

# Application of Combined Assurance as a New Approach to Integrate Internal Audit, Governance, and Risk Management: A Case Study on Indonesia Financial Service Authority

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**Abstract.** *This research analyzes the Indonesia Financial Service Authority (Otoritas Jasa Keuangan-OJK)'s best practices on assurance function to assure good corporate governance inside the institution. OJK introduces a new approach called 'combined assurance' to achieve this objective, which integrated all the risk management function between internal units, especially between assurance providers like the Internal Audit Division and Risk Management and Quality Assurance Division.*

**Keywords:** *assurance, integrate internal audit, governance, risk management*

## I. INTRODUCTION

Establishing trust with stakeholders is not an easy task. As a result, the board, as well as the firm assurance function, is bestowed with a high expectation of creating assurance for both internal and external part of firms that the operation inside is optimal and has good corporate governance. When trust among firms and stakeholders are created, a firm operation will run more smoothly and the reputation, an intangible asset, may increase the firm value and going concern significantly.

In practice, the derivation of a 'great assurance' as a common goal is quite challenging. The internal audit is expected to be able to detect errors in various divisions [1], and the risk management function is presumed to find risks in every division regarding current and future condition. The organization is also looking for a more significant contribution from the chief audit executive in a way to provide information in order to reach strategic goals [2]. However, these assurance providers are usually working on the silos, a start to inefficiencies, inconsistencies, as well as lack of consistencies [1], [3]. As a result, an operating division is often annoyed if the internal audit or risk management come to their division too often to assess their operation or risk.

Furthermore, there are also conflicts between assurance providers on what is the organization key risks. As an example, it is known that the internal audit function sees risks as a frequently found problem in a division operation and risk management sees risks as a probable condition in the future that may endanger the firm operation.

These different perceptions prevent integration between various assurance services as well as hinder effective monitoring between the divisions involved [1].

The Financial Service Authority, or also well known as Otoritas Jasa Keuangan (which will be abbreviated as OJK in the later section), is also challenged with this problem of risk identification as well as assurance activity. As an institution with a great mission and has just five years of age, OJK must have a secure and strong assurance function and internal risk management. Furthermore, as a regulator who is responsible for the capital market, banks, and corporate governance among listed firms and financial firms, OJK must act on best practice for all eyes are put on the institution.

This research explores OJK best practices on assurance function to assure good corporate governance inside the institution. To reach the goal, OJK introduces a new approach called 'combined assurance.' Combine assurance approach integrated all the risk management function between internal units, especially between assurance providers like the Internal Audit Division and Risk Management and Quality Assurance Division.

This paper is unique as OJK is the first institution to apply combined assurance approach in Indonesia and currently is followed by the Indonesian Stock Exchange as well as other financial institution. Furthermore, the writer uses a combined approach of desk study as well as in-depth interviews with experts from both the OJK Internal Audit Division and Risk Management and Quality Assurance Division to obtain insights regarding the concept.

The research is organized as follows. First, the literature review on OJK as well as the combined assurance is presented. Later, we explore the OJK reasoning of implementing combined assurance approach, application of combined assurance in OJK, as well as work to be done to assure governance inside OJK. Lastly, we will address the conclusion and key ideas taken from the study regarding the OJK case study on combined assurance.

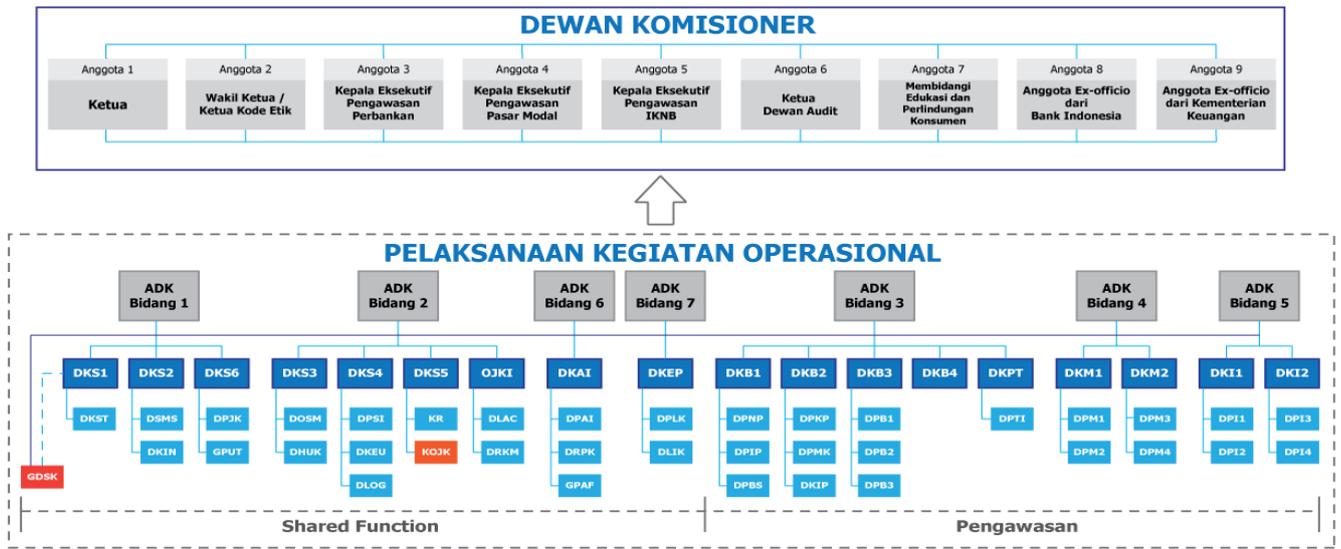


Figure 1: Organizational Structure

II. LITERATURE REVIEW

2.1 Otoritas Jasa Keuangan

Financial Service Authority or Otoritas Jasa Keuangan is an independent institution whose primary function is to promote and organize the regulatory environment as well as supervision that is integrated towards all of the activities in the financial services sector. OJK is launched in 2012 as a merged independent institution between the Indonesian Ministry of Finance and Bank Indonesia so that it can complement the previous financial system from an independent entity point of view. OJK has the responsibility for financial services activities in banking, capital market, as well as non-bank financial industries sector. OJK vision and missions are as follows [4]:

**Vision:**

*To become a trustworthy monitoring institution that oversees financial services industry, in order to protect the interests of consumers and public, and to be able to bring about the financial services industry into becoming a pillar of the national economy with global competitiveness as well as capability to promote public prosperity.*

**Mission:**

- To realize the convening of all activities in the financial sector so that they are managed regularly, fairly, transparently, and accountable.
- To realize a sustainable and stable financial system.
- To protect the interests of consumers and the public.

The organization structure of OJK, as shown in Figure 1, shows that OJK organizational structures contained Board of Commissioners and Director of Operations. Board of Commissioner leads OJK itself. These commissioners are chosen every five years and conducted meetings every week to ensure OJK responsiveness to changes in the financial industry. On the other side, the Director of Operations is responsible for the unit operation. Here, the internal audit

department, risk management, and quality control, as well as anti-fraud group, are positioned under the Head of Board of Auditors Commissioner (ADK Bidang 6). Apart from implementing combined assurance, OJK has also obtained ISO 9001:2015 regarding the internal audit, risk management, quality control, and whistleblowing system in 2017.

2.2 Combined Assurance

Combined assurance is an integrative approach to mix between the function of governance, risk management, and compliance into one comprehensive framework. The integration between various assurance services provides efficiency in time and activities as duplication of assurance provider work is prevented. Furthermore, using the risk-based perspective, combined assurance provides an organization to focus on what matters [5].

With combined assurance, the organization can have high visibility about matters that need more attention as well as those which do not [6]. Likewise, the system enables each division leader to know what risks exposure other division is suffering [7].

Combined assurance approach is first introduced in Johannesburg Stock Exchange, Stock Africa under the King Code Three. Here, firms in South Africa must apply the code or else they would receive sanctions from the stock exchange.

III. METHODS

The type of research done is a case study of the Indonesian Financial Service Authority (OJK). OJK is chosen as a field of study due to the uniqueness of approach taken by OJK (combined assurance), how OJK is the only institution in Indonesia who performs combined assurance, and the importance of this independent body to overlook the financial industries of a country to have a sound internal audit.

The data collected are obtained from both primary and secondary resources of data. For primary data, the data are obtained through an in-depth interview towards two representatives from DPAI, which are:

1. MRSA (Department of Risk Management and Quality Control)
2. MrB (Department internal Audit)

The length of the interview is three hours with both parties presents. Along with the permission of interviewees, the interview is taped on the phone.

As for secondary resources of data, the writer uses literature review from past journals regarding the internal audit, materials presented on the Corporate Governance class, as well as a book regarding combined assurance recommended by the interviewees. This triangulation of data collection and analysis allows fruitful discussion regarding the case study.

#### IV. RESULTS AND DISCUSSION

##### 4.1 History of Combined Assurance Use in OJK

For two years after OJK is created, information from various assurance-providing services inside the organization is having trouble to be integrated. Even though the internal audit function has applied the risk-based approach, other assurance services are still applying the conventional approach. One of the reasons is that OJK is a merged institution from the Ministry of Finance and Bank Indonesia and that how previous organization are still using the traditional check-it-all methods. As a result, the work of assurance providers is difficult to extract and does not provide much information to the board as much as the board wishes to.

Prof. Dr. Ilya Avianti, S.E., M.Si., Ak. CPA (Head of OJK Audit Board Commissioner 2012 - 2017) is deeply concerned about this limitation. Adding to the fact that OJK internal human resource is limited, Prof Ilya wants the scarce resource all allocated efficiently to essential processes. Furthermore, Prof Ilya sees that as OJK oversees all part of the financial services sector, OJK must ensure that its vision and mission could be reached through most efficient, best practice operation. OJK must also be a role model in good governance as it creates governance regulation for a financial institution. As Prof Ilya has auditing background, she is looking for the most appropriate risk-based framework to identify misstatements. The need for an approach to see and measure what is the significant problem in an organization is then answered when she attended a conference in early 2014 to get around the concept of Combined Assurance.

Originated in South Africa Code of Governance (King Code Three), Combined Assurance introduces coordination and cooperation between all assurance provider, including internal audit, legal, risk management, and quality control. Combined assurance prevents problems that the audit output is not suitable to the need of division. Furthermore, the

current assurance provider often comes to the operational division to ask for information and takes the time that could be used to take care of the operation. This causes duplication inefficiencies. Although the term 'combined assurance' is only used in South Africa, the broad idea is to make sure that the assurance provider has the same goal.

Prof Ilya felt that the concept is suitable to be applied in OJK. Thus, around the end of 2014, a team of OJK staffs was sent to understand the implementation of combined assurance in South Africa. Combined assurance is fixated for use in OJK through publication of *Surat Edaran Dewan Komisioner under Peraturan Dewan Komisioner 1* regarding governance.

##### 4.2 Application of Combined Assurance in OJK

OJK fully applied combined assurance first in 2016 and produced internal-based 2016 Combined Assurance Report on 2017. Following are the thirteen steps of the Combined Assurance process in OJK as well as a sample of application in each step:

###### 1. Identify strategic objective

According to Kendrick (2014), risks come from the daily operation of the business, and furthermore, strategic objective provides strategic risk. OJK is updating its annual objective yearly so the strategic objective must always be updated. An example of OJK strategic objective is 'Integrated Monitoring.' Here, the board wishes to receive updates about the internal condition at real-time.

###### 2. Identify the process

The assurance provider must identify the process done by each division of the organization. Here, the operating process is indeed different between Insurance, Bank Oversight, as well as the Capital Market division in OJK. Assurance provider must understand that each division has a unique culture and process.

###### 3. Identify inherent risk

As the process inside each division is different and that they are exposed to different people, certainly each division has inherent risk. As an example, the inherent risk for Bank Oversight division is incomplete information on the new bank proposal.

Every beginning of the year, the risk management division asks for risk register (list of risk) created by each division. Internal audit also has done the same period to each division.

###### 4. Identify control

The assurance function must understand the control mechanism in each division. An example of in OJK bank oversight division control is the mechanism and segregation of duties on accepting new bank proposal.

###### 5. Identify risk level and priority

Assurance function must identify risk level (low, medium, high) and able to identify the first line business operation. In OJK, a very high-risk level is handled by quality control subdivision, an internal audit handles a high-risk level, and the risk management division handles medium to low risk.

The risk management process must be able to identify priorities on which risk have to be handled first. Here, the risk management division provides a guideline on

how to assess the risk to be done by each division. This is because those working at the operational level knows more about the risk rather than an external unit.

#### **6. Identify assurance strategy input**

Here, each assurance providers must come up with a plan and strategy to mitigate the risk identified in the previous steps. The plan could come both from internal assurance providers' idea or external from each division. The lead for assurance provider for this integrative approach is dealt to be the risk management and quality control division.

#### **7. Create a Combined Assurance Matrix Plan**

The combined assurance matrix plan defines the roadmap for integration for all of the assurance provider. The assurance provider, including internal audit, risk management, and anti-fraud division, are also having the meeting to obtain agreement on the level of risk exposure in each division and who is responsible for who.

#### **8. Prioritize risk and assurance strategy**

The risk management and quality control are agreed upon meeting to take the lead on the integrative combined assurance process. From this, the division compiled all of the assurance strategy input as well as matrix plan to be legalized on the weekly commissioner meeting

#### **9. Management assurance**

An assurance done to management can be done through risk mitigation and division monthly risk and control self-assessment by each operating division (first line of defense). This process is actively monitored by the risk management division (second line of defense).

#### **10. Independent assurance**

Independent assurance here is done regularly by the internal audit division (third line of defense). IIA Position Paper (2013) expresses that the scope of assurance by internal audit includes a broad range of objectives and elements of risk management and internal control framework.

#### **11. Combined Assurance Reporting**

Combined Assurance Reporting compiled all of the information gathered from personal management assurance as well as an independent assurance by assurance providers. In 2016, OJK used CA score as a tool to reflect the work of all assurance providers when facing risks. In 2016, CA score emerged. This score reflects the work of all assurance provider regarding a risk. This scoring method consists of (1) self-assessment score, (2) implementation of risk mitigation, and (3) internal audit works.

CA will only work if the second and third line of defense is matured as it includes negotiation between assurance provider regarding definition and scope of risk. The hardest part of compiling the report is that the recommendation 'languages' are different across divisions. A recommendation is compiled by risk management into three categories: people (competency), process (SOP consistency), and technology (system)

#### **12. Supervision and monitoring**

Supervision and monitoring are conducted throughout the whole process of combined assurance. The output of

supervision is a suitable action plan for various risks as well as improvement in the system.

#### **13. Updating risk profile**

After a year of combined assurance integration on governance, risk, and audit, such information may be gathered, and the assurance providers, as well as the board, have a clearer idea on each division risk profile. This profile must be updated for the use on preceding year assurance providers plan for the organization.

OJK incorporates independent assurers over for various governance practices, including on whistleblowing and fourth line of defense. In the whistleblowing process, OJK cooperates with an external entity in order to maintain good governance. Here, OJK is cooperating with RSM in a way that the whistleblowing complaints are submitted to RSM to be reviewed by the audit committee (directly to the high-level board). According to the interview with OJK assurance providers, the fourth line of defense in OJK is the audit committee headed by the Audit Board Commissioner. In the last five year, the Commissioner is accompanied by four experts from the independent background.

On the determination of the risk management model, assurance providers in OJK have agreed that the 'risk' managed will only be the adverse influence risk. OJK has not yet moved to see and manage risk as an opportunity for organization growth. The reasoning for this is that the organization have not yet been entirely successful in managing the adverse influence risk. Assurance providers are likely to see this as an urgent matter once the adverse influence risk is adequately managed.

#### *4.3 Challenges on Applying Combined Assurance in OJK*

When applying combined assurance, assurance provider in OJK faces various challenges in order to make a great concept perfect at the operational level. Following are various problems faced by the assurance provider business units regarding the issue:

##### **1. Difficulties in having the same definition of 'risk.'**

The first step of combined assurance in OJK is having the same definition of risk among assurance providers. Although an agreement that 'risk' is the national language of assurance provider has been reached, the implementation is quite difficult. For example, risk identification done by risk management division is more comprehensive and concentrated on the strategic goal - this is different from the kind of internal risk audit are pursuing. Other than that, the internal audit sees risk comes from repeatedly unsolved issues on the organization while the risk management division sees risk as a probable future condition. Assurance providers are currently addressing these difficulties. As internal audit division, risk management, and quality control, as well as the anti-fraud group, belong to the same department (ADK 6), this provides an opportunity for frequent discussions on defining the most suitable risk.

##### **2. The business unit has not been enthusiastic about implementing enterprise risk management (ERM)**

Enterprise risk management is a structured and continuous process throughout an organization to manage

risk within the risk appetite of the entire entity, holistic and requires full participation and accountability within divisions in an organization. In other words, combined assurance as a form of enterprise risk management could not be done by the work of assurance providers alone.

As each business units are busy on achieving OJK strategic vision, they have not seen risk management as a matter of priority even though *Peraturan Dewan Komisiner 02* and *Surat Edaran Dewan Komisiner 02* obliged each business units to manage their own risk. Although the risk management division has created a guide to implementing risk management, the business unit has not got them excited about the concept. An example is that they are also struggling on differentiating issues (happening now) and risk (anticipated for the future). This lack of enthusiasm needs to be improved by OJK as the combined assurance process itself requires active participation from the divisions in order for it to be effective.

### **3. Risk ownership is low if the identification does not come from an operating division**

As the first line of defense have not been able or not prioritizing risk identification, risk management division is often forced to take real action. The practice that has been done in OJK is that the risk management division creates the detailed framework of risk for the division (generic formula top-down) so that the task would be complete as the risk management division also have another important goal. As a result, risk ownership from the division is low, and it is shown on the report submitted to assurance providers. Assurance providers in OJK are currently working to have each division submit risk profile following their operational work because they are the one who is doing the detail work and the one with most expert knowledge on the risk exposure.

### **4. The tone of the top is increasingly needed**

OJK has just been five years of age, and since last July, the board of commissioner has just changed to new leadership. The previous Audit Board Commissioner, Ibu Ilya, have a strong vision and willingness to imply combined assurance partly because she is the one leading the initiative. However, the spirit for governance must always be preserved from the top. As the new board has just been elected, the board should have given a clear tone from the top that governance and risk is the spirit of the organization.

The new board must also adapt fast to the organization culture, especially the Chief Audit Commissioner as the principle of combined assurance is new to be applied in Indonesia. Once all the board has the same perspective, it is easier to give a message with clarity. If this is achieved, the

division below them would also have and understand the same robust and good governance spirit.

## **V. CONCLUSION**

Over time, risks are increasingly evolving not only outside the organization but also on the inside. Assurance providers inside the organization have to coordinate with each order in order to manage risk and provide the best quality information for decision making. The Financial Service Authority (OJK) is bestowed with high responsibility to oversight, organize, and protect customers of financial services institutions. Furthermore, as a regulator, OJK is also pushed to perform the best practice of governance inside the institution for financial firms are looking up to OJK. As a result, an approach to integrate internal audit, governance, and risk management is genuinely needed for the integral institution.

OJK gets around the concept of combined assurance in 2014 from the idea of its Head of Audit Board Commissioner and has fully applied combined assurance in 2016. Combined assurance provides a holistic approach to integrate the work of various assurance provider in an organization and increase efficiency through less duplication of works. Overall, there are thirteen steps of combined assurance process from identifying a strategic objective to updating risk profile. However, the implementation of the concept is quite challenging. As the first mover of combined assurance implementation in Indonesia, OJK is facing various problems. Difficulties on defining 'risk,' business unit enthusiasm on implementing ERM, top-down approach on applying risk management, and tone of the top exist as the work to be done and improved in the institution.

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