

Enterprises Experiencing Multiple Inquires under the Registration System: Evidence from Bloomage Biotechnology

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Abstract: Since the registration system officially was implemented on the SSE Star Market in 2019, its unique audit and inquiry system has been highly concerned by the market. Under this system, the Shanghai Stock Exchange can question the proposed listed companies several times during its review process until all disclosures have been complied with or there are no new matters to be verified. The study will take Bloomage Biotechnology Ltd, which has experienced four rounds of inquiries, as the object of the case study and summarize the reasons for its multiple rounds of inquiries in terms of internal and external factors by collating the information of its four rounds of letters of inquiry and replies. From the internal factors, the main reason for these multiple inquiries are disclosure problems and insufficient investment in research and development. From the external factors, the reason is the strict regulatory policies of the pharmaceutical industry. At present, there are few research papers on audit inquiries of the registration system and the case studies are even more lacking. Hence, these results provide important case support for audit inquiries, which enrich researches on audit inquiries to a certain extent.

Keywords: Registration system, inquiry, disclosure, audit.

1. Introduction

With the rapid development of China's economy, as IPO is an important financing method for enterprises, the number of enterprises that want to expand their development through IPO is breaking new highs [1]. Facing such a situation, the strict substantive threshold under the approval system has become an obstacle to the development of many small and medium-sized enterprises, especially for science and innovation-oriented enterprises. These enterprises need to invest a lot of capital in the early stage of scientific research and innovation, so they are basically in the state of loss. However, if a company want to be listed under the approval system, it needs to meet the profitability requirement, which is obviously extremely difficult. Compared with the approval system, although the registration system has imposed a stricter disclosure system, it has relaxed the mandatory requirements for listing.

The core content of the registration system is the information disclosure, emphasizing the concept of "market dominance and government supervision". The issuing companies are required to disclose all their information accurately and truthfully with the law to the public and submit relevant documentations to the Stock Exchange [2]. Then the Exchange is mainly in the form of inquiry form for review. Under this system, if the information disclosure of enterprises is not perfect, the

information asymmetry in the market will lead to investors not being able to judge the truthfulness of the information, which will affect the level of their investment decision, and thus resulting in inefficient allocation of resources in the market. Therefore, audit inquiry is an extremely crucial part of the IPO process, that is, when the Stock Exchange finds that there are problems in the information disclosed in the company's prospectus, it will issue a regulatory inquiry letter to the proposed listed company, pointing out that there are ambiguities or errors or omissions [3]. The proposed listed company will then review, rectify, supplement, and clarify the relevant disclosure details in respect of the relevant issues, and respond to each of the inquiries until all disclosures have been complied with or there are no new matters to be verified [2, 4].

Since the registration system has been implemented in China for a relatively short period of time, the existing literature on audit inquiry mainly focuses on periodic report inquiries and there is a lack of research on IPO-related inquiries. The research on IPO audit inquiry mainly focus on the points and characteristics of audit inquiries and the economic consequences of audit inquiry. Moreover, at present, the IPO audit inquiries of enterprises under the background of the registration system are mostly theoretical studies and few scholars have analyzed them with specific cases. Based on the background of the registration system, this article selects Bloomage Biotechnology Ltd (Hereinafter referred to as "Bloomage" or "the Company"), which has been successfully listed with four rounds of inquiries, as the research object and analyzes its prospectus and four rounds of inquiry reply letters comprehensively from the perspectives of literature research, case study analysis and textual analysis, exploring the reasons that this company has been audited and questioned many times from both internal and external factors.

2. Case Description

Bloomage, founded in January 2000, is a globally recognized biotechnology and biomaterials company. As a platform company of biotechnology whole industry chain, the company's business now covers bioactive raw materials, medical end-products, and consumer end-products (functional skin care products and functional food). The company is not only the world's largest hyaluronic acid research and development, production and sales enterprise, its hyaluronic acid industrialization level also ranks first in the world. Meanwhile, utilizing synthetic biotechnology, industrial transformation is gradually achieved on bioactive substances such as gamma aminobutyric acid and 5-aminolevulinic acid.

Bloomage was listed on the Hong Kong Stock Exchange in 2008, but in 2017, to implement strategic adjustments and shorten the distance between the company's products and consumers, it was privatized and delisted from the Hong Kong Stock Exchange by Cayman Huaxi, the original offshore listing subject. On November 6, 2019, Bloomage was re-listed on the SSE Star Market, with a stock code of 688363. It has issued 49,562,600 new shares at an issue price of 47.79 yuan per share and raise a total of 2.369 billion yuan [5]. After four rounds of inquiries, Bloomage finally succeeded in landing on the SSE Star Market. Compared to other enterprises, Bloomage's inquiries are more often, and the content of the questioning involves a wide range [5]. Hence, the scope of the content can be studied more and have more general significance. In addition, Bloomage had been listed and delisted in Hong Kong, and this experience added specificity to its listing process. Moreover, Bloomage is the first beauty company to be listed on the SSE Star Market, which is a leading company in the same industry and makes the study more representative. Therefore, this article chooses Bloomage as a case company to study the reasons that it has been inquired in many rounds.

3. Inquiry Process and Cause Analysis

3.1. Inquiry Process Analysis

Bloomage published its listing application on April 10, 2019, and after receiving the first round of audit inquiries from the Exchange, it submitted its first round of inquiry responses on May 7, 2019. In this round of responses, the accounting firm, the law firm, the issuer as well as the sponsor all made relevant additions and responses. After the first round of inquiries, Bloomage successively received the second, third and fourth rounds of questions from the Exchange. Bloomage and its various intermediaries have also efficiently given responses respectively. On July 23, 2019, the issuer and its sponsor revised the relevant content in the first two rounds of inquiry response documents based on the adjustments to the notes to the financial statements. After four rounds of inquiries and multiple reviews, Bloomage finally received approval from the Listing Committee at the August 27, 2019, review meeting. According to Table 1, the following basic features can be broadly summarized: as the number of inquiries increases, the number of questions shows a clear downward trend, and the time taken to respond to the letters is progressively shorter and significantly reduced in length.

Table 1: Inquiry and response status of Bloomage (Data source: official website of the SSE Star Market)

| Round | Date of receipt of inquiry letter | Date of reply to inquiries | Number of questions | Number of pages |
|--------|-----------------------------------|----------------------------|---------------------|-----------------|
| First | April 18, 2019 | May 7, 2019 | 49 | 380 |
| Second | May 12, 2019 | May 20, 2019 | 16 | 178 |
| Third | May 26, 2019 | June 4, 2019 | 4 | 73 |
| Fourth | June 13, 2019 | June 18, 2019 | 4 | 40 |

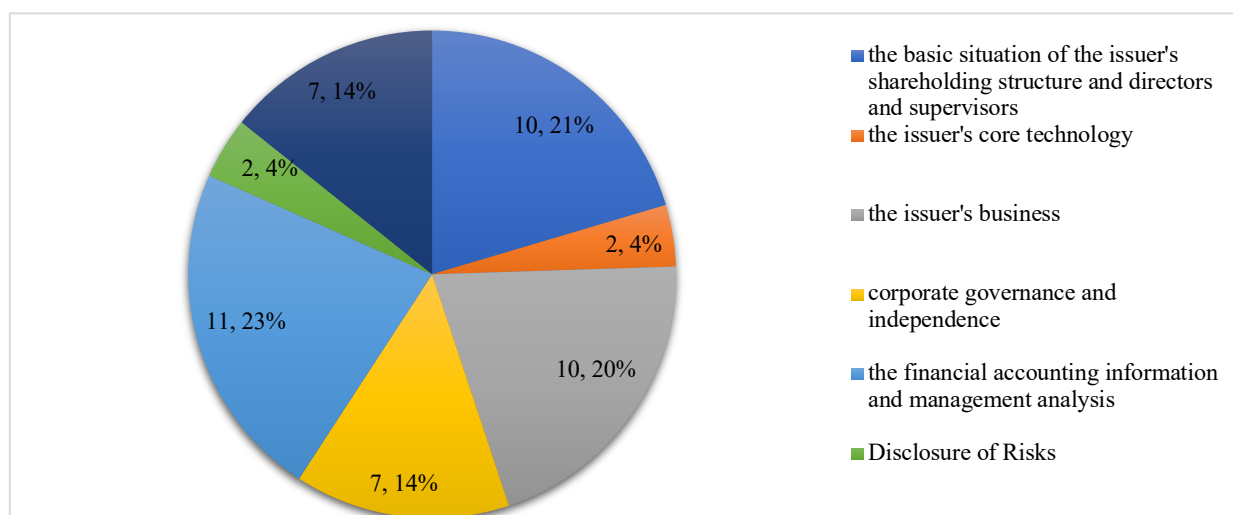


Figure 1: Proportion of various issues (Data source: official website of the SSE Star Market).

In the first round of inquiries to Bloomage, a total of 49 major issues were raised, including seven categories: the basic situation of the issuer's shareholding structure and directors and supervisors, the issuer's core technology, the issuer's business, corporate governance, and independence, etc. Each of the major issues also included several specific sub-issues, covering the entire contents of the prospectus application draft. Based on a wide range of questioning, the first round remains emphasizing some questions. By comparing the number of questions in each category, it can be clearly found that these three types of questions: the financial accounting information and

management analysis, the basic situation of the issuer's shareholding structure and directors and supervisors, the issuer's business, are the focus of the SSE [5]. The three together in the total number of questions have accounted for as high as 64%. According to Figure 1, financial accounting information and management analysis has accounted for the largest proportion of questions, 23%, mainly from the reasons for changes in gross margin and reasonableness, changes in selling expenses, share-based payment, research and development management and expenses, accounts receivable disclosure, inventory, intangible assets, etc. The issues mentioned are all required to be verified by the issuer and intermediary institutions and the prospectus is required to be revised. The following is the basic situation of the issuer's shareholding structure, directors and supervisors, accounting for 21% of the total. Due to the special circumstances that Bloomage was listed in Hong Kong and then delisted, the SSE has conducted detailed inquiries on the implementation of privatization and the dismantling of offshore structures after its delisting. It has also paid attention to the issues of new shareholders, transfer of shareholdings by Floreda, capital increase, the issuer's shareholders, the wagering agreement, the disclosure of restructuring, and reasons and impacts of resignation of the directors and supervisors, and so on. These require the issuer and intermediaries to revise and add information to the prospectus, as well as verification and comments from intermediaries. The issuer's business is ranked third with a 20% share, and the inquiries include production and operation, sales model, various related certificates, major customers, distributors and suppliers. This section requires the accountant to issue a review opinion, and the prospectus needs to be supplemented or modified.

Corporate governance and independence have accounted for 14% of the questions, which mainly required Bloomage to increase the disclosure of information on trademarks and trademark application rights, business competition and substitutability, internal management, and the reasonableness and compliance of business income and so on. Other matters have also accounted for 14% of the total. These issues relate to the differences in financial reporting and the format of the prospectus, which require the issuer to supplement and revise the relevant information in accordance with the provisions of the various standards. There are two questions related to the issuer's core technology, and these questions require the issuer to explain the biography of the company's chief scientist Dr. Guo Xueping, the source of the core technology, the relationship between the national honors received and the issuer, the technological advantages, technological sophistication, and the ability to sustain innovation, etc. Because the Star Market are set for those high-tech enterprises, the SSE need to review these issues to determine whether the nature of Bloomage is in line with the standards of the Star Market-listed enterprises. Most of these issues need to be supplemented and revised and improve the prospectus. Also, intermediaries are required to verify and express their views. The issues about disclosure of risks mainly include several aspects: new technology substitution risk, new product substitution risk, core technology personnel loss risk, trade secrets and core technology leakage risk, implementation risk of raised fund investment projects, income risk of raised fund investment projects and medical dispute risk. Some issues require the recommendation institution to verify and express opinions.

After the first round of review and inquiry, the SSE conducted three more rounds of review and inquiry on Bloomage. The inquiries in the other rounds were all based on the first round, and according to publicly available information, the focus of the inquiries was also concentrated on the above seven categories of issues. Comparing the content of each inquiry, it is found that financial accounting information issues and medical issues run through the entire process of the review and inquiry, indicating that the truthfulness, compliance of the issuer's financial information, as well as the legality of medical products, are easy to attract the attention of the Shanghai Stock Exchange. In addition, the third and fourth rounds of inquiry also demanded disclosure of whether the issuer has the ability to continue operations. From this, the review and inquiry are a gradual process from comprehensive to focused, and more information can be obtained during the process of inquiry and response, effectively reducing the problem of information asymmetry [6].

Table 2: Contents regarding privatization transaction loans in the inquiry response letter (Data source: official website of the SSE Star Market).

| Question number | Content | Response |
|------------------------|---|--|
| First question 1 (1) | round Please clarify whether the privatization transaction loan has been fully repaid, whether there is any pledge of the issuer's shares involved, and whether there are any disputes or disputes among the parties. | The issuer has pledged its equity to CITIC Bank (International), but after the repayment is completed, the pledge has been released, and CITIC Bank (International) also issued a "Confirmation Letter on the Completion of the Privatization Loan Agreement and the Absence of Disputes." |
| Second question 15 (5) | round According to the prospectus and the first round of inquiries, in 2017, Zhao Yan, through the wholly-owned Hong Kong company Grand Full, acquired, and delisted Cayman Huaxi, with the acquisition funds being the HKD 3.5 billion credit agreement under the privatization loan of CITIC Bank (International) (HKD 3.129 billion loan as of March 18, 2019). Please explain the repayment method and the source of repayment for the privatization transaction loan. | The issuer's repayment method for the privatization transaction loan is cash repayment, and the source of repayment is shareholder dividends. |

3.2. Inquiry Cause Analysis

Insufficient and incomplete information disclosure is a common reason for multiple rounds of inquiries during the listing process for most companies, and Bloomage is no exception [4, 7]. For example, Bloomage was listed on the main board of the Hong Kong Stock Exchange in 2008, but later chose to privatize and delist in 2017 due to the low stock price after listing and changes in the market competition environment. In the prospectus, it was mentioned that the source of funds for its privatization was a loan from CITIC Bank (International). Question 1 in the first round of inquiries requested an explanation of whether the aforementioned privatization transaction loan had been fully repaid, whether there were any pledges of the issuer's shares involved, and whether there were any disputes or disputes among the parties to the loan. In the initial reply, Bloomage supplemented the explanation that the issuer's equity had been pledged to CITIC Bank (International), but had been fully released after repayment, and CITIC Bank (International) also issued a "Confirmation Letter on the Completion of the Privatization Loan Agreement and the Absence of Disputes". However, the SSE still requested in question 15 of the second round of inquiries to explain the repayment method and the source of repayment funds for the privatization transaction loan. On this issue, the SSE first questioned in the first round of inquiries whether the transaction loan had been repaid without dispute. In the second round of inquiries (as listed in Table 2), it still focused on questioning this loan, indicating that the SSE believed that Bloomage had not fully and comprehensively explained how this transaction loan had been repaid in the previous round of replies. In order to fully understand the entire process of repayment of this transaction loan, the SSE also inquired about the repayment

method and the source of repayment funds for this loan. The SSE is using questions to urge Huaxi Biology to provide more comprehensive and complete information disclosure on this matter [8].

Table 3: Content regarding the Huairou government's reward funds in the inquiry response letter (Data source: official website of the SSE Star Market)

| Question number | Content | Response |
|-----------------------------|--|---|
| First round question 38 (4) | Disclose the main situation of government subsidies related to project disclosure and income, and government subsidies related to assets, such as specific government subsidy projects, accounting treatment methods, amounts for each period, granting departments, as well as the matching relationship and reasons with relevant data in non-recurring gains and losses. | The award funds from the Huairou People's Government are included in the recurring gains and losses. |
| Second round question 1 (2) | Sponsor institutions and reporting accountants should clearly express their opinions on the rationality of including the award funds from the Huairou People's Government and personal income tax refunds in recurring gains and losses. | This is because it is closely related to the company's normal business operations, conforms to national policy regulations, and is continuously enjoyed according to certain standards, thus these government subsidies are treated as recurring gains and losses. |
| Third round question 2 (2) | Clearly disclose the close relationship between the award funds from the Huairou People's Government and the company's normal business operations, the specific basis for compliance with national policy regulations, and the standards for continuous enjoyment. Also, provide specific basis for how personal income tax refunds comply with the definition of recurring gains and losses. The company should carefully assess and provide sufficient relevant basis. | The calculation and distribution standards of the financial incentive funds in the "Huairou District Fiscal Policy for Promoting Regional Economic Development" promulgated by the Huairou District Government are closely related to the actual amount of value-added tax and corporate income tax paid by the company. The issuer has supplemented the disclosure in the "Eighth Section: Financial Accounting Information and Management Analysis/Ten: Analysis of Operating Results/Five: Other Items in the Income Statement/3: Other Income" of the prospectus. |

Audit institutions pay special attention to information disclosure with unreasonable content, requiring issuers to provide clear and specific evidence [9]. In the inquiry process of Bloomage, the SSE has repeatedly asked about the reasonableness of the content. For example, in the response to question 38 in the first round of inquiries, Bloomage included the reward funds from the Huairou People's Government in the regular loss and profit, while as a government reward nature subsidy, it

should usually be incidental, that is, non-recurring. This has attracted the attention of the SSE. In question 1 of the second round of inquiries, Bloomage was required to "explain the reasonableness of including the Huairou People's Government reward funds in the regular loss and profit." The response provided by Bloomage is that "as it is closely related to the company's normal business operations, in line with national policy regulations, and continuously enjoyed according to certain standards, this government subsidy is treated as regular loss and profit." However, the term "closely related" in this response is ambiguous, especially when it refers to the close relationship between the Huairou government and the company's normal business operations, which naturally raises suspicions of benefiting and commercial bribery. Therefore, in question 2 of the third round of inquiries (given in Table 3), the SSE required Bloomage to "clearly disclose the close relationship between the Huairou People's Government reward funds and the company's normal business operations," and also emphasized "caution in judgment and providing sufficient relevant basis to the issuer," indicating that in this issue, the wording and evidence provided by Bloomage are not satisfactory to the SSE, and the truthfulness of this information disclosure is questionable [4].

According to Table 4, Bloomage's research and development investment in raw material products is only 3/1 of the industry average, which is far below that of peer companies [4, 10]. It can be clearly seen that the disclosed research and development investment of Bloomage is significantly insufficient, which cannot demonstrate its potential for innovation to the SSE. Therefore, in the second round of questioning, the SSE requested an explanation on "the methods and rationality of maintaining international leading position in the case of low research and development expense ratio compared to comparable companies in the industry, whether the relevant disclosures are accurate, whether the research and development expenses are sufficient, the existence of capitalized research and development expenses, and the case of related parties paying expenses on behalf of the company or paying expenses externally." In response, Bloomage explained that it has accumulated profound experience in research and development of raw material products and mature technology, leading at an international level, so the investment is relatively low compared to peer companies, but the research and development investment in medical terminal products and functional skincare business is significant [11].

Table 4: Rate of research and development expenses for raw material products of companies in the same industry Data source: official website of the SSE Star Market

| Company name | January-March in 2019 | 2018 | 2017 | 2016 |
|--|-----------------------|--------|--------|-------|
| Tonghua Dongbao Pharmaceutical Co., Ltd. | 2.75% | 3.63% | 4.68% | 4.28% |
| Shandong Sinobioway Biomedicine Co., Ltd. | 8.22% | 6.91% | 3.36% | 3.48% |
| Anhui Anke Biotechnology (Group) Co., Ltd | 6.12% | 11.49% | 11.92% | 9.18% |
| Hybio Pharmaceutical Co., Ltd. | 9.66% | 7.50% | 7.17% | 7.06% |
| Average | 6.69% | 7.38% | 6.78% | 6.00% |
| Bloomage Biotechnology Corporation Limited | 2.86% | 3.19% | 2.97% | 2.84% |

Bloomage is in the pharmaceutical manufacturing industry, which is a heavily regulated sector by various national authorities [12]. Therefore, the SSE has raised numerous inquiries regarding the medical technology products of Bloomage as listed in Table 5.

Table 5: Medical related content in the inquiry response letter Data source: official website of the SSE Star Market

| Question number | Content | Response |
|---------------------------------|--|--|
| First round question 42 | The issuer was asked to explain whether the issuer's products had caused any medical accidents during the reporting period, whether there were any product quality-related disputes or medical disputes. If so, please make sufficient information disclosure and risk disclosure. | The issuer stated that there were no medical accidents caused by the company's product quality issues during the reporting period, nor were there any medical disputes between patients, medical institutions, and the company. The issuer has provided risk warnings in the prospectus in the section "Risk Factors/Five, Legal Risks/(1) Litigation, Penalties, and Potential Dispute Risks Caused by Product Quality Issues" regarding disputes caused by the company's product quality issues. |
| Second round question 12 (3) | The issuer was asked whether the company's medical terminal products could be traced throughout the entire process. | The company has currently established the Huaxi Biosafety Traceability Management Platform, which can trace the entire production, warehousing, and distribution process of medical devices, with uniqueness and stability, and obtain timely and accurate information on the flow of medical devices. |
| Third round question 3 (3) | The issuer was asked to explain whether the issuer's inability to obtain the final sales of distributors for Class II, III and above products complies with industry policies and regulatory requirements and whether it complies with the industry's customary practice for tracing problematic product quality issues. | The company has established traceability codes, traceability systems, and systems to obtain the final sales of drugs and Class II, III medical devices from distributors. |
| Fourth round question 2 | The issuer was asked to provide a detailed analysis and disclosure of the specific time when the "Huaxi Biosafety Traceability Management Platform" was used and whether it complied with the relevant traceability regulations before it was used. | The issuer's management of the traceability of medical products complies with relevant national regulations. The platform was completed and officially put into use in April 2014. |

In question 42 of the first round of inquiries, they directly asked, "Please explain whether the issuer's products have caused medical accidents during the reporting period and whether there are product quality-related disputes or medical disputes. If so, please make sufficient disclosure of information and risk disclosure." In question 12 of the second round of inquiries, they requested disclosure of whether the medical terminal products can be fully traced throughout the process. On this matter, the SSE questioned the safety and control of Bloomage's medical terminal products. In

their response, Bloomage stated, "The company has established the Bloomage anti-counterfeiting traceability management platform, which can trace the entire production, inbound and outbound, and distribution process of medical devices, and has uniqueness and stability, to promptly and accurately obtain information on the flow process of medical devices." In question 3 of the third round, they required an explanation of whether the issuer cannot obtain the final sales of distributors for Class II and Class III products, and whether it complies with industry policies and regulatory requirements for tracking problematic product quality. Bloomage responded by mentioning, "The company has established traceability codes, traceability systems and systems that can obtain the final sales of drugs and Class II, Class III medical devices from distributors." However, in the fourth round of inquiries, the SSE continued to focus on the traceability issues of medical terminal products. In question 2, they requested the issuer to disclose the specific usage time of the traceability system, as well as whether it complied with relevant regulations before it was used. This shows that the issue of medical products is of paramount importance to the SSE when inquiring about Bloomage, and this is inseparable from the strict regulation of the pharmaceutical manufacturing industry [5, 13].

4. Conclusion

To sum up, this study analyzes the inquiry process of Bloomage's IPO through a case study model, exploring the reasons for multiple inquiries from both internal and external perspectives. The conclusion drawn is as follows. From an internal perspective, Bloomage's issue lies in not meeting the requirements for listing review: inadequacy and incompleteness in information disclosure, and some unreasonable aspects in the information disclosure. If a listed company does not meet the above disclosure requirements, the SSE will further inquire about these issues until the company's response dispels the SSE's doubts about these requirements. In addition, as a company seeking to list on the Star Market, based on Bloomage's information disclosure, it is evident that there is not a remarkable performance in research and development investment, and even the research and development expense ratio is far below the industry average. The SSE will focus on this during the review and then use inquiry to confirm whether Bloomage has the ability for technological innovation. From an external perspective, unlike other industries, Bloomage, as a pharmaceutical manufacturing industry, will be subject to strict regulation by the pharmaceutical regulatory authorities. Therefore, during the inquiry process, inquiries about its medical products have been continuous from the first round of inquiries to the fourth round of inquiries, which sufficiently demonstrates the cautious attitude of the SSE towards the listing of this industry. This also indicates that the SSE will focus on the characteristics of the enterprise itself in the review and inquiry process, and analyze specific issues based on specific circumstances.

After experiencing four rounds of review and inquiry, Bloomage made modifications and improvements to the prospectus based on the inquiries, making the prospectus more comprehensive and complete, enhancing consistency, increasing the coverage and length of the prospectus, improving the quality of information disclosure, and providing investors with more effective information. In addition, investors can deepen their understanding of key information about the enterprise by studying the number and length of inquiries. For a listed company, the first is to respond to inquiries promptly after receiving them. Since the goal of information disclosure is to reveal factors that may have an adverse impact on the company's operating conditions, regulatory authorities will mention these negative issues during inquiries. If explanations cannot be provided in a timely manner, it may affect investors' decisions and subsequently impact the company's interests. Furthermore, listed companies should also raise awareness of information disclosure. When disclosing information, companies should not only mention favorable information about themselves while avoiding unfavorable information, as this may increase the frequency of regulatory inquiries and greatly reduce the efficiency of the IPO. The regulatory body should refine the classification of inquiry letters and

establish a more targeted inquiry letter mechanism to improve the efficiency of inquiries. In addition, they should also take the perspective of investors, vigorously inquire about suspicious content, and provide more transparent information disclosure to eliminate doubts and protect the interests of investors. As for intermediary agencies, they should be able to promptly identify problems in information disclosure and make corresponding modifications and explanations. Besides, they should use professional knowledge to standardize the information released by companies, thereby improving the efficiency of inquiries. When it comes to false information and illegal activities by companies, they should clearly define their responsibilities and not condone such behavior.

In terms of practical significance, through the analysis of this case, it provides experience and reference for the governance and IPO review of other beauty companies intending to go public, thereby providing certain practical application value. In terms of academic significance, there are not many case studies on inquiry in the academic community under the registration system in China. This thesis also attempts to strengthen the combination of theory and practice based on relevant theoretical research and has a certain value in theoretical exploration. Nevertheless, this paper still has certain limitations. First, case studies have limitations, and the selected case company cannot represent the general level of listed companies and the industry, so the applicability of the research conclusions may be insufficient; second, the relevant data used in this paper all come from the official website of the SSE Star Market, and there may be deviations in the manual sorting process due to the large amount of data.

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