive an unqualified opinion and are disclosed in a timely manner ensure the quality of financial statements information, as measured by 1 and the receipt of the remaining audit opinions or untimely disclosure of financial statements is measured by 0.	Developed from studies of Zaid Alkilani (2019) and Pucheta-Martínez & De Fuentes (2007)
3	Board of directors (BOD)	Number of board members appointed annually.	Brown & Caylor (2006)

No.	Factor	Scale	Scale Basis
4	Company size (SIZE)	Firm size is measured by the base 10 logarithm of assets.	Brown & Caylor, (2006)
5	Audit company (COM)	Measured by 1 if the incumbent auditing firm is in the Big 4 and 0 if it is not in the Big 4.	Brown & Caylor, (2006)
6	Size of Audit Committee (SOA)	The size of the audit committee is expressed in terms of the number of members on the audit committee.	Author elaborated

3.5. Data Collection

Secondary data were utilized for the analysis. We gathered data from 2017 to the end of 2021, the time period when there are corporations establishing the AC. Consequently, we found 51 businesses listed on the Hanoi Stock Exchange (HNX) and the Ho Chi Minh City Stock Exchange (HOSE) that has established an AC. Disclosures, financial statements, management reports, and other reports serve as sources for data collection. Hence, the sample consists of 255 observations from 51 organizations throughout the five-year span from 2017 to 2021.

4. Research Results

4.1. Organizing AC in Listed Companies

Prior to 2017, JSCs were founded in Vietnam with a management structure comprised of a board of directors and a supervisory board. In the period 2017-2020, a small number of public companies have completely replaced the Supervisory Board with the AC (Table 2). Due to the legislative structure of the Enterprise Law 2020, the number of companies with an AC will increase rapidly in 2021 (Table 2).

Table 2.
Number of listed JSCs with an AC from 2017-2021.

Year	Number of listed companies with an AC
2017	20
2018	21
2019	23
2020	25
2021	51

Source: Author collected from HOSE and HNX

4.2. Description of the Research Data Sample

With the sample selecting criteria being listed in JSCs that already have an AC in the management structure, the author collected a sample of 255 observations from 51 listed joint stock companies in the period 2017-2021 (Table 3):

Table 3.
Observation description.

Factor	No. of observation	Min.	Max.	Mean
Financial report information quality (FRQ)	255	0,00	1,00	0,7804
Audit committee (ACM)	255	0,00	1,00	0,5490
Audit company (COM)	255	0,00	1,00	0,5373
Board of directors (BOD)	255	2,00	13,00	6,1529
Company size (SIZE)	255	9,00	15,00	12,4784
Size of audit committee (SOA)	255	0,00	5,00	1,2980

Financial Statement Information Quality (FRQ) receives a value of 0 or 1, respectively, for the degree of uncertainty and quality assurance, and its mean (0.7804) reflects the financial statements with dominant quality information. The Audit Committee (ACM) received a value of 0 or 1, the mean value of 0.549 reflects about half of the observations that audit committees exist in the management structure of companies. Auditing firm (COM) has a value of 0 or 1, the average value of 0.5373 reflects about more than 50% of the observed financial statements are audited by a Big 4 firm. The Board of Directors (BOD) has a number of members from 2 to 13 people, the average value is 12.4784. Company size (SIZE) has a logarithmic value of assets between 9 and 15, with an average of 12.4784. The average size of an audit committee (SOA) ranges from 0 to 5 members, with a value of 1,298. The Audit Committee is comprised of a very small number of members and a condensed organization.

4.3. Model Compatibility Analysis

The first Binary Logistics Regression result is shown in Table 4.

Table 4.

Chi-square test.

Omnibus tests of model coefficients				
		Chi-square	df	Sig.
Step 1	Step	29.673	5	0.000
	Block	29.673	5	0.000
	Model	29.673	5	0.000

Table 5.

Wald test (1st step).

Variables in the equation							
		B	S.E.	Wald	df	Sig.	Exp(B)
Step 1 ^a	ACM	2,227	0,751	8,787	1	0,003	9,274
	COM	-1,214	0,411	8,723	1	0,003	0,297
	BOD	-0,038	0,103	0,133	1	0,716	0,963
	SIZE	0,523	0,232	5,082	1	0,024	1,688
	SOA	-0,317	0,253	1,570	1	0,210	0,728
	Constant	-4,971	2,769	3,221	1	0,073	0,007

Note: a. Variable(s) entered on step 1: ACM, COM, BOD, SIZE, SOA.

Table 4 shows the results of Chi-square test to assess the suitability of the regression model. The sig value of Chi-square test in the Model row is $0.000 < 5\%$, reflecting that the regression model is suitable.

Table 5 shows the results of Wald's test. The coefficients of factors ACM, COM, SIZE are statistically significant (p-value $< 5\%$). The remaining 2 factors BOD, SOA with Sig value $> 5\%$ show no significance in the regression model. Therefore, do not test hypotheses [H3] and [H5] respectively and do not further estimate the effects of BOD and SOA. In the next step, the author will regress the model with only statistically significant factors.

4.4. Result of Findings Analysis

From the results of the above Wald test, the regression continues with the dependent variable being FRQ, the independent variable being ACM, COM, SIZE. The results (Table 6, Table 7) are as follows:

Table 6.
Prediction interval.

Classification table					
Observed			Predicted		
			Financial statement quality		Percentage correct
			0,00	1,00	
Step 1	Financial statement quality	0,00	9	47	16,1
		1,00	7	192	96,5
Overall percentage					78,8

Note: a. The cut value is 0.500.

Table 6 reflects the model-wide prediction value of 78.8%.

Table 7.
Wald test (2nd step).

Variables in the Equation							
		B	S.E.	Wald	df	Sig.	Exp(B)
Step 1 ^a	ACM	1,429	0,340	17,635	1	0,000	4,176
	COM	-1,233	0,407	9,160	1	0,002	0,291
	SIZE	0,512	0,233	4,832	1	0,028	1,668
	Constant	-5,048	2,763	3,338	1	0,068	0,006

Note: a. Variable(s) entered on step 1: ACM, COM, SIZE.

Looking at the sign of coefficient B in Table 7, we accept the hypothesis [H1], [H4] and reject the hypothesis [H2].

From the value of B in Table 7, the regression model is estimated as follows: $\text{Ln}(\text{Odds}) = -5.048 + 1.429 \text{ ACM} - 1.233 \text{ COM} + 0.512 \text{ SIZE}$

Model for forecasting information quality of financial statements: $E(Y/X) = e^{\text{Ln}(\text{Odds})} / (1 + e^{\text{Ln}(\text{Odds})})$

Analyze the impact of each factor on the quality of financial statements information:

+ Factor ACM (Audit Committee): The factor of Audit Committee has the coefficients $B_1=1,429$ and $\text{Exp}(B_1)=4,176$ with the value $P_0=10\%$ for the analysis.

$$P_1 = P_0 \times \text{Exp}(B_1) / (1 - P_0 \times (1 - \text{Exp}(B_1))) = 10\% \times 4,176 / (1 - 10\% \times (1 - 4,176)) = 0.3169 = 31.69\%$$

For instance, the randomly selected initial probability for qualified financial statement information is 10%, when the company has an AC, the probability of qualified financial statement information is 31.69%, which is an increase of 21.69% compared to the original probability while other factors remain unchanged, and the ACM factor is considered separately.

+ With the same estimation, the COM factor (Auditing firm) and the SIZE factor (Company size) are analyzed, and the results are shown in Table 8.

Table 8.
The degree of influence of factors on the quality of financial statements information.

No.	Factor	B	Exp. (B)	Initial probability 10%	Increase/Decrease	Order of influence level
				Later probability		
1	Audit Committee (ACM)	1.429	4.176	31.69%	+21.69%	1
2	Audit company (COM)	-1.233	0.291	3.13%	-6.87%	2
3	Company size (SIZE)	0.512	1.668	15.64%	+5.64%	3

Table 8 also reflects the order of influence on the quality of financial statements information: Audit Committee, audit firm, company size. This order suggests that companies focus their resources to improve the quality of financial statement information.

5. Discussion

Research results show that the existence of an AC in JSCs increases the quality of financial reporting information. This result is similar to the research results of the authors in the international context such as: Ashfaque Ali Banbhan et al., (2021); Erin and Adegboye (2021). From a business perspective, the AC is a new part of corporate structure in Vietnam that follows the trend of worldwide integration, which also aims to enhance the accuracy and veracity of financial information. Moreover, the implementation of AC helps to manage and control risks in order to increase efficiency, enhance overall company performance, and meet stakeholder interests. In addition, the research results reinforce the evidence in Vietnam that company size positively affects the quality of financial reporting information (similar to the study of Soyemi & Olawale (2019)). When the financial statements are audited by Big4 audit company, the quality of information is increased (similar to the research of Jerry & Saidu (2018)).

6. Conclusion

The research results answered two research questions and validated the hypotheses. Research findings indicate: (i) Audit Committee, firm size, and Big4 audit firms have an impact on the quality of financial statements information, with the Audit Committee factor having the most positive impact; (ii) the model to predict the quality of financial statements information was also estimated.

The empirical evaluation of the extent to which the AC improves the quality of financial statements information in the period following the establishment and operation of an AC with a compact personnel structure (five or fewer members) in the management structure is also presented. This finding encourages corporations to analyze and weigh benefits when selecting a management structure organization in compliance with the Enterprise Law 2020.

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