Journal of Management, Accounting, General Finance and International Economic Issues
https://ojs.transpublika.com/index.php/MARGINAL
Online ISSN 2809-8013 | Print ISSN 2809-9222

https://doi.org/10.55047/marginal.v5i3.2325

Original Article

Control Environment and Financial Reporting Reliability in Islamic Philanthropic Organizations: Evidence from Indonesia

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Received : 01 July - 2026
Accepted : 20 August - 2026
Published online : 22 August - 2026

Abstract

The gap between Indonesia's zakat potential and actual collection underscores the need for greater public trust through enhanced governance. This study addresses the increasing demand for accountability and transparency in zakat management, which highlights the importance of reliable financial information in maintaining stakeholder trust and supporting organizational sustainability. The objective of this study is to examine the influence of the control environment on financial reporting reliability within an Islamic philanthropic organization in Indonesia. Drawing on Agency Theory and the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control Framework, this research investigates how organizational integrity, ethical values, governance structures, accountability mechanisms, and employee competence contribute to financial reporting reliability. A quantitative explanatory approach was employed using survey data collected from 171 employees of Rumah Zakat, one of Indonesia's leading National Zakat Institutions. The collected data were examined through Partial Least Squares Structural Equation Modeling (PLS-SEM). The results indicate that the control environment has a positive and significant effect on financial reporting reliability, with a path coefficient of 0.668 (t-statistic= 15.926), explaining 44.6% of the variance in financial reporting reliability (R^2= 0.446). The analysis points out that organizations characterized by strong ethical cultures, effective oversight, clear authority structures, and competent personnel are more likely to produce accurate, relevant, understandable, and comparable financial information. The implications of this study suggest that strengthening the control environment through enhanced ethical values, governance structures, employee competence, and accountability mechanisms can improve financial reporting reliability and reinforce public trust in Islamic philanthropic organizations.

Keywords: Control Environment, Financial Reporting Reliability, Internal Control, Islamic Philanthropy, Zakat Institution.

1. Introduction

Accountability and transparency have become critical issues in the management of nonprofit organizations, particularly those entrusted with public funds. In Islamic philanthropic organizations, such as zakat institutions, accountability is not only a managerial responsibility but also a moral obligation to donors, beneficiaries, regulators, and society. As organizations responsible for collecting, managing, and distributing zakat funds, zakat institutions are expected to demonstrate good governance practices and provide reliable financial information to maintain public trust and organizational sustainability.

Indonesia possesses enormous zakat potential due to its large Muslim population. However, the realization of zakat collection remains considerably below its estimated potential. One of the factors frequently associated with this gap is the level of public confidence in zakat management institutions. Donors are more likely to channel their zakat through formal institutions when they believe that the organization manages funds transparently, responsibly, and effectively. Therefore, improving accountability and financial transparency has become an important strategic objective for zakat institutions.

Financial reporting serves as one of the primary mechanisms through which organizations demonstrate accountability. Reliable financial information enables stakeholders to evaluate organizational performance, assess resource utilization, and make informed decisions. Financial reports that are accurate, relevant, understandable, and comparable can strengthen stakeholder confidence and support organizational legitimacy. Conversely, unreliable financial information may increase uncertainty, reduce transparency, and weaken public trust.

Various organizational factors affect the dependability of financial reporting, and the control environment ranks among them. The Committee of Sponsoring Organizations of the Treadway Commission (COSO) characterizes the control environment as the fundamental basis of an organization's internal control structure. It encompasses ethical values, integrity, leadership commitment, organizational structure, employee competence, and accountability mechanisms that collectively shape organizational culture and behavior. A strong control environment encourages compliance with policies and procedures, promotes ethical conduct, and supports the production of reliable financial information.

Only scant empirical investigation has been directed toward the specific contribution of the control environment, viewed as a separate component of the COSO Internal Control Framework, toward enhancing financial reporting reliability in Islamic philanthropic entities, which operate subject to unique governance and faith-based accountability requirements not found in public or commercial organizations (Chan et al., 2021; Gadelha et al., 2022; Mitakos & Mpogiatzidis, 2024). By investigating this relationship in the context of Rumah Zakat, one of Indonesia's largest National Zakat Institutions (LAZNAS), this study addresses this gap by providing empirical evidence from the Islamic philanthropy sector, which remains relatively underexplored (Rahman, 2021).

This study therefore sets out to analyze the impact of the control environment on financial reporting reliability within a single Islamic philanthropic organization located in Indonesia. It is hoped that the findings will enrich the existing literature on nonprofit governance and Islamic philanthropy through the provision of empirical data illustrating how the control environment enhances financial reporting reliability. In addition, the study offers useful implications for strengthening governance, accountability, and societal trust in institutions responsible for zakat administration.

Based on the background shared earlier, the guiding question that this study seeks to answer is: Does the control environment significantly influence financial reporting reliability in an Islamic philanthropic organization? On this basis, the study seeks to examine and appraise the influence of the control environment on financial reporting reliability within a zakat management institution in Indonesia.

2. Literature Review

2.1. Agency Theory

The relationship between principals and agents in organizational environments is explained by Agency Theory, which was originally advanced by Jensen and Meckling (1976). Principals delegate authority to agents to perform activities on their behalf, creating the potential for information asymmetry and conflicts of interest (Younas, 2022). Scott (2015) explained that agents generally possess more information regarding organizational activities than principals, making it difficult for principals to fully monitor managerial actions. Consequently, governance mechanisms are required to reduce agency problems and ensure accountability (Hendrastuti & Harahap, 2023).

In nonprofit organizations, agency relationships involve multiple stakeholders, including donors, regulators, beneficiaries, and organizational management (Lestari & Nisa, 2024). Zakat institutions, in particular, face substantial accountability demands because they manage public funds entrusted for social and religious purposes (Humaidi et al., 2022). Reliable financial reporting corresponds with reducing information asymmetry and increasing stakeholder confidence (Sem & Hastuti, 2024). Therefore, governance structures and internal control systems are necessary to ensure that financial information accurately reflects organizational activities and resource utilization.

2.2. Control Environment

COSO Internal Control Framework designates the control environment as the foundational element of the internal control system (COSO, 2013; Kenton, 2026). The term denotes the norms, processes, and organizational frameworks that lay the groundwork for executing internal control measures across all parts of the institution (Eulerich et al., 2024). The control environment is composed of multiple essential aspects, including adherence to integrity and ethical principles, the fulfillment of oversight duties, the formal organizational design, the distribution of authority and responsibility, an emphasis on competence, and established accountability procedures (Gadelha et al., 2022). These elements collectively influence organizational culture and employee behavior (Alqarawee, 2023). A strong control environment encourages compliance with policies and procedures, promotes ethical conduct, and supports transparency and accountability within the organization (Junusi, 2020).

Previous studies have highlighted the importance of the control environment in enhancing governance effectiveness and improving organizational performance (Rahman, 2021). Organizations characterized by strong ethical values, effective oversight, and competent personnel are more likely to implement effective internal control systems and maintain high-quality reporting processes (Li, 2020). Recent empirical evidence in the banking sector further demonstrates that the control environment positively influences organizational performance and that this relationship is strengthened through good corporate governance mechanisms (Otoo et al., 2026). These results underscore the strategic importance of the control environment as the bedrock of a sound internal control system across a range of organizational settings. Hence, a strong control environment is expected to enhance the reliability of financial reporting by fostering ethical behavior, strengthening accountability, ensuring compliance with organizational policies, and supporting the preparation of financial information that is accurate, consistent, and prepared under the framework of applicable accounting standards.

2.3. Financial Reporting Reliability

Financial reporting reliability refers to the extent to which financial information accurately represents organizational conditions and can be trusted by users in making decisions (Ramadhan & Hapsari, 2023). Reliable financial information should be free from material errors, unbiased, and capable of faithfully representing economic events and transactions (Fithri D. et al., 2022).

Financial reporting reliability is commonly reflected through several qualitative characteristics, including reliability, relevance, comparability, and understandability (Setiawan et al., 2023). These characteristics enable stakeholders to evaluate organizational performance, assess accountability, and make informed decisions (Judijanto et al., 2023). In nonprofit organizations, reliable financial reporting plays a crucial role in strengthening public trust and demonstrating responsible stewardship of organizational resources. Recent studies also emphasize that reliable financial reporting is supported by continuous process improvement, standardized reporting procedures, and systematic validation mechanisms that reduce reporting errors and improve reporting timeliness (Adiwibowo, 2026).

A reliable financial reporting system cannot be achieved solely through accounting procedures but also depends on the effectiveness of organizational governance. A strong control environment establishes ethical behavior, accountability, and supervisory mechanisms that reduce reporting errors and enhance the credibility of financial information. Consequently, organizations with a strong control environment are more likely to produce financial reports that faithfully represent organizational activities and support informed stakeholder decision-making.

For zakat institutions, financial reporting reliability is particularly important because donors and regulators rely on financial reports to evaluate whether zakat funds are managed transparently and effectively (Setiyawati, 2020). Consequently, organizations must establish governance mechanisms capable of supporting the preparation of reliable financial information.

2.4. Previous Research

Previous studies have generally reported positive relationships between internal control systems and financial reporting quality (Li, 2020; Rahman, 2021; Setiawan et al., 2023). Research conducted in public sector institutions, nonprofit organizations, and private corporations suggests that effective governance and internal control practices contribute to more accurate and transparent financial reporting.

The control environment is considered one of the most important determinants of reporting quality because it influences employee behavior, organizational culture, and compliance with reporting standards (Fatimah et al., 2024). Organizations that emphasize integrity, accountability, ethical conduct, and competence are more likely to produce financial information that is reliable and useful for decision-making purposes.

Collectively, these studies suggest that organizations with stronger governance practices and more effective internal control systems tend to produce higher-quality financial reporting (Li, 2020; Rahman, 2021; Setiawan et al., 2023). As the foundation of the COSO Internal Control Framework, the control environment influences employee behavior, promotes ethical values, strengthens accountability, and supports compliance with organizational policies and reporting standards (Alqarawee, 2023; Eulerich et al., 2024; Gadelha et al., 2022). These conditions are expected to reduce reporting errors and information asymmetry, thereby enhancing the reliability of financial reporting (Hendrastuti & Harahap, 2023; Younas, 2022).

The conceptual associations between the variables under examination in this study are presented in Figure 1, grounded in the theoretical arguments and earlier empirical findings reviewed above.

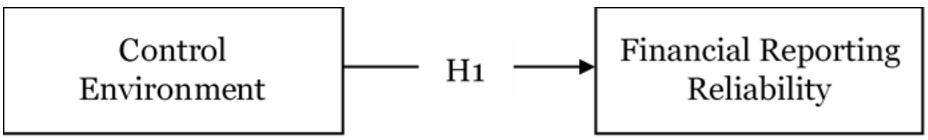

Figure 1. Research Framework

Source: Developed by the author based on Agency Theory and the COSO Internal Control Framework

Based on Agency Theory and the COSO Internal Control Framework, organizations with a strong control environment are expected to reduce information asymmetry, strengthen accountability, and consequently improve financial reporting reliability. Accordingly, the following hypothesis is proposed:

H1: Control Environment positively and significantly influences Financial Reporting Reliability.

3. Methods

To investigate the impact of the control environment on financial reporting reliability in an Islamic philanthropic organization, this study employed a quantitative approach with an explanatory research design. The choice of a quantitative method reflected the study's aim to test the causal linkage between variables, relying on empirical data collected via survey techniques. The research was conducted at Rumah Zakat, one of Indonesia's largest National Zakat Institutions (LAZNAS), which is engaged in the collection, management, and distribution of *zakat*, *infaq*, *sadaqah*, and other religious social funds.

In 2025, data were gathered via survey questionnaires distributed to Rumah Zakat personnel working in operational, financial, program, and support capacities. The questionnaire utilized a five-point Likert format, where 1 indicated strong disagreement and 5 indicated strong agreement. For data analysis, the Partial Least Squares Structural Equation Modeling (PLS-SEM) approach was applied using SmartPLS 4. PLS-SEM was chosen in lieu of covariance-based SEM (CB-SEM) due to its advantages in prediction-oriented studies, its lack of reliance on the multivariate normality assumption, and its robust performance when dealing with sample sizes that fall into the relatively small or medium categories (Hair et al., 2022). This approach is well-suited for analyzing relationships among latent constructs and for theoretical model development in a relatively underexplored research context such as Islamic philanthropic organizations.

3.1. Population, Sample, and Data Collection Technique

All employees of Rumah Zakat engaged in organizational operations constituted the population for this research. A purposive sampling method was applied, in which participants were chosen according to particular criteria aligned with the study's aims (Fadel et al., 2024). The criteria included employees who possessed an understanding of internal control processes, organizational governance, and the preparation and utilization of financial reporting information.

In total, 171 usable questionnaires were collected and subjected to analysis. According to Hair et al. (2022), this number of observations is considered adequate for PLS-SEM, which is appropriate for research oriented toward prediction and which yields robust estimations under conditions of small to moderate sample sizes.

3.2. Variable Measurement and Data Analysis Technique

The independent variable in this study was the control environment, while the dependent variable was financial reporting reliability. The indicators used to measure the control environment were derived from the COSO Internal Control Framework (COSO, 2013) and earlier empirical research (Gadelha et al., 2023), and they encompass integrity and ethical values, oversight responsibilities, organizational structure, commitment to competence, and accountability. Financial reporting reliability was assessed through the qualitative attributes of financial information, namely reliability, relevance, comparability, and understandability, consistent with applicable financial reporting standards and prior investigations (Setiawan et al., 2023).

Data analysis proceeded in two distinct stages: first, an evaluation of the outer model (measurement model), and second, an evaluation of the inner model (structural model). The measurement model was scrutinized through convergent validity, discriminant validity, Average Variance Extracted (AVE), Composite Reliability, and Cronbach's Alpha. Subsequently, the structural model was examined using path coefficients, the R^2 measure of determination, effect sizes (f^2), and bootstrapping for hypothesis testing. The criterion for support required a t-statistic greater than 1.96 and a p-value less than 0.05, with alpha set at 5 percent.

4. Results and Discussion

4.1. Research Results

4.1.1. Research Model Results

Analysis of the data was performed with Partial Least Squares Structural Equation Modeling (PLS-SEM) via SmartPLS 4, and the procedures for evaluating both the measurement and structural models followed those described in the methodology portion of the study (Hair et al., 2022). Figure 2 presents the structural model and the estimated path between the Control Environment and Financial Reporting Reliability constructs.

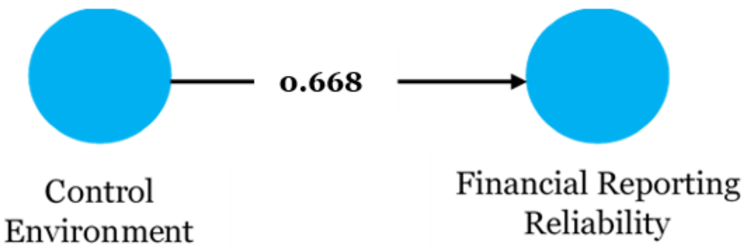

Figure 2. Research Model Results
Source: Processed research data (2026)

A standardized path coefficient of 0.668 emerged from the structural model assessment, signifying a positive relationship between the Control Environment and Financial Reporting Reliability. This result indicates that improvements in the control environment are associated with higher levels of financial reporting reliability, suggesting that a stronger control environment contributes to more reliable financial information within the organization.

4.1.2. Results of Construct Reliability, Validity and Hypothesis Testing

The outcomes of the measurement model assessment, which encompass construct reliability and convergent validity are presented in Table 1.

Table 1. Reliability and Validity Tests Results

Variable	AVE	Composite Reliability	Cronbach's Alpha
Control Environment	0.529	0.918	0.901
Financial Reporting Reliability	0.657	0.939	0.925

Source: Processed research data (2026)

To establish the validity and reliability of the constructs used in this research, the measurement model was subjected to evaluation. Average Variance Extracted (AVE) served as the indicator for convergent validity, and Composite Reliability alongside Cronbach's Alpha was used for construct reliability (Hair et al., 2022). Table 1 reports that every construct surpassed the 0.50 AVE benchmark, thereby demonstrating acceptable convergent validity. More specifically, the AVE values were 0.529 for Control Environment and 0.657 for Financial Reporting Reliability.

In addition, the Composite Reliability and Cronbach's Alpha figures obtained for each construct exceeded the recommended lower bound of 0.70, demonstrating strong internal consistency and reliability. This evidence indicates that the measurement items properly reflect the intended constructs and that the research tool is dependable enough to support further analysis. Consequently, the measurement model fulfills the validity and reliability criteria and is deemed appropriate for examining the structural relationships proposed in the study.

Table 2. Discriminant Validity (HTMT and Fornell-Larcker Criterion)

Relationship	HTMT	Fornell-Larcker (√AVE diagonal)
Control Environment → Financial Reporting Reliability	0.717	CE: 0.727 · FRR: 0.810 (correlation: 0.668)

Source: Processed research data (2026)

Evaluation of discriminant validity relied upon the Heterotrait-Monotrait Ratio (HTMT) and the Fornell-Larcker criterion. The HTMT figure for Control Environment and Financial Reporting Reliability was computed as 0.717, a value that does not exceed the conservative limit of 0.85 (Henseler et al., 2015), and this finding demonstrates that the two constructs are empirically separate. This was further confirmed by the Fornell-Larcker criterion, where the square root of AVE for each construct (0.727 for Control Environment; 0.810 for Financial Reporting Reliability) exceeded their inter-construct correlation (0.668), satisfying the discriminant validity requirement.

Examination of the coefficient of determination (R^2) followed, with the aim of assessing the structural model's predictive power (Hair et al., 2022). The R^2 for Financial Reporting Reliability stood at 0.446, which indicates that 44.6 percent of the variation in that variable is explained by the Control Environment, while 55.4 percent remains unexplained by factors not incorporated in this research framework. This result points to a moderate level of explanatory power and underscores the important contribution of the Control Environment to Financial Reporting Reliability in the organizational setting. To support this interpretation, Table 3 provides the results of the structural model evaluation and hypothesis testing.

Table 3. Hypothesis Testing Results

Relationship	Path Coefficient (β)	t-statistic	p-value	Result
Control Environment → Financial Reporting Reliability	0.668	15.926	0.000	Supported

Source: Processed research data (2026)

Evidence from the results indicates that the control environment produces a positive and statistically meaningful influence on financial reporting reliability. The path coefficient stands at 0.668, reflecting a strong positive relationship between the two variables. With a t-statistic of 15.926, which exceeds the 1.96 benchmark, and a p-value less than 0.05, Hypothesis 1 receives empirical support. Furthermore, the f^2 value (Hair et al., 2022) computed at 0.806 reveals that the control environment exerts a considerable effect on financial reporting reliability.

4.2. Discussion

The findings indicate that the control environment has a significant positive effect on financial reporting reliability within Islamic philanthropic organizations. The positive relationship suggests that organizations characterized by strong ethical values, effective oversight, clear organizational structures, competent personnel, and accountability mechanisms are more likely to produce reliable financial information. A strong control environment contributes to the establishment of organizational norms and behaviors that support transparency and compliance. Employees operating within such an environment are more likely to adhere to reporting standards and organizational procedures, thereby reducing the risk of errors and misstatements in financial reporting.

The findings also imply that governance mechanisms are essential for maintaining accountability in organizations that manage public funds. Reliable financial information enables stakeholders to assess organizational performance, monitor resource utilization, and make informed decisions regarding organizational accountability. These results align with earlier studies showing that effective governance and robust internal control systems enhance organizational accountability and improve financial reporting quality (Rahman, 2021; Setiawan et al., 2023). Furthermore, recent evidence from developing economies suggests that effective governance supported by strong internal control mechanisms strengthens organizational performance and stakeholder confidence, reinforcing the importance of governance in achieving organizational sustainability (Tang et al., 2026). Consequently, improvements in the control environment may strengthen stakeholder confidence and support organizational legitimacy.

The present findings are also supported by previous studies emphasizing the importance of reliable financial information in organizational decision-making. Devi et al. (2021) argued that access to reliable financial information enables stakeholders to make more informed financial decisions and improves overall decision quality. Although their study examined financial knowledge, financial behavior, and financial satisfaction at the individual level, the underlying implication remains relevant to organizational settings, where reliable financial reporting serves as an essential basis for accountability and resource allocation. Similarly, Kartawinata et al. (2021) highlighted that organizational and financial outcomes are influenced by the quality of information available to decision-makers, while Nabila et al. (2023) demonstrated that examining relationships among organizational constructs using SEM-PLS provides valuable insights into the mechanisms through which governance practices influence organizational performance. In their entirety, these works lend support to the present outcomes by stressing that trustworthy financial reporting represents both an accounting deliverable and a strategic instrument for improving governance practices, organizational clarity, and stakeholder confidence.

From a theoretical perspective, the findings support Agency Theory (Jensen & Meckling, 1976; Scott, 2015), which argues that governance mechanisms are necessary to reduce information asymmetry between principals and agents. In the context of zakat institutions, donors, regulators, and beneficiaries act as principals, while organizational management functions as the agent responsible for managing entrusted resources. A strong control environment promotes ethical behavior, accountability, and compliance with organizational policies, thereby reducing the likelihood of information distortion and enhancing the reliability of financial reporting.

Organizational culture's role in shaping employee behavior offers another explanation for the significant effect of the control environment on financial reporting reliability. Where management shows strong commitment to integrity, ethical standards, and accountability, employees are more inclined to follow reporting procedures and internal control guidelines. Likewise, clear structures of authority and skilled personnel underpin the accurate recording, processing, and disclosure of financial information. Recent research applying the COSO Internal Control Framework in public sector entities also indicates that the overall effectiveness of internal control systems depends on the interaction between the five COSO components including control environment, risk assessment, control activities, information and communication, and monitoring (Tahsaldar et al., 2026).

This finding diverges from the results of the present study: while Tahsaldar et al. (2026) found monitoring to be the only statistically significant COSO component, the present study finds the control environment to be a strong and significant predictor. This divergence may reflect differences in organizational maturity, water governance institutions in their study may already possess well-established control environments, making monitoring the binding constraint, whereas Rumah Zakat, as a comparatively younger LAZNAS, may still benefit most from strengthening its foundational control environment. In contrast, the present findings align with Rahman (2021) and Setiawan et al. (2023), who similarly reported that a strong control environment enhances financial reporting quality in zakat management institutions. As a result, the organization is better positioned to produce financial reports that are accurate, relevant, understandable, and comparable.

Given that the control environment accounts for 44.6 percent of the variance in financial reporting reliability ($R^2 = 0.446$), the remaining 55.4 percent probably reflects the contribution of the four unexamined COSO components which are risk assessment, control activities, information and communication, and monitoring activities (COSO, 2013; Tahsaldar et al., 2026) along with organizational influences such as resource constraints, leadership tenure, and the quality of external audits. Future inquiries that include these dimensions would afford a more comprehensive understanding of the determinants of financial reporting reliability in Islamic philanthropic organizations.

This study contributes to the understanding of governance practices within Islamic philanthropic organizations. Unlike previous studies conducted in corporate and public sector settings (Li, 2020; Otoo et al., 2026; Rahman, 2021), this research demonstrates that the control environment remains a critical determinant of financial reporting reliability in nonprofit organizations operating under both managerial and religious accountability requirements. Strengthening governance fundamentals emerges as a key implication of these findings, serving both to support openness and to preserve societal trust in zakat management organizations.

The results carry managerial implications, suggesting that investments in ethical organizational culture, staff competency development, governance arrangements, and accountability systems may substantially elevate the standard of financial reporting. Therefore, management should continuously strengthen the organizational control environment by promoting ethical values, enhancing employee competencies, reinforcing governance and accountability mechanisms, and ensuring compliance with organizational policies. In addition, organizations should continuously improve financial reporting processes through standardized procedures, digital approval workflows, and systematic validation mechanisms to reduce reporting errors and enhance reporting reliability. These managerial initiatives are expected to strengthen transparency, governance credibility, and stakeholder confidence while supporting continuous improvement in financial reporting practices (Adiwibowo, 2026). Overall, the findings confirm that the control environment serves as a critical foundation for producing reliable financial information and supporting effective governance practices within zakat management organizations.

5. Conclusion

This study examined the effect of the control environment on financial reporting reliability in an Islamic philanthropic organization. The findings indicate that the control environment has a positive and significant influence on financial reporting reliability. The results demonstrate that organizational integrity, ethical values, effective oversight, clear organizational structures, employee competence, and accountability mechanisms contribute to improving the reliability of financial information.

The statistical findings revealed a meaningful connection between the control environment and financial reporting reliability, suggesting that strengthening the former is linked to greater reliability in the latter. Such evidence indicates that improved internal governance practices can elevate the quality of financial reporting and thereby reinforce accountability within the organization. Based on the results, management of zakat institutions should continuously strengthen the control environment by promoting ethical behavior, improving employee competencies, enhancing oversight mechanisms, and reinforcing accountability practices. Such efforts are expected to improve financial reporting reliability and strengthen stakeholder confidence in the organization.

This study advances current understanding within the field of nonprofit governance and Islamic philanthropy by demonstrating empirically that the control environment exerts a significant positive influence on financial reporting reliability in zakat management organizations. A limitation, however, is that the study focuses on only one Indonesian Islamic philanthropic entity, which restricts the extent to which conclusions can be extended to other nonprofits or different institutional contexts. Subsequent investigations are advised to explore the remaining COSO framework components, include additional governance factors, and involve a variety of nonprofit organizations or international comparisons in order to produce more extensive empirical findings on financial reporting reliability.

5.1. Acknowledgments

The author gratefully acknowledges Rumah Zakat for providing support and access to the data required for this study. The author also extends appreciation to the respondents who took part in the survey and provided insightful responses to the research process.

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